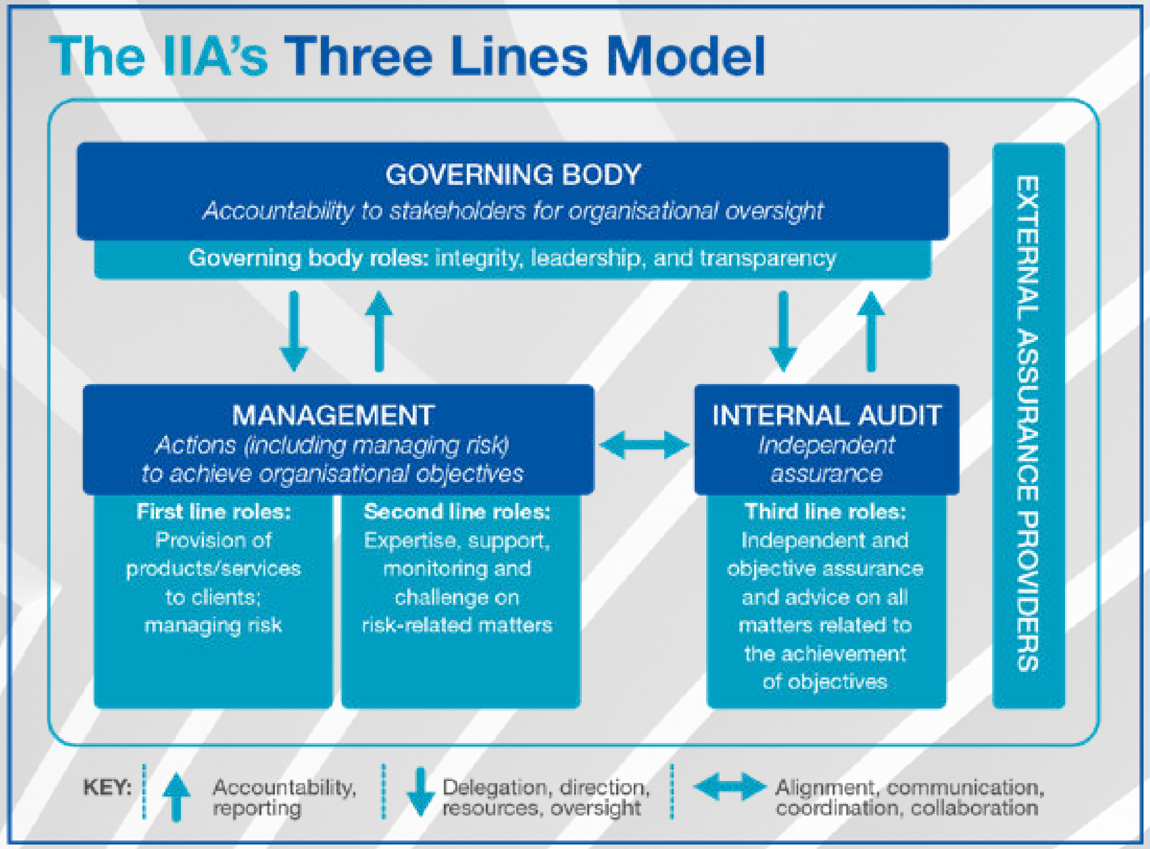
Three Lines Model: One year on

pkf-l.com

The Institute of Internal Auditors ('IIA') published The IIA's Three Lines Model: An update of the Three Lines of Defense in July 2020, setting out the results of the IIA's review and refreshing the original Three Lines of Defence Model that was published in January 2013.



Source: The IIA's Three Lines Model: An updates of the Three Lines of Defense (July 2020)

The objectives of the new Three Lines Model is to help organisations identify and implement structures and processes that assist in the achievement of organisational objectives and facilitate strong governance and risk management. Here we summarise the changes to the model and the implications.

What's changed?

Removal of 'defence' from the title – this shifts the emphasis from value protection and risk-reduction to value creation and contribution to the achievement of strategic objectives.

More principles-based – the new model is supported by six principles: Governance; Governing body roles; Management and first and second line roles; Third line roles; Third line independence; and Creating and protecting value.

Greater focus on the importance and role of governance - this is achieved via three components:

1. Governing body which is responsible and accountable to stakeholders.
2. Management (first and second line roles) which is responsible for actions to manage risk and achieve organisational objectives.
3. Internal audit (third line roles) which provides independent assurance.

Less prescriptive – the old model was prescriptive and rigid with regards to the silo structure and unique roles and responsibilities. The new model allows for greater flexibility such as the blending of first and second line roles. Further, the new model highlights the need for alignment, communication, co-ordination and collaboration across first, second and third line roles.

Promotes behaviours – the new model promotes the behaviours and decision making that underpin an appropriate and cohesive risk culture, a key focus for the regulators.

So one year on...what have we seen?

In our experience, not many organisations are aware of the new model and still refer to the Three Lines of Defence Model. Few have formally reviewed the new Three Lines Model and considered its implications.

However, far more organisations are aware of the benefits of and need for a Three Lines Model. This is particularly evident in the insurance broking sector where the second and third lines are often less evolved. A number of insurance broking firms are strengthening their second and third line functions, often driven driven by growth, increased risk profile and stakeholder expectations. The benefits and importance of second and third lines roles are being recognised by these firms.

Challenges for those firms adopting the new Three Lines Model:

For those who have considered the new model, we have observed the following challenges:

1. The model is based on principles and broad statements which make it difficult for organisations to interpret and apply in the way the IIA intends. This requires organisations to understand the principles raised in the guidance and evaluate their current structure.
2. Larger or regulated organisations have established governance frameworks and internal audit functions with distinct second line risk and compliance functions. However, these organisations often still need to improve the effectiveness of the co-ordination and interactions across the three lines.
3. Smaller organisations will find it easier to adopt the new model as its principles allow a greater flexibility such as the blending of first and second line roles.

Key considerations in implementing the new Three Lines Model

Governing bodies	Management	Internal audit functions
Ultimately, governing bodies sit above the Three Lines Model – it is imperative that existing governance structures and their interaction with key forums are appropriate, with clear accountability and oversight, including clear delegation of responsibilities to other forums / committees.	Management is responsible for taking actions (including risk management) and designing and implementing the controls and procedures necessary to achieve organisational objectives.	Audit Committees should encourage and seek views in relation to the new model and hold sessions to learn and allow for meaningful discussions on how it applies to their organisation. Audit Committees may need to reassess their existing approach to fulfilling their oversight duties in respect of risk and control.
The new model provides an opportunity for organisations to re-assess the reporting lines from management and the internal audit function to the governing body.	Appropriate MI reporting (planned vs actual and expected outcomes) should be established from the first line to the governing body and linked to objectives and risk.	Internal audit needs to report on the adequacy and effectiveness of governance and risk management (including internal control). There needs to be a link to the organisational objectives, including an emphasis on internal audit to promote and facilitate continuous improvement and identify / better understand opportunities within the organisation.
It is the role of the governing body to ensure appropriate structures and processes are in place for effective governance, including the setting of clearly defined risk appetites, thresholds, indicators etc. The governing body must provide suitable oversight and set the tone for a risk culture that is aligned to strategic objectives.	Respective roles of first and second line should be considered and the decision taken as to whether these will be blended or separate. The pros and cons of both options should be assessed, including considering what is appropriate and proportionate for the organisation.	Principle 5 clearly states that internal audit independence is key. Independence does not mean isolation and there should be regular interaction and communication between management and internal audit, ensuring that duplication, overlap or gaps in assurance are minimised.

The updating of the Three Lines Model provides a useful opportunity for organisations to review and refresh their structures.

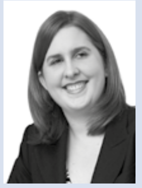
Ultimately, the new Three Lines Model has been designed to help organisations reach their strategic goals and objectives, with all three lines working collaboratively to support this.

For internal audit functions, the new model emphasises the importance of communication and collaboration between the lines. It is important for internal auditors to work across the various lines of their organisation. Independence doesn't mean isolation and internal audit functions have an obligation to have regular interactions with management and ensure their work is relevant, helping the organisation both strategically and operationally.

If you have any questions or would like support in implementing or adapting to the new Three Lines Model, please contact our Governance, Risk & Control Assurance team.

Our expert team can help you

To find out more please contact us.



Jessica Wills
Partner & Head of Governance, Risk & Control Assurance
+44 (0)20 7516 2229
jwills@pkf-l.com

Sam Shaikh
Director
+44 (0)20 7516 2345
sshaikh@pkf-l.com

Nick Borzenko
Senior Manager
+44 (0)20 7516 2340
nborzenko@pkf-l.com

PKF Littlejohn LLP,
15 Westferry Circus,
Canary Wharf,
London E14 4HD

Tel: +44 (0)20 7516 2200
www.pkf-l.com