

# Risk!

## In the May Risk: **Risk Preparedness and Service Providers**

May's issue puts identity risk in the main position as protecting your database is discussed in *Being Prepared*. Meanwhile, a recent survey finds that risk management and IT professionals are not as well prepared for audit jobs. Find out more about it. The continuing story of supply chain risk covers how to prepare for compliance in *Safe or Sorry?* Then a recent panel of experts explores the preparedness of the world for *Tsunamis, Hurricanes, Earthquakes and Asteroids*.

## Survey

## Risk Management and IT Audit Skills Need Improvement According to Survey

*New research assesses current competencies and needs in the internal audit profession*

## Identity Risk

## Being Prepared:

### *Applying a risk-based approach to identity management*

Kevin Cunningham

While it's true that most IT security executives consider themselves risk averse, the reality is that for businesses to compete effectively, and employees to perform their jobs efficiently, organizations need to give users wide ranging access to critical enterprise systems and data. In the context of recent high profile data breaches such as the DuPont and Prudential insider theft incidents, the fact remains that managing identity data is both the lifeblood—and Achilles heel—of every organization.

Dealing with potential security breaches is simply part of business—and one that C-level executives are being forced to address head-on. However, the problem for most enterprises is determining where the greatest sources of identity risk exist, and how to proactively address these vulnerabilities before they become costly liabilities.

Within a large corporate environment, thousands of users access millions of data files on a daily basis, which makes tracking identity compliance information such as “who accessed what and when” nearly impossible to manage. No matter how much technology IT throws at the problem, the sheer volume of information changing hands is often too much for an organization to handle.

But what if companies could focus their identity management efforts on the most important data sources - such as those containing privacy data and financial information? What if they had the ability to centralize, filter and interpret complex identity data for more proactive detection, prevention and correction of important identity risks?

The concept of risk-based management isn't new; in fact, the SEC and Public Company Accounting Oversight Board recently issued guidance encouraging companies of all sizes to implement a risk-based approach to Sarbanes-Oxley compliance—in effect, seeking to reduce the effort and costs involved in identifying, evaluating, reporting and documenting regulation-driven controls.

*Continued on page 2*

In a recently released study, internal audit practitioners cited risk management and IT auditing as the top two areas for improvement in the profession. These and other findings are detailed in Protiviti's inaugural Internal Audit Capabilities and Needs Survey report.

Fraud risk management (FRM), enterprise risk management (ERM) and the COSO ERM framework also stands out as key technical competencies in need of improvement, despite the relatively high competency levels reported by respondents. These results underscore the high importance of these areas for organizations as they seek to achieve greater success in an ever changing global business climate.

“Today's internal audit professionals have more diverse and higher level responsibilities than ever before,” said Bob Hirth, managing director and head of Protiviti's global internal audit practice. “This has created the need for a proportional increase in their knowledge, skills and expertise, particularly in those areas deemed to be business critical by management and boards of directors. The survey results provide insights not only into how these professionals rate their skills in a variety of functions, but also about the relationship between their perceived capabilities and the critical areas for improvement. This has significant implications for the future direction of internal

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# Identity Risk

*Being Prepared continued from page 1*

While it seems like common sense, implementing a risk-based approach to identity management requires a sound understanding of one's IT architecture, as well as how widely distributed identity data relates to and supports an organization's strategic business initiatives. Unfortunately, few companies have the appropriate skills or resources to handle these challenges effectively.

A recently published Ponemon Institute *Survey on Identity Compliance* highlights these issues in detail. According to the research, although more than 70% of respondents confirm that identity management activities are strategically important, they cite inefficient processes, insufficient data and the lack of collaboration between business and IT groups as the leading causes of risk across the enterprise. Specifically:

- **58% use mostly manual methods to monitor identity controls.** Many identity and access management tasks are still dependent on multi-step processes and paper-based workflow, driving business costs up and organizational efficiencies down.
- **87% employ a decentralized identity compliance strategy.** An overwhelming majority of companies focus compliance efforts on applications, departments or locations in lieu of centralized policy enforcement and access review procedures.
- **51% take a detective (or reactive) approach to identity-related compliance issues.**

Most organizations still don't know a compliance breach has occurred until after the fact.

In addition, companies say they face a number of key barriers in quantifying important identity risks. 42% of respondents say the data they need to assess risk is difficult to obtain, 41% say they lack the appropriate tools to track and assess such risks, and another 21% say they have no way to assign tangible risk values to technical resources – bringing us full circle to the issue of business context, and how important it is in mitigating the risks associated with user access privileges and activities.

Fortunately, managing identity risk does not have to devastate the bottom line. What companies need is a solution that automates the process of identifying, measuring and monitoring identity risk, integrating all identity risk data into a centralized management solution. Such tools provide real-time insight into potential risk factors across even the most complex enterprise environments—hundreds of applications and tens of thousands of users—and allow organizations to proactively focus internal controls to reduce potential compliance exposure and liability. As an end result, organizations can focus their risk management efforts more strategically, track progress over time, and provide quantifiable proof of enhanced security and reduced risk to the business. ▲

*Kevin Cunningham is president and founder of Sailpoint where he oversees product development, marketing, sales and services. SailPoint Technologies, Inc. develops software that helps organizations achieve regulatory compliance, improve internal controls and manage risks associated with the proliferation of enterprise-wide identity data.*

## Coming in June Risk!

### Credit Risk Management

Financial institutions weigh in on the latest requirements in this necessary treasury function.

## Risk!

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# Survey

*Risk Management and IT Audit Skills Need Improvement According to Survey* continued from page 1

auditing and its role in helping organizations grow and prosper.”

Recognizing the growing scope and complexity of duties in the internal audit profession, More than 450 chief audit executives (CAEs), internal audit directors, managers and other professionals were surveyed to better understand the evolving functions of internal audit departments within organizations across a variety of industry sectors. Respondents rated how they perceive their present capabilities, where they see need for improvement, and how they prioritize those needs within the areas of general technical knowledge, audit process knowledge, and personal skills and capabilities.

Under the audit process knowledge section, survey respondents identified auditing IT functions (including security, continuity and change control) as an area with a lower level of overall competency and one with a significant need for improvement in knowledge and skills. “These results underscore a key challenge for internal audit departments and functions,” Hirth noted. “Given the constantly changing nature of IT and the specialized expertise required to audit these processes, it is imperative for internal auditors to acquire and keep current with IT audit skills. In addition to improving baseline IT audit skills, internal audit organizations may also look to outside

expertise to guide them in this technically difficult, dynamic and complex area.”

The survey also addressed personal skills. Respondents cited developing board committee member relationships (outside of the audit committee) as the area with the lowest average competency and the greatest need for improvement.

“This may reflect a tendency among internal auditors to focus their attention on the audit committee, whose members may be more likely to ‘speak their language,’ and with whom, traditionally, interaction and relationships have been frequent and strong,” Hirth said.

At the other end of the spectrum, written communication skills have the highest competency ratings among those from all sizes of businesses, in all industries and at all levels of responsibility.

To request a complimentary copy of the Internal Audit Capabilities and Needs Survey report, visit [www.protiviti.com](http://www.protiviti.com). ▲

*Protiviti (www.protiviti.com) is a leading provider of independent risk consulting and internal audit services. Protiviti, is a wholly owned subsidiary of Robert Half International Inc. (NYSE symbol: RHI). Founded in 1948, Robert Half International is a member of the S&P 500 index.*

## Supply Chain Compliance

### Safe or Sorry?

*12 Steps to an effective compliance program*

*Larry Christensen*

Export compliance for shipments coming out of the U.S. and the re-exports of items containing U.S. content will continue to remain one of the manufacturing world’s greatest challenges. The Bureau of Industry and Security’s statistics for fiscal year 2005, show 31 criminal convictions, \$7.7 million collected in criminal fines, 69 administrative or civil penalties, and \$6.8 million collected for those violations. When you look at the various cases, it is clear BIS is expanding enforcement to include conspirator liability between corporations in the supply chain, primary liability of reexporters, those who store goods and those who facilitate their export, such as freight forwarders.

When things go wrong and companies find out they have done business with a prohibited destination, end use, party, or a party that diverts the item, the first and most problematic question asked by regulatory officials is “do you have a file describing the due diligence you performed before the export or reexport?” If the answer is yes, there still may be a per se violation that will prompt the enforcement authorities to impose an administrative fine. If the answer is no, there are more serious civil and possibly criminal liability risks. The

next steps are expensive, time consuming, and reputation damaging.

Companies and individuals are obligated not to do business with illegal parties or entities, destinations, and end uses. They are also expected to take steps to ensure they do not commit such violations. With experience, there are key steps that should be taken to ensure compliance failures do not stop your supply chain in its tracks.

- **Obtain board-level commitment.** Before any compliance program can be successful, buy-in from the board of directors and senior level staff must be secured. The U.S. Government Sentencing Guidelines state that corporate officers and board members must be knowledgeable about the content of their compliance program, exercise reasonable oversight, and give compliance officers direct access to the board. Increasingly around the world, we see governments imposing a standard of care on the board and or senior management. Senior officers risk personal liability should your compliance program fail.
- **Assess processes.** Hire outside trade experts to perform a compliance gap analysis on your current compliance processes. Then fill the gaps. What gates and stops have been and can be established? How are compliance records stored and located?
- **Embargoed countries.** Your company is not allowed to trade with certain countries. Make sure that you have established a list of embargoed countries and created effective stop measures that ensure

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# Supply Chain Compliance

*Safe or Sorry? continued from page 3*

items are not shipped to those countries directly or indirectly.

- **Electronically screen names and addresses** in your master customer/partner files against the various government black lists. With more than 50 international restricted party lists in existence, it is important to work with a firm that organizes these ever-changing lists into a central database that is monitored and updated daily.
- **Establish an on-going name and address screening process.** Just because you have screened a customer once does not mean your name screening is done forever. Governments constantly add and delete names from the various restricted lists. In 2004, more than 14,000 updates were made to the restricted party lists, while more than 162,000 updates were made since September 11, 2001. It is vital that you remain current with list updates and modifications.
- **Perform end use and diversion risk screening.** Take steps beyond mere name screening by collecting end use information from customers and other parties in the supply chain that work with you. Be certain that your product is being purchased for its intended use. In addition to end use screening, perform diversion risk screening. Collect information about the nature of your customer's business to determine whether your product or service is consistent with the business of your customer. Make sure that your customer is not diverting your product to another party.
- **Obtain jurisdiction and classification information from each supplier.** Perform jurisdiction and classification when that information is not easily obtained from a reliable supplier with a good reputation for compliance.
- **Perform license determination.** Develop a license determination process for list-based license requirements and perform license determination prior to each export and each reexport.
- **Write and implement processes and procedures that are part**

**of each business function.** Compliance must be a key concern across the company. Processes should be in place for IT, R&D, engineering, manufacturing, sales, order entry, fulfillment, shipping, comptroller, legal, the board of directors and compliance to ensure that the proper measures are taken to control the export and reexport of goods, technology and software.

- **Train, train, train.** Do not develop processes and procedures only to file them away in a cabinet. Procure training for the whole company with different levels of training based upon each job function. Train on your processes and on the ever-changing substantive rules. Train your staff until they understand how an effective compliance program can make or break a company, and then train them again.
- **Follow ISO 9000 and Sarbanes-Oxley standards** as well as the export control best practices recommended in the Nunn-Wolfowitz report.
- **Perform audits every year.** Make sure that your compliance engine is running smoothly by performing annual audits. Alternate by performing an internal audit one year and an external audit the next. It is better to be safe than sorry, and every process breaks down over time unless it is audited. ▲

*Larry E. Christensen is vice president of export controls for JPMorgan Chase Vastera and adjunct professor of law at Georgetown University Law Center. He has worked in export controls and trade sanctions since 1979. A 1972 graduate of Duke Law School, Mr. Christensen served the Department of Commerce for eleven years in the Office of Chief Counsel of Export Administration and as Director of the Office of Regulatory Policy. In that role, he headed the complete redrafting of the Export Administration Regulations (EAR) in 1995 – 1996, the first such rewrite since 1949.*

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## Tsunamis, Hurricanes, Earthquakes and Asteroids: *Are we ready for the next 100 years?*

Betty Penzner, AFP

Recently a panel of experts presented a discussion on international risk and natural disaster and its future at the annual conference of the American Society of International Law. Their conclusion was that analysis and mitigation can occur if only someone would pay attention.

The issue is how risk of natural disaster can be calculated and how that plays a role in international affairs said Arthur Lerner-Lam, director, Center for Hazards and Risk research, The Earth Institute at Columbia University. "Let's mainstream risk into sociological development."

He continues by quantifying the risk. "The number of people affected is a thousand times more than the number of people hurt," he said. Yet, he doesn't see progress in modeling of vulnerabilities in risk in the last few years.

David Fisher is an attorney with the International Federation of Red Cross and Red Crescent Societies and he addressed relief and recovery, noting statistics from the University of Brussels revealed that disasters have gone up exponentially since the '70s. "We can expect more tsunamis, more hurricanes, and more droughts."

He has done case studies in countries around the world of providers and receivers of international assistance. His group is developing a set of guidelines.

Michael Cohen, economist, The New School, director of the Graduate Program in International Affairs asked what is the conventional wisdom of disasters? They are natural. Are they democratic? He said in places they are not natural, but disasters by design. During Katrina, the water came off the river not the Gulf. This is not a case of disasters affecting everyone equally.

"Most disasters are not events. Most disasters are processes," Cohen said. "Because they are processes they must be tied to specific context." They could be connected

to human security he concluded.

Among the challenges in mitigating disasters is warning the constituency according to Lerner-Lam. Limiting the damage done is relative to the development of the country. A well developed country will have warning systems and first responder systems. But, enormous resources have been spent on a warning system without thinking about how to get the warning to the people themselves.

The growth of the international relief community has brought "an embarrassment of riches" and a big problem in relief efforts according to Fisher. While there have been lessons learned, some common problems continue to emerge following a disaster. International NGOs form, some spontaneously and it is hard to determine which ones are authentic. There are no international standards that say one international organization is legitimate and another is not. Diaspora communities often form relief efforts as do corporations in the private sector. One rule of thumb, said Fisher, is if you are not recognized by a legal name, you can't open a bank account.

Another problem is the mountains of used clothing, much unusable that is received. One example was a ski jacket sent to a tropical locale. And much of the donated goods get stuck in customs. There are no international rules for this.

Developing countries have lost \$690 million in infrastructure as a result of disaster since the 1990s Cohen said. We know climate change is continuing. Urban growth is continuing. So those areas are more vulnerable to disaster. Infrastructure is a good indicator of the ability to absorb the disaster.

"In the end we're stuck with the local impacts," Cohen said. The concern needs to be on the security of the people rather than the state.

You need to identify the communities, said Lerner-Lam. Who has the jurisdiction? What resources are needed? What has the trust?

The military has the logistics capacity but it is more expensive than civilian operations suggested Fisher. The military can have a political strategy. Following the Oslo guidelines: the military use is limited. It rebuilds the infrastructure.

Cohen added, a larger number are living in insecure land tenure. Land tenure is a human right. This is affecting the poor more than anyone else.

A way to forecast when a risk is going to be would be ideal. According to Lerner-Lam, the U.N. and the World Bank produced global exposure to multihazard areas review and found that programs weren't taking advantage of this information. The World Bank has developed a fund. But a lack of risk preparedness remains. ▲

### PodCast

#### Risk Management Challenges

AFP's Kraig Conrad lays out the current risk management challenges when it comes to global supply chain risk, and highlights a few potential solutions.

[http://www.afponline.org/pub/podcasts/p\\_20070404\\_conrad.mp3](http://www.afponline.org/pub/podcasts/p_20070404_conrad.mp3)

## ECB President Trichet Cautions Credit Derivative Markets

European Central Bank (ECB) President Jean-Claude Trichet recently warned that transparency in the credit derivative market should be improved.

The ECB president spoke at the general meeting of the International Swaps and Derivatives Association in Boston. Trichet warned in the speech that more must be learned about credit derivative impact on the monetary policy transmission mechanism and that transparency improvements are needed to fully assess their risks to the financial system.

“Empirical evidence and theoretical reasoning on this subject are admittedly still limited ... there is growing consensus that credit derivatives have implications for the conduct of monetary policy,” Trichet said. Policy maker influence in the credit channel will likely further change as credit risk is transferred out of origination and off balance sheets.

Later in his speech Trichet said that “opacity of the credit derivatives market ... is a potential source of concern ... the complex interaction between cash instruments and credit derivatives had made it increasingly difficult to monitor where different, possibly sizeable, positions are taken and where risks are concentrated.” Position concentration tends to build in highly-leveraged markets that lack some framework for transparency.

Credit derivative innovations have created an asset class by which credit risks can be disaggregated and traded separately. Though innovations offer benefits, Trichet questioned the current understanding of conditions in which credit derivatives bolster financial system resilience.

Trichet identified three conditions in which credit derivatives may enhance system resilience under normal and stressed market conditions.

The first condition requires that risks are accurately measured and priced. Credit derivative complexity complicates risk

measurement--a circumstance that is further confounded by a lack of empirical data for these instruments under stressed market conditions.

Secondly, risks need to be appropriately managed. “Aggressive investors display a more volatile risk-taking attitude,” according to Trichet, and they likely are not maintaining balance sheets resilient enough to endure significant volatility increases or major system shocks.

The last condition relates to investor behavior throughout all circumstances in the market, in what Trichet referred to as “an appropriate heterogeneity of both investors’ behavior and risk appetite” in order to sustain liquidity. Stressed market conditions often propel common investment strategies across investors, a “dangerous herding behavior” that could dry up liquidity and focus counterparty risk on market leaders.

Trichet offered a path forward that would allow the market to further innovate while reducing risks to financial systems the market may create. The ECB president suggested further understanding of transparency issues, the research and development of an appropriate transparency framework, and the identification of a public and private sector collaboration to lead the charge.

The full-text version of Trichet’s speech is available from the European Central Bank. [[www.ecb.int](http://www.ecb.int)] ▲

## Report Suggests Stand-Alone Terrorism Insurance Strength

Findings released this week show that stand-alone terrorism insurance is growing to provide more predictable cover in most parts of the world. Challenges still exist for some locations and unique properties.

Growth in the industry’s abilities to deliver cover with increased capacity and more stable rates has supported take up of stand-alone terrorism insurance, according to a recent report from Aon’ Crisis Management

Division. “Depending on locations ... it is quite straightforward in the current market to put together a layered program, up to US\$750 million (and in select cases up to US\$1.2 billion), at an affordable price.”

The report, titled “Stand-Alone Terrorism Insurance Market Update,” found that a favorable premium-to-claims ratio attracted stand-alone insurers and created new capacity by nearly 20% since January 2006. The expanding capacity has helped premiums decline as rates have fallen by nearly 60% since 2002.

Some challenges remain for select locations with a high concentration of ‘trophy’ assets or perceived high risk of future attack. The Aon report identified specific locations of notable capacity limitations. They are:

- Brussels - 1000 post code
- Frankfurt
- London - Canary Wharf area
- Dublin - 02 post code
- New York City - midtown and downtown zip codes, specifically: 10017, 10018, 10019, 10021, 10036, 10048
- Chicago central business district
- Toronto
- Hong Kong
- Singapore

Additionally, stand-alone insurers are generally cautious in underwriting transport, hotel and infrastructure risks.

The Aon report was released on the same day that the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises announced a hearing on the future of the Terrorism Risk Insurance Act of 2002 (TRIA), the federal terrorism insurance backstop.

The backstop defined in TRIA is set to expire at the end of this year. Though TRIA pulled business from stand-alone insurers contributing to softness in the market, there are groups that argue these types of government solutions prevent the market from maturing.

The full Aon Risk Management report is available at [www.aon.co.uk](http://www.aon.co.uk). ▲

## Geithner Upeat on Implications of Credit Market Innovations

Rapid credit market advancements in recent years have created concern over their impact on financial system stability. New York Federal Reserve Bank President Timothy Geithner says that impact may be positive.

Though the advantages of market-based credit derivatives can be undermined by their complexity, Geithner believes credit market innovation should improve broader market efficiency and financial-shock resilience. The rapid growth has prompted concerns that these innovations may—among other things—intensify credit cycles and encourage excessive leverage.

“By spreading risk more broadly, providing opportunities to manage and hedge risk, and making it possible to trade and price credit risk, credit market innovation should help make markets both more efficient and more resilient,” Geithner said recently at an event in Charlotte, North Carolina, hosted by the Federal Reserve Bank of Richmond.

Contrary to often referenced concerns, market volatility does not appear to increase with the use of derivatives. Geithner said that there is no strong empirical support that derivatives increase volatility in financial markets, stating that “volatility is not higher where derivatives are most prevalent.”

While supporting the advantages and advancements in credit markets, Geithner offered three points that “deserve more reflection.” Areas that require attention are market liquidity and liquidity risk, impact of complexity on credit derivative valuation and risk measurement, and challenges related to institutional failure and market infrastructure.

Financial shocks accompanied by sharp increases in risk premiums could give rise to a drop in asset values and an increase in volatility that compound the shock. In these market conditions, liquidity would dry up limiting the use and application of market-based credit protection when it is most needed.

Credit instrument complexity challenges their valuations, particularly with limited historical data that demonstrates instrument behavior in stress events. According to Geith-

ner, “even the most sophisticated participants in the markets for these instruments find the risk management challenges associated with these instruments daunting.”

The volume of over-the-counter derivatives and the increase in the number and size of leveraged funds may impede the process of resolution of a large failed financial institution in these markets. These dynamics could lead to an extended period of uncertainty that may confound resolution of the failed institution and rattle the market. Furthermore, the market has grown faster than back office systems responsible for post-trade processing. Amid failures or rising defaults positions are difficult to verify with significant confirmation backlogs and paper-based processes.

Geithner closed his speech by offering suggestions to policymakers and supervisory agencies for addressing the three risks he identified. He encouraged global financial supervisory agencies to continue encouraging the market to improve its infrastructure on its own while strengthening regulatory capital regimes to increase capacity to absorb loss in stress conditions. ▲

## Risk Jobs

### Global Risk Job Postings

GlobalRiskJobs ([www.globalriskjobs.com](http://www.globalriskjobs.com)) is an international electronic job posting board specifically designed to address the nuances of risk and compliance. GlobalRiskJobs is managed by a team of professionals with extensive experience in executive recruiting and risk management.

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<http://grj.searchease.com/JobSeekerX/ViewJob.asp?JobID=VFhVY%2BtN725KUlienS7eKxE0%2FQ>

##### Compliance Advisor, St. Petersburg, FL

<http://grj.searchease.com/JobSeekerX/ViewJob.asp?JobID=4hbfpC85FKJcSK%2BYMTemrS4ag>

##### Quantitative Analyst/ Credit Derivatives, Chicago, IL

<http://grj.searchease.com/JobSeekerX/ViewJob.asp?JobID=SR0LYu6UR4n%2FQlsgPJwUADZT6A>

##### Risk Examiner/ Audit Specialist, New York, NY

<http://grj.searchease.com/JobSeekerX/ViewJob.asp?JobID=ib0N%2Br6z3k1E7wZD%2BvHwGidHVg>

##### Leader, Risk Analysis, Purchase, NY

<http://grj.searchease.com/JobSeekerX/ViewJob.asp?JobID=o2kbgslbx%2BzyYwd7dNz6qxcKmA>

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