



NEW YORK REPORTS

GOLD AWARD CHAPTER

July 2005



Dear Colleagues:

The dog days of summer are certainly upon us! Much like the audit profession, this summer has been sizzling hot. I hope that everyone has been taking some time away from the office to enjoy the weather with family and friends (*especially those of you whose companies have not yet embraced a summer-time casual dress code policy!*). Beach weather or not, the Chapter's Executive Committee has been quite active so far this summer. Here is an update on recent events and a preview of events planned for the coming months.

- On **July 21st** we held our annual training and social event. In the morning, Arnold Schanfield of Weiser LLP offered some insights on internal audit's role in enterprise risk management. After the session, we headed to Shea Stadium to witness the NY Mets obliterate the San Diego Padres (final score 12-0). We had about 80 attendees at the training session and the weather in Queens could not have been better. Thanks to Richard Dapcic for organizing the event, Linda Tan for handling the registration table, and New York Life Insurance Company for providing our meeting facility.
- On **August 12th** we're hosting our second Business & Industry Event of the summer: "Continuous Monitoring - A Strategy for Effective Controls and Using Transactional Analysis for Fraud Detection", presented by Derek Warburton of ACL Services Ltd. The turnout for these Business & Industry events has been very strong, so if a topic peaks your interest, be sure to sign yourself up early. Special thanks to Mike Lugo, Andrea Perkins, and James Wall for organizing this event.
- In September, we have two events planned. First, on Friday, **September 16th**, we're kicking-off our monthly workshop/luncheon program. Our workshop instructor, Sandra Miller, will be conducting a full-day workshop presentation titled, "Engage, Influence, And Motivate: How Auditors Can Use The Social Sciences To Add Value". Our luncheon presenter is Sal Marciano, weeknight sports anchor at WB11 News at Ten. Then, on **September 19th**, there is a Business & Industry Event titled "Auditing Tone At The Top" (presented by Ernst & Young). Be sure to check the Chapter's website for registration details.
- Planning on taking the Certified Internal Auditor (CIA) Examination this November? You'll be glad to know that we have scheduled CIA Review classes from **October 10th-13th** to help you prepare. As in the past, the format will be a one-day training session for each part of the exam. For more details and registration information, check our website. Many thanks to Carol McFarlane, Jennifer VanAlstyne, Pat Murtha, and Juan Perez for their efforts in planning these review classes.

Before I wish you all a great ending to the summer, I would like to recognize a significant accomplishment by one of our Past Chapter Presidents, Thomas J. Warga, who was just recently named IIA Chairman of the Board! Please join me in wishing him success in this role. Tom will be speaking at our Chapter luncheon in November.

Enjoy the rest of the summer. I look forward to seeing you at one of our upcoming events.

Luca A. Pagoto, President
IIA New York Chapter



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Fraud 101 for Audit Committees

In "Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention", the American Institute of Certified Public Accountants (AICPA) outlines six actions audit committees should take to better understand and prevent fraud from management overriding internal controls.

According to the AICPA, management override of internal controls is one of the major fraud risks facing companies. For example, the chief financial officer and the controller collude with other employees to post fictitious journal entries that overstate revenue or understate expenses. Think of Qwest Communications and WorldCom when envisioning this. Generally, management sees the posting of fictitious entries to meet earnings forecast as a temporary fix that benefits the company. However, the temporary fix soon becomes an establish pattern that may eventually lead to the collapse of the company.

Audit committees are advised to:

Maintain skepticism – audit committee members should question the need for exceptions to normal safeguards. An open display of skepticism along with knowledge of the business can deter the need for unnecessary overrides.

Understand the business - each audit committee member needs to strengthen his or her understanding of the business.

Brainstorm to identify fraud risks – committee members need to discuss and assess the potential for fraud in the operations.

Use code of conduct to assess corporate culture – determine whether the right "tone of the top" is set.

Establish whistleblower program – help the company create a culture where employees view ethics and whistle-blowing as adding value to the company.

Develop information network and feedback program – the audit committee should meet periodically with key groups, include the internal auditor, to discuss matters affecting the financial reporting process.

For more information on "Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention" and other AICPA fraud prevention training, visit www.aicpa.org/audcommctr.



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Lax Security at BJ's Led to Identity Theft

BJ's Wholesale Club (BJ's) and the Federal Trade Commission (FTC) settled charges that the wholesaler violated the Gramm-Leach-Bliley and FTC Acts. According to the FTC, identity thieves obtained and used customers' debit and credit card information because the wholesaler did not adequately protect its customers' personal information.

Banks and credit unions filed claims against BJ's seeking approximately \$13 million for the fraud(s). BJ's operates 150 warehouse stores and 78 gas stations in New York and 15 other states and has about 8 million members. The wholesaler had net sales of about \$6.6 billion in 2003.

The Gramm-Leach-Bliley and FTC Acts require companies to take reasonable steps to protect sensitive consumer information, to review their data security policies and procedures periodically, and to update them when necessary. According to the FTC's complaint, BJ's weak security permitted identity thieves to create fake copies of debit and credit card from customers' personal information collected and stored on BJ's computer networks. When a customer makes a credit or debit card purchase, BJ's collects the customer's name, card number, and card expiration date from the magnetic strips at the back of the card. However, BJ's did not encrypt the card information when it transmitted or stored it on its computers the FTC alleges. BJ's did not develop security measures to detect and prevent unauthorized access to its networks the FTC added. In addition, the wholesaler stored customers' information long after it was needed, a violation of bank security rules.

The FTC's settlement requires BJ to implement a comprehensive security program that includes administrative, technical, and physical safeguards. In addition, a qualified independent third party security professional must audit the program every other year for 20 years.

When does a person decide to become an accountant?

When he realizes he doesn't have the charisma to succeed as an undertaker.



New York Chapter of the Institute of Internal Auditors

www.nyiaa.org



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It's summer time and I'm inside editing a newsletter! Not to worry, we're going to dedicate this issue to summer in New York City.

EDITOR'S CORNER

As a New Yorker, to me Summer means free concerts in the parks, block parties, street festivals, parades, and lots of BBQ. Like all New Yorkers I love the smell of summer in the City, hot dogs roasting, ice cream melting, chicken burning . . . and FRAUD. So let's bring the summer into "NY Reports".

Michelle Duke, CPA
Newsletter Chair



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Why are the Elderly More Victimized by Financial Fraud?

The National Association of Securities Dealers (NASD) Investor Education Foundation awarded WISE Senior Services of Santa Monica, CA, \$127,700 to conduct a research project that will explore why the elderly are more frequently victimized by financial fraud crimes and to develop strategies that will help protect the elderly against these immoral crimes.

The project *Off the Hook Again: Understanding Why the Elderly Are Victimized by Economic Fraud Crimes*, will examine, over an 18-month period, the susceptibility of the elderly to fraudulent solicitations and their level of financial literacy. Researchers will conduct four major surveys to create and develop practical messages to increase fraud awareness among seniors.

“When older Americans invest they are prime targets of scam artists. And, NASD’s own research indicates that older Americans are in need of greater education covering financial and investing basics,” said Robert R. Glauber, Chairman & CEO of NASD, who also serves as Chairman of the NASD Investor Education Foundation. “This project will help us find more effective strategies to help seniors recognize and protect themselves from the deceptive pitches and tactics scam artists use.”

Management Fraud and Qwest

The Securities and Exchange Commission (SEC) alleges that Qwest Communications International Inc. (Qwest) committed accounting and financial reporting fraud. Qwest, without admitting or denying the allegations, agrees to pay \$250 million. Investors defrauded will receive the \$250 million under the Fair Funds provision of the Sarbanes-Oxley Act.

According to the Securities and Exchange Commission, Qwest fraudulently recognized \$3.8 billion dollars in revenue and excluded \$231 million in expenses in order to meet 1999 to 2002 revenue and earnings forecasts. Randall J. Fons, Regional Director of the SEC Denver Office said, “Qwest senior management created a corrupt corporate culture in which meeting Wall Street expectations was paramount . . . As a consequence, accounting rules, policies, and controls that interfered with meeting financial targets were ignored.”

As part of its settlement with the SEC, Qwest is required to maintain a permanent chief compliance officer reporting to a committee of outside directors. The Chief Compliance Officer will help the board of directors maintain and enforce a code of conduct for the corporation and respond to other ethical matters.



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NASD REVIEWS

Series 7 Exam Goes Global?

The new Global Capital Markets Qualification (GCMQ) exam will qualify capital market professionals to work in the equity and debt capital markets, and syndicate and investment banking in both the United States and the United Kingdom.

The National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE), and the Securities & Investment Institute (SII), will launch the GCMQ exam in late 2006. The SII sets professional standards for the securities and investment industry in the United Kingdom (UK).

The GCMQ exam will be a two-part examination. The “core” GCMQ portion of the exam will test candidates’ entry-level knowledge of capital markets in the US and UK while the regulatory portion will test candidates’ knowledge of the US and the UK regulations. The NASD and NYSE will develop the US Capital Markets Rules and Regulations Exam to assess knowledge of US regulations, while the SII will develop the U.K. Capital Markets Rules and Regulation Exam to assess knowledge of the U.K. securities and investment rules and regulations. When fully developed, the GCMQ exam will replace the Series 7 examination for U.S. candidates seeking to work only in capital market business. Licensed capital market professionals, who are currently fully licensed in the US or UK, can become qualified in the other jurisdiction by taking the missing regulatory exam section.

Richard G. Ketchum, chief regulatory officer of the New York Stock Exchange states, “Given the historic ties between our two nations, this agreement is a logical place to begin the task of creating more transportability of qualifications standards for securities professionals worldwide. Since capital markets have long led the way in globalization, it only makes sense to have a common testing standard that provides increased flexibility while maintaining high standards of knowledge in our respective marketplaces.”



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NASD Reviews Fee-Based Account Suitability

The National Association of Securities Dealers (NASD) fined Morgan Stanley DW, Inc. \$1.5 million and ordered the firm to pay more than \$4.6 million in restitution for failing to adequately supervise its fee-based brokerage business.

NASD's investigation showed that from January 2001 through December 2003, Morgan Stanley failed to establish and maintain a supervisory system designed to review the appropriateness of the account and monitor its fee-based brokerage business to determine whether its fee-based accounts remained appropriate for its customers.

Morgan Stanley has enhanced its supervisory system and procedures since the NASD inquiry. The NASD credited the firm with identifying and removing several inappropriate accounts from its fee-based program.

This case is part of the NASD's focus on fee-based accounts and its supervision. Visit www.nasd.com for more information on Fee-Based Compensation.

Question to Members



What information is included on your Internal Audit intranet site?

Send responses to
member_questions@nyiaa.org

e-Learning to Focus on Hot Compliance Issues

The NASD recently introduced web-based training, the E-Learning Exchange, as part of its strategy to educate security firms on compliance and regulatory issues. The first two e-learning courses will look at anti-money laundering issues. The E-Learning Exchange will add courses on variable annuities, fee-based accounts, and branch office supervision in 2005.



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SAMPLING

Discover all New York City has to offer!

Enjoy music and dance in Lincoln Center, theater in Central Park, and the rich African-American, Latino, Caribbean-American, and European-American cultures of Harlem:

Lincoln Center Out of Doors

Just for Kids: Soulworks /Andrea E. Woods & Dancers and WOMEN OF THE CALABASH

Date: August 17, 2005

Time: 10:30am at Lincoln Center North Plaza

Visit www.Lincolncenter.org

Shakespeare in the Park

Two Gentlemen of Verona: The Musical

Date: **August 16 - September 11 2005**

Time: 8:00PM at Central Park Band Shell

Visit www.publictheater.org

Harlem Week

Harlem is ... Theater featuring community works

Date: **August 1 – September 15**

Time: 7:00 AM – 6:00 PM at the Cathedral Church of St. John the Divine

1047 Amsterdam Ave. at 112th St.

Visit www.communityworksnyc.org & www.discoverharlem.com for more information on this and other events.

River to River Festival

Summer Soul Nights: Ray, Goodman and Brown

Date: 08/18/2005

Time: 7pm at South Street Seaport, Pier 17

Visit www.rivertorivernyc.org



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Protecting Social Security Numbers

In testimony before Congress, the Federal Trade Commission raised concerns about the misuse of Social security numbers. In its testimony the FTC stated, "Ultimately, what is required is to distinguish between legitimate and illegitimate collection, uses, and transfers of Social Security numbers."

Guidance on Internal Control Audits

The Public Company Accounting Oversight Board (PCAOB) advised external auditors to:

- Integrate audits of internal controls with the audit of the company's financial statements.
- Tailor the audit plan to the risks found in the company.
- Identify those accounts and processes that are relevant to the internal control over financial reporting.
- Use the work of others, i.e. internal auditors.
- Communicate, directly and timely, with management.

The guidance focuses on the scope of internal control audits and how much testing of a company's internal controls over financial reporting is required. PCAOB Chairman, William J. McDonough noted that while the internal control audits can significantly improve the quality and reliability of financial reporting, "internal control audits cost too much."

Visit www.pcaob.org for more information.