
COMBINED ASSURANCE — A POTENTIAL INTEGRATED GOVERNANCE OPTION FOR SMES?

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Abstract

Against the backdrop of recent corporate scandals, but also due to increasing digitalization, the discussion about integrated approaches to corporate governance under the umbrella term of combined assurance (CA) is gaining in importance. Whereas this has so far been considered increasingly from the perspective of internal auditing, this article supplements the ideas of integrated corporate governance with an explicit view of compliance management in medium-sized companies. It is based on an empirical study of 141 companies conducted by the Aalen Institute for Corporate Management (AAUF) in 2021. The study compared, among other things, the three lines of defense (TLoD)/three lines (TL) approaches of the Institute of Internal Auditors (IIA) and the combined assurance approach, which are widely used in the literature.

1. INTRODUCTION

Recent corporate scandals, as well as comparisons with external and internal corporate governance systems in other economies, suggest that there is still room for improvement in the German corporate governance system. With the revised version of the German Corporate Governance Code (GCGC), the legislator has already taken a step in the right direction. Further new legislation such as the FISG (German Law on Strengthening the Financial Markets Integrity) and the StaRUG (Act on

the Stabilisation and Restructuring Framework for Businesses) should lead to a further adjustment and professionalization of the corporate governance structures of German companies.

In corporate practice, it has been shown time and again that several problems complicate the work of internal and external monitoring bodies: First of all, decision-makers are still not sufficiently aware of the problems. In addition, compliance management, internal auditing, controlling and risk management are often not adequately staffed or budgeted. The often different assignment of the various functions to different departments and officers does not help to improve the coordination of data, instruments, systems and processes. Last but not least, the various monitoring functions also frequently use different or, optimally, only partially integrated IT systems.

Under generic terms such as governance, risk and compliance (GRC) or integrated governance, risk and compliance (IGRC), integrated approaches to corporate monitoring have long been called for. Whether this is necessary or "old wine in new bottles" (the German approach to monitoring already offers an integrated view) remains to be seen. However, the impulse for more integration is to be welcomed and can equally be discovered in the new version of the COSO Enterprise Risk Management (ERM).

It seems clear that corporate monitoring can benefit from an integrated framework in practice. The Institute of Internal Auditors (IIA) has already made a proposal in this regard with the fundamental TLoD model and its further development, the TL model, which is widely used in international corporate practice.

2. METHODOLOGY

For the empirical study of combined assurance (CA) in practice, data was collected using a standardized online questionnaire. The questionnaire contained both closed and open questions. The selection of the companies and the generation of their e-mail addresses were carried out randomly using the Nexis database. The survey was finally conducted in the period from February to March 2021, with a pre-test with several experts being carried out beforehand. 8,688 companies comprised the distribution list. However, 1,269 of the emails sent could not be delivered. Thus, 7,419 companies received the link to the survey. The questionnaire was accessed 141 times during the survey period, which corresponds to a participation rate of 1.9 percent. 56 respondents answered all the questions asked, while 85 ended the survey prematurely. Finally, the data were analyzed using Microsoft Excel and SPSS.

The questionnaire was structured as follows: In total, the survey consisted of 37 questions, which were divided into six sections. First, specific information about the company itself was asked. This was followed by questions about the company's compliance organization and other monitoring units, such as Internal Audit. The last three sections

deal with the TLoD and CA approaches and the implementation status of the two concepts.

The clear majority of companies (80 percent) are sole proprietorships and not part of a group. With regard to the legal form of the companies, 68 percent operated as a GmbH (limited liability company), 4 percent as a GmbH & Co. KG (limited personal company), 3 percent as GbR (personal company), 2 percent as AG (stock corporation) and 23 percent as other legal forms. 63 percent of the companies were founded between 1990 and 2010, 19 percent before 1990 and 19 percent after 2010. 72 percent of the companies have fewer than 50 employees, 16 percent have between 50 and 249 employees and 12 percent have more than 250 employees. In terms of industry, 33 percent of the companies were in the service sector. A further 14 percent stated that they were active in the healthcare or social sector. Furthermore, the industry sector accounted for 9 percent, trade for 6 percent and banking and insurance for 3 percent. The remaining 35 percent fall into the "other/no information" category.

With regard to the company structure, 38 percent of the companies state that they are family businesses. In 39 percent of cases, the management is exclusively family-organized and in another 39 percent, it is both external and family-organized. 21 percent stated that they exclusively use outside management. The largest shareholders in the companies are partners (35 percent), family (35 percent), the public sector (13 percent) and private equity (9 percent).

3. EMPIRICAL RESULTS

First, the understanding of compliance was determined in the form of an open question. The majority of the definitions given overlapped: 36 percent of the respondents understood the term "compliance" to mean the company's adherence to rules, standards and laws. Other individual mentions relate, for example, to the transparency of business processes, the adaptation of internal processes to external conditions, and contract and insurance management.

The next question was designed to identify the goals and tasks of compliance. 88 percent of respondents state that compliance is used to comply with guidelines and standards. 60 percent of the respondents state the protection of reputation. 49 percent use compliance to increase the transparency of processes. For 47 percent, compliance has the task of reducing liability. 16 percent say they use compliance functions to increase competitiveness. 12 percent say it is to reduce costs. 7 percent are concerned with goals such as increasing the value of the company or ethically responsible corporate management.

After the respondents were asked about their understanding of the term "compliance", this question provides information on whether the companies have a compliance organization or at least a compliance officer. This showed that 33 percent have an organizational unit or

a person responsible for compliance management in the company organization. Accordingly, 67 percent stated that no one is explicitly entrusted with compliance within the company.

Of the companies surveyed, 67 percent use controlling as an additional monitoring unit alongside compliance. 36 percent name the supervisory board/advisory board as an additional monitoring unit. 33 percent cite risk management. 27 percent name internal auditing as an additional monitoring unit. 12 percent mention other units such as quality management or budget monitoring.

The companies were also asked to rank the involvement of corporate bodies in the work of the monitoring units. 76 percent (58 percent decision and 18 percent participation) state that the board of directors or management is involved in the work of the monitoring units. In contrast, the respondents state that the annual general meeting (61 percent not at all and 10 percent consultation/information) and the supervisory board/advisory board (39 percent not at all and 32 percent consultation/information) are only slightly involved.

Whether internal auditing is an independent department in the company surveyed was answered by 46 percent with "Yes". Accordingly, 54 percent of the companies stated that internal audit is not an outsourced department.

In contrast to the previous question on the autonomy of internal auditing, the survey also asked about its independence. In this context, 35 percent of the respondents stated that Internal Auditing is not an independent body at all. A further 13 percent described internal auditing in their company as not very independent. A medium level of autonomy was reported by 16 percent of respondents. In contrast, 35 percent have a strongly independent internal audit department.

The TLoD model is not known to 81 percent of the subjects. In contrast, 19 percent said they were familiar with the TLoD model.

That they are familiar with the CA approach was indicated by 10 percent of the participants. Accordingly, 90 percent had no knowledge of the integrated governance approach.

11 percent of the companies use the TLoD approach. 5 percent use the CA approach, although multiple answers would in principle have been possible.

4. OUTLOOK

The cooperation between internal and external supervisory bodies and monitoring functions such as internal audit, compliance, risk management and control is crucial to the success of a company. The "*three lines of defense*" approach and, in particular, its further development "*combined assurance*" are valuable concepts for increasing the quality of monitoring.

The goals and tasks of compliance are described by the clear majority of the sample as adherence to guidelines and standards.

33 percent of the companies have a compliance officer, and 42 percent of them have a management board. Additional monitoring units are controlling (88 percent), a supervisory board or advisory board (36 percent) and risk management (33 percent). Furthermore, almost half of the companies use an internal control system (ICS), which is usually subordinate to management or control. With regard to internal auditing, 46 percent have an independent department, although only 30 percent carry out regular audit planning.

The TLoD model is known to 19 percent of respondents — 11 percent have implemented it. 67 percent consider the implementation experience to be good. The main challenges are a lack of knowledge about the concept, cooperation and coordination between the individual lines, and compliance with legal and regulatory requirements. The CA approach is known to 10 percent of participants and implemented by 5 percent. The opportunities of the applications are considered to be high. Finally, 86 percent of the participants state that the availability of audit and combined assurance experts on the labor market is low.

Overall, the study shows that both TLoD/TL and CA have been little known and hardly implemented to date. This is certainly not only, but also due to the rather medium-sized character of the sample. However, statistical analyses show that even the larger companies in the survey have only a moderate level of implementation. In addition to qualitative follow-up studies, a great deal of persuasion work will have to be done here in the future in order to communicate the advantages of integrated approaches to corporate monitoring and corporate governance even better. Companies, but above all researchers and academics, should pay greater attention to the assessment by practitioners that there are hardly any experts who have knowledge of integrated approaches to corporate monitoring and corporate governance. There seems to be not only a subjective but also an objective shortage of experts in this field, which must be remedied.

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