

GLOBAL PERSPECTIVES AND INSIGHTS

The Three Lines Model – An Important Tool for the
Success of Every Organization



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Introduction

Governance has never been more important, as organizations navigate the turbulence of a global pandemic, technological transformation, widening economic disparity, geopolitics, globalization, climate change, and more. Governing bodies and management are grappling with questions about disrupted working environments, changing markets, and lost revenues. The IIA's Three Lines Model provides timely answers for organizations seeking strong governance to support innovative means to ultimately be successful.

The Three Lines Model helps organizations identify structures, design processes, and assign responsibilities that best assist the achievement of objectives and facilitate strong governance and risk management. It makes the case for the three essential players in governance: governing body, management, and internal audit. At the same time it clarifies the main essential elements governance requires at its most basic: accountability, actions, and assurance and advice. Fundamentally this is what governance is.

Why Is Governance Necessary?

Owners put their trust in governing bodies. Yet board members are commonly removed from the activity, meeting a few times a year while doing other jobs, leaving governing bodies generally to delegate actions and resources to management. This creates two degrees of separation between the owners and what's actually going on. When the complexities added by human nature, the propensity for subjectivity, self-interest, uncertainty, risk, and even fraud are considered, a clear question emerges: How can the board honestly declare to the stakeholders what is going on? Governing bodies can gain some degree of confidence by asking management, but, ultimately, they need independent objective validation, a fundamental of governance.

Organizational governance refers to efforts to satisfy the interests of stakeholders, including the structures, policies, and practices needed to do so. Governance is necessary for a number of reasons:

- Organizations are often overseen on behalf of stakeholders by others.
- Those charged with governance are not positioned to have first-hand knowledge of all that is undertaken by management.
- Stakeholder groups may be very diverse including those not easily identified, such as future generations who may be impacted by the actions of the organization.
- The interests of stakeholders can be divergent and subject to change.
- Human beings can be untrustworthy, biased, and egocentric.
- Operations can be complex and difficult to fully comprehend.
- Everything is subject to variation and uncertainty.

Governance can be understood as an attempt to address these challenges through leadership, transparency, and integrity. The minimum requirement for the exercise of governance is clear responsibility for and alignment among:

- Accountability to stakeholders for performance.
- Actions and the application of resources to achieve goals, taking account risk.
- Objective confirmation and assurance on all significant matters independent from responsibility for them.

Successful governance provides confidence and trust to stakeholders that the decisions, actions, and outcomes of the organization are such that they will fulfill the desired purpose of the organization. We know stakeholders want success, but not at any price. They demand that the achievement ideally be efficient, ethical, and sustainable. They are interested not just in outcomes but in behaviors, conduct, stewardship, and so on. How can stakeholders or the governing body possibly know what is truly happening without independent assurance, without internal audit as their eyes and ears?

What Is the Three Lines Model?

The Three Lines Model is a fairly simple framework, easy to understand and explain, supported by a simple graphic. Grounded on six key principles, The Three Lines Model encourages organizations to consider the roles needed for effective governance to help foster success. Through a deeper understanding of these roles and how they work with each other to support organizational achievements, organizations can decide for themselves what an appropriate structure is. The model is used in conjunction with the organization's particular goals, circumstance, culture, resources, etc., as the foundation for building the structure and processes the organization needs to manage risk and achieve objectives.

Who Is the Three Lines Model For?

The intended audience for The Three Lines Model is any party interested in the success of organizations. More specifically, the benefits of The Three Lines Model fall to those charged with governance, management, risk management, external assurance, and, of course, internal audit. Not only can internal auditors deepen their appreciation of the key relationships and internal audit's contribution to success, they can share the model with those who can influence the way in which internal audit is regarded, structured, and resourced, and how it operates. This includes:

- Governing bodies and audit committees.
- Those who work closely with internal audit, especially management, risk-related functions, external auditors, and other assurance providers.
- Outsourced service providers.
- Regulators, especially in the financial services sector.
- Legislators, policy makers, thought leaders, educators, and careers advisors.

- Standard setters for related professions and activities, especially external audit, risk, governance, accounting, and financial management.
- Those who hire internal auditors, including HR and recruitment agencies.
- National, regional, and global organizations and individuals that influence any of the above.

What Prompted Creation of the Three Lines Model?

The Three Lines Model released in July 2020 is a careful revision of the Three Lines of Defense model, now more than 20 years old. While the old model was well known and widely adopted as a simple way to explain internal auditing, the opportunity to better reflect modern organizational practices and understanding was becoming increasingly prominent.

Perhaps the most important reason The Institute of Internal Auditors launched the January 2019 review of the former model was that the description of internal audit as the third line of defense had become outmoded. It had become incompatible with the International Professional Practices Framework (IPPF) definition of the mission of internal audit: *To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight*. The use of the word *defense* brought too narrow of a focus: Internal audit sees ahead, advises and consults, and does more than just stop bad things from happening.

Some critics of the old model said that the concept of risk had become dated; use of the term *lines* suggested silos and hard lines that could not be crossed; the lines alluded to sequential operations – first to second to third; the positioning of the board in the old graphic made it look remote, floating above the organization; it boxed in internal audit, as if saying ‘you can’t do that, you are third line’; it did not seem flexible for smaller organizations, the public sector, and non-regulated organizations; it left internal auditors wondering about so-called “blurring” of the lines and what it means when the chief audit executive (CAE) takes on roles outside of internal audit.

A high-caliber working group was formed to determine if the model was still relevant and address criticisms collected over the years. The task of this elite team of professionals was to carefully weigh each challenge and consider all related nuances.

What Stayed the Same

Following the gathering of exposure comments from more than 2,000 practitioners across the globe, and further study by the working group, a stronger model and graphic emerged. Many things were left unchanged. The new model:

- Is fully consistent with the IPPF.
- Is authoritative.
- Applies to all organizations.

- Is designed to help organizations plan and structure resources and activities that support the management of risk to avoid overlap, gaps, and confusion.
- Focuses primarily inside an organization, although some consideration is given to external parties.
- Considers the roles of, and relationships among, the governing body, management (including risk-related functions), and internal audit.
- Maintains the language and familiar numbering of “three lines” in the interests of recognition and continuity.
- Is simple and supported by an easy-to-understand graphic.
- Is principles-based.

What Is New

The Three Lines Model encourages a principles-based approach to match the needs and circumstances of an organization. Clearly, all organizations are different and there can be no one-size-fits-all approach. This led to the model’s explicitly defined six principles on which it is based.

An additional significant change was in the use of language, eliminating the use of “lines” and instilling the idea of “roles.” Defining the key roles and describing the relationships among those core roles in the new Three Lines Model confirms coordination and alignment are essential to ensure organizational coherence and avoid silos.

Most importantly, the new model amplifies the critical need for assurance on the adequacy and effectiveness of risk responses, including controls, as a fundamental component of governance. This is achieved through the competent application of systematic and disciplined processes, expertise, and insight by internal audit.

The Principles

The Three Lines Model principles are at the heart of the framework and together reveal how successful governance works, as described in the [Three Lines Model Position Paper](#).

Principle 1: Governance

Governance of an organization requires appropriate structures and processes that enable:

- Accountability by a governing body to stakeholders for organizational oversight through integrity, leadership, and transparency.
- Actions (including managing risk) by management to achieve the objectives of the organization through risk-based decision-making¹ and application of resources.

¹ Risk-based decision-making: a considered process that includes analysis, planning, action, monitoring, and review, and takes account of potential impacts of uncertainty on objectives.

- Assurance² and advice by an independent internal audit function to provide clarity and confidence and to provoke continuous improvement through rigorous inquiry and insightful communication.

Principle 2: Governing body roles

The governing body ensures:

- Appropriate structures and processes are in place for effective governance.
- Organizational objectives and activities are aligned with the prioritized interests of stakeholders.

The governing body:

- Delegates responsibility and resources to management to achieve the objectives of the organization, while ensuring legal, regulatory, and ethical expectations are met.
- Establishes and oversees an independent, objective, and competent internal audit function to provide clarity and confidence on progress toward the achievement of objectives.

Principle 3: Management and first and second line roles

Management's responsibility for actions (including managing risk) to achieve organizational objectives comprises both first and second line roles.³ *First line roles* are most directly aligned with the delivery of products and/or services to clients of the organization, including support functions⁴ to make this possible. *Second line roles* provide assistance with managing risk.

First and second line roles may be blended or separated. Some second line roles may be assigned to specialists to provide complementary expertise, support, monitoring, and challenge to those with first line roles. Second line roles can focus on specific objectives of risk management, such as: compliance with laws, regulations, and acceptable ethical behavior; internal control; information and technology security; sustainability; and quality assurance. Alternatively, second line roles may span a broader remit for risk management, such as enterprise risk management (ERM). However, responsibility for managing risk remains a part of first line roles and within the scope of management.

Principle 4: Third line roles

Internal audit provides independent and objective assurance and advice on the adequacy and effectiveness of governance and risk management (including internal control) through the competent application of systematic and disciplined processes, expertise, and insight. It reports its findings to management and the governing body to provoke continuous improvement. In doing so, it may consider assurance from other internal and external providers.

² Assurance: independent confirmation and confidence.

³ The language of "first line", "second line", and "third line" is retained from the original model in the interests of familiarity. However, the "lines" are not intended to denote structural elements but a useful differentiation in roles. Logically, governing body roles also constitute a "line" but this convention has not been adopted to avoid confusion. The numbering (first, second, third) should not be taken to imply sequential operations. Instead, all roles operate concurrently.

⁴ Some consider support functions (such as HR, administration, and building services) to be second line roles. For clarity, the Three Lines Model regards *first line roles* to include both "front of house" and "back office" activities, and *second line roles* to comprise those complementary activities focused on risk-related matters.

Principle 5: Third line independence

Internal audit's independence from the responsibilities of management is critical to its objectivity, authority, and credibility. It is established through: accountability to the governing body; unfettered access to people, resources, and data needed to complete its work; and freedom from bias or interference in the planning and delivery of audit services.

Principle 6: Creating and protecting value

Governing body roles together with first, second, and third line roles collectively contribute to the creation and protection of value when they are aligned with each other and with the prioritized interests of stakeholders. Alignment of activities is achieved through communication, cooperation, and collaboration, and supports the reliability, coherence, and transparency of information needed for risk-based decision making.

Key Roles Explained

The refreshed model refers to first line roles, second line roles, etc., and not lines, to confirm it is not about structure but about roles and relationships, how they may be assigned, combined, or separated, and the inter-relationships. In the old model, first line suggested a rigid, structural feature. Functions, teams, even individuals may have a mix of roles, so it is hard to say they sit "in the first line" or "in the second line." The model also moves away from talking about "crossing the line" or "blurring the line."

Roles should always be clear. The roles may be assigned as the organization decides (or regulator requires). First and second line roles can be separated or blended together. Individuals, teams, and functions may have a mix of such roles or be more specialized.

- First line roles are defined as those most directly focused on providing the client with products and/or services, and include the roles of support functions such as HR, admin, IT, and building services. Those with first line roles are responsible for managing risk.
- Second line roles are those that focus on specific aspects of risk management, including compliance with ethical, legal, and regulatory requirements; control; quality assurance; IT security; sustainability; and broader responsibilities such as enterprise risk management (ERM). Second line roles provide additional challenge, expertise, oversight, and scrutiny.

The model describes management responsibilities as comprising first and second line roles regardless of how they are allocated. There may be senior individuals with second line roles (e.g., a chief risk officer) who reports directly to the governing body to create a degree of independence. However, these remain within the scope of management's responsibilities.

Internal audit's unique position in being independent from management and the responsibilities of management is the third line role. Because of this independence, it is able to provide objective assurance and advice.

The model confirms that, logically, it is not possible to be both independent of management and assume management responsibilities (i.e., first and second line roles). Where internal audit has these first and second line roles, independent assurance on such activity must be drawn from other sources.

Grounded in Governance

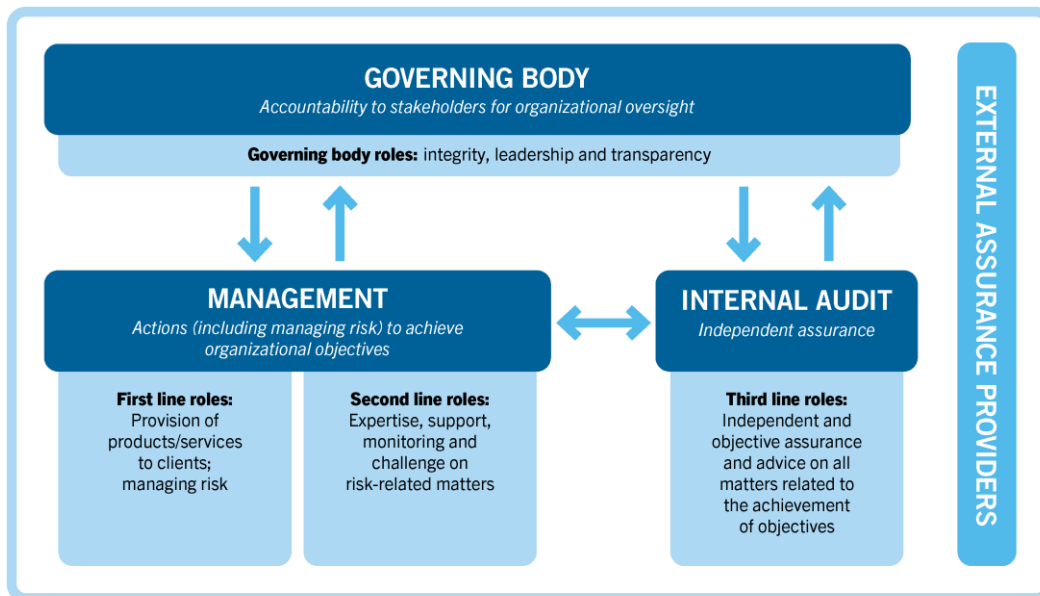
Another significant change in the new model is it is grounded in governance as opposed to simply risk management and control to include both value creation and protection, both the offensive and defensive aspects of managing risk.

The IIA's 2030 vision is to position internal audit as indispensable to governance, and The Three Lines Model shows how the key fundamental components of governance, including internal audit, relate to each other. The key to internal audit's role in governance is its independence, but independence does not mean isolation. Communication, cooperation, and collaboration are vital, and internal audit must be attuned to the priorities of the organization and fully engaged with management.

The New Graphic

At first glance, the updated graphic appears to be just that, a modernized version of the old model. But there are some significant differences seen when studied closely, and these important changes are central to explaining the fundamentals of governance.

The IIA's Three Lines Model



KEY: ↑ Accountability, reporting ↓ Delegation, direction, resources, oversight ↔ Alignment, communication coordination, collaboration

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The new graphic more distinctly defines governance as requiring three essential components: accountability by the governing body to stakeholders for oversight; actions (including managing risk) by management to achieve organizational objectives; and assurance and advice by an independent internal audit function to provide insight, confidence, and encouragement for continuous improvement.

Changes to the new graphic include better recognition of the significance of the role played by the governing body, and adoption of the term *governing body* in favor of *board* to ensure ready acceptance around the world in both public and private sectors. The new graphic allows for as many reporting lines between management and the governing body as required (e.g., CEO, CRO). By omitting the word *defense*, the graphic makes it clear defense is not the sole, nor even the primary, focus of the model nor of risk management generally.

Perhaps most significantly, arrows now go both ways from the governing body roles to management and internal audit, and horizontally between management and internal audit. This better represents a relationship among three roles, and illustrates the cooperation that must exist. CAEs can ask internal auditors to work with the governing body on a project or the audit committee can request internal audit to head up a fraud investigation, all part of a healthy governance structure.

Applying the Model

The Three Lines Model accommodates the existence in organizations of varying structures. It is important to note that the graphic model itself is not designed to be a structural diagram or an organization chart. It is designed to show that first and second line roles may be blended or separated, and there may be many reporting lines to the governing body (e.g., CEO, CRO, CCO) giving these functions the required degree of independence.

As many individuals reporting directly to the board can be structured as required, and this secures a degree of independence for compliance or risk management, etc. Insofar as those with second line roles advise, monitor, assess, report, and provide assurance, they are actually playing third line roles, although their independence may not be the same. When those same people with second line roles also make decisions about risk management — designing and implementing, determining limits, setting policy, establishing goals, etc. — they are “in the kitchen making sausages” and are clearly part of management actions and responsibilities. Risk management in all cases remains the responsibility of management.

Internal audit is qualitatively different. It is not just another second line consulting function. It is independent from the responsibilities and decisions and interference of management and is accountable directly to the governing body.

Organizations can structure however they like depending on goals, resources, regulation culture, etc. First and second line roles, no matter how they are assigned, remain within the responsibility of management. Internal audit is independent of the responsibilities of management. Can second and third line roles be combined? Yes, at the discretion of the governing body, but these roles are incompatible: A person can't both be responsible for something and provide independent opinion of it. However, if internal auditors take this role, they must find someone else to give an independent view.

The Three Lines And....

The Three Lines Model is meant to be adaptive, as it recognizes the importance of roles and how they can be combined or separated. Different sectors may find the need to assign roles or create inter-relationships depending how best to structure governance for their organizations. But despite these different nuances, internal audit stays fundamentally the same in the structure of successful governance.

Here are a few examples of how The Three Lines Model and different industries and issues may face a few challenges in setting up an internal audit function, but can still work together to instill governance by providing independent, objective assurance.

Enterprise Risk Management: ERM is a structured, consistent approach to managing risk that benefits the entire organization by identifying, assessing, deciding on responses to, and reporting on opportunities and threats that may impact an organization's objectives. When ERM is done well, it is integrated and imbedded throughout an organization. This is basically a formalized application of how The Three Lines Model can and should work when a solid governance structure is at the core of every decision an organization makes. Organizations don't exist to manage risk, risk management is part of governance. For ERM to be effective and to avoid unnecessary overlap, confusion, or gaps, it requires clarity and great communication among the key players.

Financial Services: Since the 2008 financial crisis, regulators have become increasingly specific in their expectations regarding the internal control structures and risk management functions of large banking institutions and insurance firms. However, well-defined separation between the business, the risk management/compliance functions, and internal audit is not necessarily practical or required by regulation in smaller financial services firms. The Three Lines Model sets the bar in terms of best practices, but leaves room for organizations to utilize less rigid divisions between lines according to unique needs. They can preserve independence but still serve their organizations in a practical way. The Three Lines Model can be considered of use in financial services firms on a continuum, from a small local institution or insurance company through to a large multinational institution or insurance company.

Public Sector: Internal audit in governments varies widely, depending on the jurisdiction. For example, in the United States, internal audit is different in local, state, and federal government entities. Often internal audit is embedded within a department, reporting up to the department head. Internal audit may be fragmented in organizations such as United Nations and other multilateral financial institutions, where duties can be called inspections, remediation, investigations, evaluations, or oversight services. Caution, lack of confidence, or concern for independence in public sector entities that internal audit is doing more than providing assurance is prevalent. Often there is not a genuinely independent audit committee, and governance is subject to political cycles. The goal of the entity is focused on providing a public service rather than optimizing financial return. While titles may be different and auditors may not report to a CAE, applying The Three Lines Model in the public sector results in consensus. Governing bodies can compare findings and know the results are part of the same internal process used throughout.

Sustainability: Impact investments to promote a social good or prevent a social ill are more popular than ever during the pandemic crisis. This means governing bodies and management need to consider at every stage not only financial risks but environmental, social and governance issues. The Three Lines Model is critical to providing the right assurance over long-term thinking. Internal audit is perfectly situated within the organization to provide assurance over nonfinancial information and provide insight on the longer

perspective, best structured using The Three Lines Model. General Motors, for example, implemented The Three Lines Model almost immediately after it was released in July 2020 to achieve governance consistency at the global level.

Small and Medium Entities: SMEs traditionally have limited resources and fewer staff with less opportunity for specialization, which often results in combinations between first line roles and second line roles. Job duties and titles are more intertwined (e.g., directors with executive roles). There also may be no in-house internal audit function. SMEs need to understand the risk they take as an organization if they don't have the three roles of governance as outlined in The Three Lines Model. Some roles can be compressed: first line roles and second line roles combined are still management, however. Without the third line role the entity does not have governance, and there would be no checks and balances on manager tendencies toward self-interest – reporting to the board only what makes them look good. The third line role can be outsourced to an external service provider, with the organization having “the responsibility for maintaining an effective internal audit activity,” according to IIA Standard 2070.

Fraud/transparency: A specific application of The Three Lines Model will benefit organizations when it comes to fraud, transparency, and corruption, with the model serving as implementation guidance. When taking a look at the broad role of management, focus on what the role is around fraud reinforced by the Three Lines Model. If management is involved in fraud, and there is no internal audit function, the governing body is relying on the fraudsters to confirm any information it receives.

The Association of Certified Fraud Examiners' 2020 report on global occupational fraud and abuse ranked internal audit among the top three parties to which whistleblowers report. The ACFE study, [Report to the Nations](#), also found internal audit detected 15 percent of reported fraud and corruption cases, second only to general tips at 40 percent. What's more, the report noted the presence of internal audit as an anti-fraud control (74 percent) reduced by half the median fraud loss amount. Interestingly, while external audits were the most common of the controls examined in the study (83 percent of the victim organizations had their financial statements audited by an outside auditor) they only accounted for 4 percent of the discovered frauds.

Conclusion

One of the great hopes for the new Three Lines Model is that it will help clarify internal audit's role and provide the profession with more confidence, as well as demonstrate appropriate flexibility and scalability to widen applicability to include all organizations. The model will not only create more confidence within the internal audit function, but with the governing body and management as to internal audit's value.

The Three Lines Model dispels confusion about offering advisory services. Advising is not “crossing the line” or “blurring the line” or putting independence at risk. Internal audit is ideally positioned to provide valuable, credible, authoritative, objective advice and insight precisely because it is independent. Effective assurance can only be based on good insight. If internal audit cannot provide insight it is limiting the value it offers.

This is also pertinent to comparisons between the independence of internal audit and external audit, often misunderstood. Internal audit is fully independent. Its independence is secured by the oversight of the audit committee. The audit committee oversees the hiring and firing and compensation of internal



audit, just as it does for external audit. The great advantage internal audit has is that it is fully knowledgeable about and vested in the organization and its success.

Structure depends on the organization, as traditional “lines” can be subdivided or have significant areas of overlap. Structure is not established once and for all but needs to be kept under review in the context of changing priorities and circumstances. To that end, The Three Lines Model is a journey.

