

**A REPORT TO CONGRESS  
IN ACCORDANCE WITH §357**

**OF THE**

**UNITING AND STRENGTHENING AMERICA BY PROVIDING  
APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT  
TERRORISM ACT OF 2001**

**(USA PATRIOTACT)**

**SUBMITTED BY THE  
SECRETARY OF THE TREASURY  
APRIL 26, 2002**

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## **I. INTRODUCTION AND SUMMARY OF RECOMMENDATIONS**

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (“USA PATRIOT Act”) Act of 2001, Pub. L. No. 107-56. Section 357 of the USA PATRIOT Act provides:

### **Section 357 – Special Report on Administration of Bank Secrecy Provisions**

(a) REPORT REQUIRED. – Not later than 6 months after the date of enactment of this Act, the Secretary shall submit a report to the Congress relating to the role of the Internal Revenue Service in the administration of subchapter II of chapter 53 of title 31, United States Code (commonly known as the “Bank Secrecy Act”).

(b) CONTENTS. – The report required by subsection (a) –

(1) shall specifically address, and contain recommendations concerning –

(A) whether it is advisable to shift the processing of information reporting to the Department of the Treasury under the Bank Secrecy Act provisions to facilities other than those managed by the Internal Revenue Service; and

(B) whether it remains reasonable and efficient, in light of the objective of both anti-money-laundering programs and Federal tax administration, for the Internal Revenue Service to retain authority and responsibility for audit and examination of the compliance of money services businesses and gaming institutions with those Bank Secrecy Act provisions; and

(2) shall, if the Secretary determines that the information processing responsibility or the audit and examination responsibility of the Internal Revenue Service, or both, with respect to those Bank Secrecy Act provisions should be transferred to other agencies, include the specific recommendations of the Secretary regarding the agency or agencies to which any such function should be transferred, complete with a budgetary and resources plan for expeditiously accomplishing the transfer.

The Secretary of the Treasury submits this report in accordance with the above requirement. After reviewing the role of the Internal Revenue Service (“IRS”) in administering the Bank Secrecy Act (“BSA”) in partnership with its fellow Treasury bureau, the Financial Crimes Enforcement Network (“FinCEN”), the report concludes that, in light of the expertise, resources and focus of the IRS, the IRS should continue to perform the information processing and examination functions.

The IRS has cultivated substantial anti-money laundering expertise over the years and contributed significantly to the administration of the BSA since its enactment in 1970. In recent years, the partnership forged by the IRS and FinCEN has been aimed at improving the administration of the BSA and prioritizing the challenges both agencies recognize need to be addressed. This report summarizes a number of the ongoing initiatives being worked on by the IRS and supported by FinCEN which are showing positive results and which are strengthening the performance of the information processing and examination functions. It would be both wasteful of resources and disruptive to the administration of the BSA to transfer these functions, especially since there is no other comparable agency with a similar combination of expertise and resources that could readily assume them.

## **II. BACKGROUND**

The Bank Secrecy Act<sup>1</sup> authorizes the Secretary of the Treasury, *inter alia*, to issue regulations requiring financial institutions and other persons to keep records, file reports that are determined to have a high degree of usefulness in criminal, tax, regulatory, intelligence and counter-terrorism matters, and implement counter-money laundering programs and compliance procedures.

The two components of the Department of the Treasury with significant responsibilities for the administration of the BSA – which is part of the substantial role they both play in the fight against many forms of financial crime – are FinCEN and the IRS. The Department of the Treasury relies on the expertise and resources of each bureau to perform the many functions

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<sup>1</sup> Titles I and II of Public Law 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5330. Regulations implementing Title II of the Bank Secrecy Act (codified at 31 U.S.C. 5311-5330) appear at 31 CFR Part 103. The Secretary has delegated the authority to administer Title II of the Bank Secrecy Act to the Director of the Financial Crimes Enforcement Network.

necessary to carry out the purposes of the BSA. This section of the report summarizes the background and requirements of the BSA.

### **Bank Secrecy Act**

In October 1970, in response to evidence from the United States law enforcement community that bank secrecy was impeding the investigation of organized crime and other criminal activities, Congress enacted legislation commonly referred to as the Bank Secrecy Act. The BSA is designed to assist in the detection and prevention of criminal activity by creating a paper trail from financial institutions back to the criminal organization. It authorizes the Department of the Treasury to require banks and other financial institutions to retain designated financial transaction records that the Secretary deems to be useful in criminal, tax and regulatory investigations. In addition, the BSA authorizes the Secretary to require financial institutions and, in some cases, other businesses and private citizens, to file reports on a wide variety of financial transactions that establish and preserve a financial trail for investigators to follow as they track criminals, their activities and assets.

Since 1970, the BSA has been amended a number of times to give the Department of the Treasury a wider variety of regulatory tools to combat money laundering. In 1986, money laundering was made a crime in its own right in recognition of the growth and seriousness of the problem of money laundering. In 1992, the Secretary was authorized to promulgate regulations requiring financial institutions to establish anti-money laundering programs.<sup>2</sup>

Currently, many types of financial institutions are subject to regulations promulgated under the BSA, including:

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<sup>2</sup> See Money Laundering Control Act of 1986, Pub. L. No. 99-570 and Annunzio-Wylie Anti-Money Laundering Act, Pub. L. No. 102-550. For a more comprehensive discussion of the timeline relating to the development of the BSA, see FinCEN's website at: [www.treas.gov/fincen](http://www.treas.gov/fincen) under "Regulatory/BSA Timeline".

- approximately 24,000 depository institutions, including state and federally – chartered commercial banks, savings banks and other thrifts, and credit unions;
- an estimated 160,000 money services businesses, comprised of such diverse financial providers as check cashers, currency dealers or exchangers, issuers, sellers and redeemers of traveler's checks, money orders and stored value, and money transmitters;
- some 40,000 U.S. Post Office sites;
- approximately 600 casinos or other gaming organizations located in some 30 states and territories and on tribal lands;
- approximately 5000 securities firms; and
- an undetermined number of other entities, such as insurance companies, that may become subject to the BSA regulations under § 5312 of the BSA or as a result of the USA PATRIOT Act.<sup>3</sup>

The BSA requires the filing of the following reports by financial institutions, by trades or businesses, or by other persons:

- Currency Transaction Report (CTR), Form 4789, for use by financial institutions to report currency transactions exceeding \$10,000;
- Currency Transaction Report by Casinos (CTRC), Form 8362, for use by casinos to report currency transactions exceeding \$10,000;
- Report of International Transportation of Currency or Monetary Instruments (CMIR), Form 4790, for use by any person to report the transportation into or out of the United States of currency and certain other monetary instruments on any one occasion in excess of \$10,000;
- Report of Foreign Bank and Financial Accounts (FBAR), Form TD F 90-22.1, for use by any person to make an annual report of a financial interest in a foreign account if the aggregated value of the foreign financial account exceeds \$10,000 at any time during the calendar year;
- Suspicious Activity Report (SAR), Form TD F 90-22.47, for use by depository institutions to report suspicious financial transactions;
- Registration of Money Service Business (MSB), Form TF F 90-22.55, for use by certain MSBs to register with the Department of the Treasury;

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<sup>3</sup> For purposes of the BSA, 31 U.S.C. § 5312(a)(2) defines financial institutions. Section 352 of the USA PATRIOT Act requires all such financial institutions as defined by the BSA to establish anti-money laundering programs unless subject to exemption by the Secretary. Section 356 permits the Secretary to extend suspicious activity reporting requirements to commodities brokers and requires the Secretary to study whether these requirements also should be extended to investment companies.

- Suspicious Activity Report by Money Services Businesses (SAR-MSB proposed), Form TD F 90-22.56, for use by money transmitters and issuers, sellers and redeemers of traveler's checks and money orders to report suspicious financial transactions;
- Designation of Exempt Person (DEP), Form TD F 90-22.53, for use by depository institutions to report eligible customers with routine needs for currency who have been exempted from CTR reporting; and
- Report for Cash Payments Over \$10,000 Received in a Trade or Business, Form 8300, for use by trades or businesses that are not financial institutions under 31 CFR 103.11 (and thus required to file CTRs to report receipt of cash in excess of \$10,000).<sup>4</sup>

In addition, suspicious activity report forms for the securities industry and casinos and card clubs are being developed in anticipation of the implementation of SAR reporting by these industries.<sup>5</sup>

The financial information reported on these BSA forms is used by law enforcement as one of many tools to follow the money trail and build investigations. Over time, the BSA has become an important tool in the fight against money laundering and, with passage of the USA PATRIOT Act, a vital part of the effort to cut off and disrupt the financial infrastructure of international terrorism. The use of BSA reports for other criminal, tax and regulatory purposes, however, continues to be essential. Thus the IRS, with both civil and criminal divisions, is in the unique position of being a consumer of BSA information as well as playing an important role in administering the regulatory infrastructure that produces them. Bringing this broad spectrum of experience to the table makes the IRS a valuable partner in the administration of the BSA.

FinCEN contributes its financial crime expertise and networking ability to the administration of the BSA and, together with the policymakers at the Department of the

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<sup>4</sup> Section 365 of the USA PATRIOT Act requires all persons engaged in a trade or business receiving a cash payment for a transaction in excess of \$10,000 to file a report with FinCEN. This report, the Form 8300, previously had been filed only as a tax form with the IRS and its dissemination was strictly limited. It is now regularly available to FinCEN's law enforcement clients as well.

<sup>5</sup> Section 356 of the USA PATRIOT Act requires the Secretary to publish a final rule requiring brokers and dealers in securities to file SARs by July 1, 2002. FinCEN published the proposed rule on December 31, 2001. See 66 FR 67669. On March 29, 2002, FinCEN published a notice reopening the comment period on the proposed standard for the reporting by casinos and card clubs of suspicious activity. See 67 FR 15138.

Treasury, coordinates the implementation of regulatory policies through the network of law enforcement, regulatory and financial communities. This specialized and small bureau relies on the nationwide organization of the IRS to provide the resources and expertise to physically manage the vast data repository of financial information reported under the BSA and to examine the thousands of entities subject to BSA regulation that lack a federal functional regulator, *i.e.*, money services businesses and the gaming industry. An examination of the role each of these Treasury bureaus plays in the administration of the BSA, which illustrates how they complement each other in a manner that would be extremely difficult to reproduce should such functions be transferred outside of the auspices of the IRS, is set forth below.

### **III. THE ROLE OF THE FINANCIAL CRIMES ENFORCEMENT NETWORK**

FinCEN, created in 1990,<sup>6</sup> has a unique combination of law enforcement and regulatory responsibilities and is recognized for its expertise in money laundering and financial crimes.<sup>7</sup> Initially, the organization was asked to focus on the detection of financial crimes by providing analytical support to law enforcement investigations. In October 1994, FinCEN absorbed Treasury's Office of Financial Enforcement, the office that administered the BSA in conjunction with the IRS and other government agencies, to create a single anti-money laundering agency combining regulatory, intelligence and enforcement missions. This consolidation enabled FinCEN to better support one of the primary purposes of the BSA, that is, to continually improve the usefulness of the financial recordkeeping and reporting system to law enforcement in its fight against money laundering and other financial crime.

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<sup>6</sup> FinCEN became a Treasury bureau with passage of the USA PATRIOT Act on October 26, 2001.

<sup>7</sup> FinCEN's mission is to support law enforcement investigative efforts, foster interagency and global cooperation against domestic and international financial crimes, and provide U.S. policymakers with strategic analyses of domestic and worldwide money laundering developments, trends and patterns. FinCEN works toward those ends through information collection, analysis and sharing, as well as technology assistance and innovative, cost-effective implementation of the BSA.



FinCEN's regulatory efforts provide the cornerstone for FinCEN's support to law enforcement. FinCEN promulgates the BSA regulations which prescribe the reporting, recordkeeping and anti-money laundering requirements for over 200,000 financial institutions subject to the BSA. FinCEN develops the BSA forms necessary to capture the reported financial information in a manner that is both readily comprehensible to regulated entities as well as useful to law enforcement analysts and investigators. FinCEN also interprets the BSA's regulatory requirements and provides financial institutions with compliance guidance. When necessary, FinCEN will also initiate regulatory enforcement actions when compliance cannot otherwise be achieved.

In calendar year 2001, FinCEN's Office of Compliance and Regulatory Enforcement (OCE) answered over 2400 telephone inquiries relating to BSA compliance and responded to over 200 written inquiries. OCE also established the Financial Institutions Hotline to facilitate and expedite the reporting to law enforcement by financial institutions of suspicious transactions that might relate to terrorist activity. Over 950 calls asking questions and reporting suspicious activity related to terrorism have been received since the Hotline was established in September 2001, resulting in over 480 reports being provided to law enforcement.

By applying state-of-the-art technology to the approximately 14 million BSA reports filed each year, FinCEN is able to provide intelligence and analytical support to law enforcement at the federal, state, local and international levels. To support financial criminal investigations, FinCEN combines BSA information with other governmental and commercial information from a variety of data sources, researches and analyzes the information, and incorporates other critical forms of intelligence. FinCEN's ability to link a variety of databases, including the BSA financial database maintained by the IRS, provides one of the largest repositories of financial information available to law enforcement in the country.

FinCEN's expertise and technology draw representatives from approximately 20 agencies – analysts and agents from the major federal investigative agencies in the U.S. – who serve on long-term details at FinCEN. FinCEN has three major programs to support law enforcement: *(i)* it provides direct analytical support for criminal investigations to approximately 150 law enforcement agencies; *(ii)* the “platform” program provides more than 40 agencies with on-site access to FinCEN's facilities and database resources to research and analyze cases; and *(iii)* under the Gateway program, state and local law enforcement in every state as well as federal law enforcement are provided with direct, on-line access to records filed under the BSA. FinCEN also has the unique capability to identify trends and patterns and to pin-point national-level security issues; disseminate information on money laundering methodologies; and prepare geographic threat assessments associated with money laundering and other financial crimes.

FinCEN performs its mission with a workforce of less than 300 employees, contractors and detailees.<sup>8</sup> Most of FinCEN's workforce is located in the Washington metropolitan area; FinCEN does not maintain regional offices or field operations. Therefore, in order to carry out its regulatory mission, FinCEN has developed partnerships with many other federal regulatory agencies that are the primary supervisors or functional regulators of financial institutions subject to the BSA. These agencies, through resources located both at headquarters and in field offices, are essential to the effective and efficient administration of the BSA.<sup>9</sup> See Exhibit A for a picture of the coordinating role FinCEN plays with respect to these other regulatory agencies to maintain consistent administration of the BSA. Such partnerships will be expanded as additional

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<sup>8</sup> FinCEN's regulatory staff, responsible for developing and resolving policy, legal, operational and enforcement issues which arise as part of the administration of the BSA and are further described above, numbers less than 30.

<sup>9</sup> FinCEN's regulatory partners at the federal level include the federal financial regulatory agencies – the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and the Securities and Exchange Commission. Each regulator administers its own anti-money laundering regulations and is responsible for the examination of those financial institutions within its respective jurisdiction regarding compliance with the BSA and the implementation of effective anti-money laundering programs. Noncompliant institutions may be referred to FinCEN for enforcement action in appropriate circumstances.

types of regulated industries become subject to the BSA under provisions of the USA PATRIOT Act.

For those financial institutions subject to BSA regulation that currently lack a federal functional regulator, specifically, money services businesses and casinos, the IRS plays a significant role similar to other federal agencies in that the IRS identifies those organizations subject to the BSA; assists in the education and regulatory guidance function; and, most importantly, examines them for compliance with the BSA. The IRS also provides critical resources for processing and maintaining the financial information collected on the BSA reports through its Detroit Computing Center. These functions are described in more detail below.

#### **IV. THE ROLE OF THE IRS IN THE ADMINISTRATION OF THE BSA**

##### **Overview**

The IRS, which is in the process of modernizing its operations and functions, has a workforce of approximately 113,000 located in its headquarters and deployed in campus sites and field offices throughout the country.<sup>10</sup> The Department of the Treasury has relied upon various areas within the IRS, comprised of both civil and criminal divisions, to assist in the implementation and carrying out of the purposes of the BSA since its enactment in 1970. See Exhibit B, depicting the key functions IRS performs with respect to the administration of the BSA.

The IRS collects, processes and maintains a substantial amount of financial information from over one hundred million individuals, large corporations, small businesses and tax-exempt

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<sup>10</sup> A more thorough discussion of the organization and operations of the IRS and the modernization of its functions is contained in the *IRS Strategic Plan, FY 2000-2005*, Publication 3744(3-2001).

organizations that file withholding information and submit tax payments.<sup>11</sup> Consequently, the IRS has developed a substantial infrastructure – resources, expertise, business procedures and information technology – to process and access this financial information. This infrastructure also provides for the outreach component to support filers who need guidance or other assistance in order to properly report information or file returns with the IRS as well as the compliance and enforcement component; the IRS examines and audits the activities of filers, and initiates civil and criminal investigations and pursues sanctions where appropriate.

The civil operating divisions of IRS and IRS Criminal Investigation (CI) together are the most frequent users of the financial information obtained from the reports filed under the BSA.<sup>12</sup> In many instances, BSA information is not only useful for developing money laundering investigations, but also is helpful in uncovering tax evasion or fraud schemes.<sup>13</sup> For example, CI's use of the BSA financial information facilitates detecting, investigating and prosecuting criminal conduct such as abusive trusts, offshore tax evasion and corporate evasion schemes.

The Department of the Treasury views the use of IRS resources to perform the BSA information processing function and the examination of money services businesses and the gaming industry for BSA compliance as an effective leveraging of existing but scarce government resources. This view is based on the following factors: (i) the IRS Detroit

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<sup>11</sup> The IRS has organized its operating divisions to serve such taxpayers based on the type of filer. The IRS estimates that its Wage and Investment Division serves approximately 88 million filers, representing some 116 million individual taxpayers; the Small Business/Self Employed Division serves about 45 million fully or partially self-employed individuals and small businesses; the Large and Mid-Size Business Division serves some 210,000 filers, mostly corporations with assets over \$10 million; and the Tax Exempt and Government Entities Division services some 2.4 million entities ranging from small local community organizations to major universities and huge pension funds.

<sup>12</sup> Various divisions of the IRS are the largest users of the BSA data, making over 650,000 queries to the BSA financial database in 2000 and over 740,000 in 2001 to use the information collected on the BSA forms. The total number of queries made by all law enforcement and regulatory users was just over 1 million in 2000 and just over 1.1 million in 2001.

<sup>13</sup> For example, during fiscal year 1999, the IRS CI initiated 102 criminal investigations of possible tax law violations with leads developed solely from scrutiny and analysis of the reports filed under the BSA. One example is an investigation that was initiated by CI when BSA data revealed numerous large cash withdrawals from the defendant's corporate account. The investigation uncovered evidence of large unpaid payroll tax liabilities and characterizations of employees as independent contractors even after a certified public accountant had specifically advised him this characterization was inappropriate. Criminal convictions were obtained.

Computing Center, which handles the BSA information processing function, is well set-up for this function as the IRS already collects, processes and maintains millions of pieces of financial information for IRS operations; *(ii)* the processing and accessing of financial reports is a routine function in the IRS infrastructure; *(iii)* IRS is familiar with the information processing needs of BSA data users, as BSA information is heavily utilized by the IRS in the performance of its core mission; *(iv)* the over 200,000 financial institutions subject to the BSA and which file BSA reports, and the some 160,600 money services businesses and casinos subject to examination by the IRS, are a small subset of the over one hundred million filers IRS already interacts with and reviews for compliance; and *(v)* the examination function builds on the financial, investigative and accounting expertise – and industry knowledge – that IRS personnel have already developed as part of the existing infrastructure. These functions, and how they are performed by the IRS with respect to its role in the administration of the BSA, are described in more detail below.

### **BSA Information Processing Function**

The IRS, through its Detroit Computing Center,<sup>14</sup> and in partnership with a number of FinCEN offices, performs a wide range of functions necessary to receive, process and post to its BSA financial database the information from almost 14 million BSA forms filed annually.<sup>15</sup> As reflected on Exhibit B, the Detroit Computing Center's operation to process the information resides in the Currency Reporting and Compliance Division (CRC). The CRC functions cover everything from receiving the forms, reviewing for quality control, posting the information into a database and answering questions from filers and potential filers.

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<sup>14</sup> The Detroit Computing Center was created in the mid-1960s as an administrative processing center and took on the processing of CTRs in the mid-1980s. This work had previously been performed in the Ogden and Memphis Service Centers.

<sup>15</sup> In calendar year 2001, the Detroit Computing Center processed over 13.7 million BSA reports. This total included 13,033,321 CTRs and CTRCs; 203,471 SARS and SARCs; 177,151 FBARs; and 174,488 Designation of Exempt Person forms. In addition, 130,857 Form 8300s were processed. Pursuant to Section 365 of the USA PATRIOT Act, any Form 8300 filed for transactions occurring after 1/1/02 is now a BSA form available to law enforcement.

The Detroit Computing Center has been notably successful in processing timely important information received on BSA reports. For example, SARs, the most time-sensitive of the reports, are entered into the system and available to users within ten business days of receipt, even when received in paper form. The Detroit Computing Center also successfully integrated the Form 8300 into the BSA database in an efficient and timely manner after passage of the USA PATRIOT Act. These forms were available to law enforcement users within weeks after the first such report was required to be filed under the BSA.

The Detroit Computing Center also has an effective system for the complete and accurate processing of the millions of other BSA reports. When these BSA reports, such as CTRs, are received at the Detroit Computing Center, steps are taken to assure that the data is as complete and as accurate as possible. BSA reports received on paper are first designated as either “acceptable” or “unacceptable” to process. Unacceptable reports are those that cannot be processed, for example, because the reports are illegible, mutilated, filed using the wrong format, or completed in color ink or on a type of paper that cannot be processed. Unacceptable BSA reports are returned to the filer with instructions to refile and a file is maintained in order to monitor compliance, *i.e.*, to make sure the report is refiled.

Acceptable BSA reports filed on paper are routed to an editing section where designated fields on the form are examined to assure that the data will be entered correctly into the computer by the keypunching function.<sup>16</sup> After they are keypunched, paper forms--and those forms filed on magnetic media--are “perfected” as part of the posting of the forms onto the BSA financial database. Some of the entries on the forms are corrected by the computer. For example, the computer will determine if the zip codes shown are correct according to the city and state shown

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<sup>16</sup> The actual transcription of paper BSA forms is contracted out to a firm under a multi-million dollar contract. Of the some 13.7 million BSA forms posted onto the financial database at the Detroit Computing Center in 2001, approximately 29% were received on paper. That number is expected to decline as electronic filing capabilities become available later in 2002.

on the form. Forms with other mistakes, for example, an invalid state code, are listed on an error register. Specialists then correct the errors online. Finally, if the report is missing information deemed critical (names, addresses, account numbers, etc.), the filer is notified by mail and instructed to supply the missing information. In the interim, the computer record is annotated to indicate that correspondence is taking place concerning the form. These critical steps assure accurate information is available to the law enforcement and regulatory users accessing the BSA financial database.

FinCEN works closely with staff from the Detroit Computing Center with respect to issues that arise relating to the processing of the financial information received on the reports. Over the years, many questions have arisen regarding what the BSA requires and FinCEN provides that guidance to the Detroit Computing Center. The Detroit Computing Center's CRC identifies what items on the form are frequently missing, or most often need editing or data perfection, and FinCEN uses this information to provide tips and filing guidance to the industry filers. FinCEN also uses this information to improve the clarity of the instructions when updating BSA forms or designing new forms.

The CRC staff also serve as one of the primary interfaces with those industries regulated by the BSA relating to the filing of BSA reports, and financial institutions and businesses subject to the BSA receive technical advice from CRC on the requirements for the filing of relevant BSA reports and other regulatory compliance matters.

In calendar year 2001, CRC staff handled almost 1,500 phone calls from businesses and institutions asking questions on how and when to file various BSA reports.<sup>17</sup> Over 3,600 pieces of correspondence were sent out dealing with such matters as:

- documents being returned to filers as unacceptable;

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<sup>17</sup> FinCEN provides interpretative guidance to CRC staff on how to answer the questions received. Filers with questions regarding the completion of the CTR form, CTR paper or magnetic filing issues, use of the CTR exemption regulations, completion of the Designated of Exempt Person form or the MSB registration form, are asked to contact the Detroit Computing Center Hotline. For other questions, an institution may contact FinCEN's Regulatory Helpline.

- letters to filers advising them that forms had been filed incorrectly;
- registration of magnetic media filers;
- resolution of backfiling requests;
- verification of filing in response to filer inquiries; and
- requests from IRS and other law enforcement agents for certifications regarding whether certain BSA reports were filed, which were needed to support examinations or investigations.

The CRC staff also made six court appearances as expert witnesses regarding BSA reports that were filed.

The technological support for the BSA forms, which includes the design and maintenance of the BSA financial database and the dissemination of data in a secure manner to law enforcement and regulatory personnel throughout the nation, are also performed at the Detroit Computing Center through the IRS Systems Development Division.<sup>18</sup> The IRS Systems Development Division provides essential services in the administration of the BSA. Programming of databases must occur when any BSA form is revised or created in order to accept the form and provide the information to users. In addition, users make numerous requests to create special reports reflecting designated BSA data that requires programming assistance. Other functions performed are technology improvements and upgrades that must be incorporated into the BSA financial database.

The Detroit Computing Center and FinCEN staffs have been working on a number of projects and initiatives that reflect an ongoing commitment to providing improvements to the information processing function and the quality of the BSA data received for use by law enforcement and regulatory agencies.

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<sup>18</sup> In 2000, the BSA financial database at the Detroit Computing Center was queried over 1 million times by a combination of federal, state and local law enforcement agencies and by regulatory agencies. In 2001, queries rose to over 1.1 million.



- **Electronic Filing Capability.** The IRS Systems Development Division and FinCEN are working in coordination with a vendor to develop a highly secure Internet-based network for electronic filing of BSA reports and broadcast alerts as required by Section 362 of the USA PATRIOT Act. Meetings are ongoing to discuss current and new processes that need to be considered for the highly secure network, which has been named the PATRIOT Act Communications Systems (PACS). A group of 27 financial institutions, including banks, thrifts, money services businesses and broker-dealers, have been selected for the pilot testing of PACS. Pilot participants will be asked to file SARs and CTRs through PACS in addition to using their current filing method. The pilot testing process is expected to be completed and the PACS system available to the industry in the third quarter of calendar year 2002. Once PACS is fully operational, it is likely that additional BSA forms will be available to be filed utilizing this system.
- **Other Non-Paper Filing Methods.** The Detroit Computing Center has also taken the initiative to increase the filing of CTRs on magnetic media. In 2001, the Detroit Computing Center sent a survey to the largest paper filers of CTRs to encourage them to file their documents on magnetic media. As a result of the survey and follow-up discussions, magnetic filing increased substantially. To reduce the number of paper forms filed, the Detroit Computing Center and FinCEN are working to make available the magnetic specifications for additional BSA forms that have the potential to be filed on magnetic media by financial institutions.
- **BSA Form Issues.** Staff from the Detroit Computing Center work closely to support FinCEN staff in the development or updating of the various forms used to report the financial information required under the BSA. By drawing upon the Detroit Computing Center's experience in processing the form, interacting with the filers and in programming the database, FinCEN is able to incorporate data fields and develop instructions on the forms that minimize filing errors. FinCEN is also working more closely with the Detroit Computing Center to receive more frequent feedback on the most common errors made by filers. This information will be used by FinCEN to improve the forms when they come up for renewal and to develop guidance for the industry on the most common filing mistakes made. For example, the initial SAR forms filed by money services businesses after January 1, 2002 were reviewed expeditiously and tips for better completion will be contained in the most recent *SAR Activity Review* (April 2002) as well as posted on FinCEN's website.
- **Data Quality Assurance Procedures.** The Detroit Computing Center and FinCEN are in the processing of reviewing and evaluating the quality assurance procedures used by the Detroit Computing Center for processing the BSA forms. The evaluation will assess whether all such procedures are essential, consistently applied, and whether such procedures are carried out in the most efficient manner possible. If appropriate, resources will be redeployed to higher priority functions to make sure the data is the most useful it can be for law enforcement.
- **Database Programming Projects.** The IRS Systems Development Division located at the Detroit Computing Center and FinCEN are working on a number of programming projects relating to the BSA financial database. The Detroit Computing Center mainframe computers are being converted to IBM DB2 databases. It is anticipated that after conversion, users will have a greater ability to search through the financial information

housed in the BSA financial database. FinCEN continues to work with the IRS to provide users faster and more reliable connectivity to the BSA financial database and to implement a web-based program (Secure Outreach) that would allow users to access the BSA financial database from personal computers through the Internet. A new oversight system to review all requests for changes to the BSA database, including queries and reports, is being evaluated. The new system will allow programming resources to be allocated based on policy decisions, availability of resources and regulatory requirements.

As can be seen, the partnership developed between FinCEN and the Detroit Computing Center forms the basis for an effective and efficient performance of the information processing function for reports received under the BSA. The effectiveness of this partnership is best demonstrated by its result – satisfaction with the system by its law enforcement users. The most recent conference hosted by FinCEN for its Gateway members in February 2002 showed a high level of user satisfaction.

Notwithstanding the above described efforts, the BSA information processing function faces a number of challenges. FinCEN and the Detroit Computing Center have been, and are continuing the process of, identifying areas where improvements should be made. Such areas include improving the strategic planning process regarding future database technology needed to enhance access methods for users; speeding up the development and implementation of such database enhancements;<sup>19</sup> addressing any operational needs relating to the filing and processing of BSA forms, especially as reporting requirements under the BSA are expanded; and enhancing coordination of budgetary needs between the IRS and FinCEN. By focusing on these challenges as a priority, a more comprehensive approach to the administration of the information processing function under the BSA can be achieved. Additional resources will be needed as the BSA is expanded to cover more industries and to require additional reporting, and such resource needs

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<sup>19</sup> In Treasury Secretary O'Neill's testimony before the Senate Appropriations Subcommittee on Treasury, General Government and Civil Service on March 14, 2002, he discussed Treasury's continuing commitment to stewarding change through technology improvements. Treasury's fiscal year 2003 budget request for the IRS contains critical support for IRS computer modernization to support IRS improvements in operations efficiency and performance by adopting best business practices and state-of-the-art technology.

will be presented by both the IRS and FinCEN to Congress in future budgetary submissions. Additional information will be provided to Congress as these initiatives move forward.

### **BSA Examination Function**

The authority to examine financial institutions for BSA compliance has been delegated to the IRS pursuant to 31 CFR § 103.56(b)(8)<sup>20</sup> and under Treasury Directive 15-41 (December 1, 1992), attached as Exhibit C. In accordance with the mandate of Section 357 of the USA PATRIOT Act, this report focuses on the IRS program under which IRS examines for compliance with the BSA's reporting, recordkeeping and compliance program requirements by the following financial institutions:

- over 160,000 money services businesses, comprised of such diverse financial service providers as check cashers, currency exchangers or dealers, issuers, sellers and redeemers of traveler's checks, money orders and stored value, and money transmitters; and
- approximately 600 casinos or other gaming organizations located in some 30 states and territories and on tribal lands.

The IRS examination program contains three essential functions: *(i)* identification of those financial institutions subject to the BSA requirements (and thus examinations) because they fall within the definitions contained in 31 CFR Part 103;<sup>21</sup> *(ii)* conducting outreach and educational efforts to assist financial institutions in understanding and meeting their obligations under the BSA; and *(iii)* performance of an examination, review or other type of audit activity to assess compliance with the BSA. This last component also allows for an assessment of whether the educational and outreach component has been effective in conjunction with a broad

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<sup>20</sup> 31 CFR § 103.56(b)(8) provides that the authority to examine institutions to determine compliance with the requirements of Part 103 is delegated "[t]o the Commissioner of Internal Revenue with respect to all financial institutions, except brokers or dealers in securities, not currently examined by federal bank supervisory agencies for soundness and safety." The definition of gaming entities and money services business entities as financial institutions subject to BSA requirements, and the content of the various reporting, recordkeeping and compliance program requirements applicable to such entities under the BSA, is contained at 31 CFR Part 103.

<sup>21</sup> Certain financial institutions have a federal functional regulator such as the Securities and Exchange Commission, the Office of the Comptroller of the Currency or the other federal financial regulators; these agencies charter, insure or otherwise regulate a defined universe of financial institutions. In the case of money services businesses and casinos, no such federal functional regulator exists and identifying those entities subject to BSA requirements is part of the IRS examination function.

assessment as to whether a particular industry, generally, is in compliance. An examination also provides the opportunity to give useful feedback to the financial institution and to assure that corrective action has been taken with respect to any compliance program deficiencies or any violations of the BSA (*e.g.*, with respect to reports not being filed timely or records not being maintained.)

IRS field personnel have special expertise in standard accounting, audit and financial practices, which renders them uniquely qualified to undertake the examination of a wide range of business entities for compliance with the BSA's financial reporting, recordkeeping and other requirements. With the necessary investigative skills and knowledge of the law, IRS staff have demonstrated their ability to interact directly with affected businesses, provide effective educational outreach and conduct quality examinations. It should be noted that such examinations for BSA compliance also result in referrals to CI for tax evasion or money laundering investigations when appropriate.<sup>22</sup>

Over the years, the IRS has devoted significant personnel and other resources to perform the BSA examination function at its national program and field offices. Currently, approximately 186 FTEs (full-time equivalent personnel) are engaged in the examination function for BSA compliance.<sup>23</sup> Over the last three years, these IRS personnel conducted more than 15,000 examinations for compliance with the BSA. In addition, over the last year alone, IRS personnel made some 3000 BSA educational visits to financial institutions and conducted 126 seminars reaching more than 4000 participants.

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<sup>22</sup> In fiscal year 2000, 596 civil tax cases resulting from leads from BSA examinations were resolved; of these, 14 cases were referred for criminal investigation. In fiscal year 2001, 526 civil tax cases resulting from leads from BSA examinations were resolved; of these, 22 cases were referred for criminal investigation.

<sup>23</sup> The IRS anti-money laundering program is comprised of resources that address both Title 31 or BSA functions as well as Form 8300 compliance. With Form 8300 compliance now relevant under the BSA as well, FinCEN and the IRS are working together to leverage off IRS efforts for 8300 examinations under the BSA as well. Currently, the IRS has some 108 additional FTE's focused on Form 8300 compliance.

The results of the identification, education and examination efforts by field resources are reported on a quarterly basis to the IRS national program office. In fiscal year 2001, the reports show the following BSA compliance results:

- Virtually the complete range of financial institutions subject to IRS examination authority received BSA outreach and education, through visits, mailings or otherwise, and/or were examined for BSA compliance;
- In approximately 633 examinations of financial institutions for BSA compliance, the IRS discovered BSA deficiencies and letters were sent to the entities outlining such deficiencies for corrective action; and
- In approximately 3,773 examinations of financial institutions for BSA compliance, the IRS determined that compliance with the BSA was sufficient and that the examination could be closed without further action by the IRS.

In some examinations of financial institutions, the compliance deficiencies and violations of the BSA requirements are so significant that an assessment of a civil money penalty needs to be considered as an appropriate sanction. In such a case, the IRS refers that matter, by transmitting the results of its examination of the financial institution, to FinCEN for consideration to bring a civil enforcement action.

FinCEN administers the enforcement of the BSA, including the assessment of civil money penalties, in a consistent manner across all financial institutions subject to the requirements of the BSA. Of the 16 matters in which FinCEN assessed civil money penalties over the last three years, 14 of these matters were against casinos or money services businesses. All 14 of these matters were initiated based on the examination and referral reports to FinCEN developed by the IRS.<sup>24</sup>

The IRS, as part of its modernization program, has given responsibility for its anti-money laundering program, including its BSA examination functions, to its Small Business/Self-

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<sup>24</sup> Since April 1999, FinCEN has brought civil money penalty actions against eight casinos, two currency exchangers or dealers, and four check cashers or their owners or senior managers. FinCEN posts its assessments of civil money penalties against financial institutions for violations of the BSA on its website at [www.treas.gov/fincen](http://www.treas.gov/fincen).

Employed Division.<sup>25</sup> During 2000 and 2001, the IRS evaluated its BSA examination program.<sup>26</sup>

The review concluded that additional field resources were needed to be committed to the program and that organizational improvements were needed. Therefore, the IRS is working on a number of the following initiatives to improve the performance of the BSA examination function:

- **Strengthening its national program office resources.** Located in IRS headquarters, the IRS national program office for BSA centrally oversees the BSA examination efforts by the IRS. By strengthening this office, IRS oversight of resources in the field also will be strengthened. Staff resources have increased recently from three to five personnel and in late 2001, a new senior position of anti-money laundering program manager was created. These national office resources are dedicated solely to the successful operation of the anti-money laundering program administered by the IRS. The numerous functions they perform are depicted under the Small Business/Self-Employed Division of the chart contained in Exhibit B.
- **Establishing better performance-based indicators.** Improvements are needed in how to assess whether program objectives and desired outcomes are being met rather than relying on historical indicators, where measurement was based on the number of employee hours spent on BSA examination activity. The IRS is in the process of identifying relevant performance-based indicators and incorporating them into its program. These indicators will include a measure of the quality of the examinations. Reviews of field operations by the national program analysts are already incorporating case reviews as part of the assessment of the effectiveness of each district's program. In order to more efficiently and effectively utilize its resources, the IRS has also begun to develop a data-driven workload identification process. This process will include analysis of the newly created MSB registration database and agent lists obtained from registrants in conjunction with the BSA financial database. This analysis will provide a risk-based approach to the enforcement and education process.
- **Improving field office accountability and the tracking of results.** The IRS is reorganizing its field structure and establishing new standards for field personnel to increase accountability and efficiency. The new structure is designed to ensure that all personnel engaged in BSA compliance program activities are fully and adequately trained and the majority of program personnel work exclusively on BSA compliance and anti-money laundering activities. New and revised training courses have been developed and will be provided to all examiners. Redesign of the field structure includes organizing field examiners in groups dedicated exclusively to the BSA program. Field operation staffing increases are also planned for fiscal year 2003.

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<sup>25</sup> The Small Business/Self-Employed Division of IRS will work with all of the IRS operating divisions, see footnote 11 *supra*, in order to carry out the BSA examination function for financial institutions served by those divisions.

<sup>26</sup> "The Program for Ensuring Compliance with Anti-Money Laundering Reporting Requirements Should Be Improved," Treasury Inspector General for Tax Administration, No. 2001-40-024 (December 2000).

- **Improving educational outreach** A more comprehensive and efficient educational approach is being structured to interact with those financial institutions subject to the requirements of the BSA. Historically, the IRS conducted education and outreach through personal visits with each institution – this was largely effective on a local basis but severely limited the number of educational sessions possible due to available resources. To increase efficiency and standardize educational materials, the Small Business/Self-Employed Division will utilize its Taxpayer Education and Communication Section to handle the outreach and educational aspects for the BSA examination program. Efforts are underway to evaluate how these aspects of the program can be enhanced. This approach permits the examiners in the field to focus their efforts on the identification of additional financial institutions and the examination of such entities.

Key to the successful performance of the administration of the BSA as it relates to money services businesses and casinos is the coordination between FinCEN and the IRS. The IRS has assigned a new full-time liaison to FinCEN from the Small Business/Self-Employed Division to facilitate and coordinate the activities between the two organizations. FinCEN, in turn, dedicates a significant portion of its regulatory resources to providing program support to the money services business and casino industries. Furthermore, it has recently assigned one full-time compliance specialist, backed by other resources when appropriate, to work with the Small Business/Self-Employed Division to support its national program office on the following projects which are important to the overall effective administration of the BSA:

- **Money Services Business Project Implementation** FinCEN and the IRS are working closely on a multi-year project to implement the new registration and suspicious activity reporting requirements affecting money services businesses. At the outset, FinCEN and the IRS jointly identified the need for increased resources that the money services business outreach effort would entail. Funding was secured by FinCEN to finance both an informational campaign orchestrated through an outreach contractor and to support an increase in the IRS examination force. A total of 70 examination personnel will be added to the BSA examination function with hiring expected to begin in September 2002.<sup>27</sup> In addition, FinCEN and the IRS are coordinating on the substance and focus of educational materials under development through the contractor and on the creation by the IRS of examination standards and guidelines tailored to money services businesses. The IRS is

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<sup>27</sup> IRS personnel, particularly for BSA examination and anti-money laundering positions, require a significant amount of training because such positions perform more complex and sophisticated functions. Preferably, hiring for BSA examination positions would occur by hiring experienced IRS examiners. However, the IRS has experienced hiring challenges in recent years, which have impacted its ability to bring on BSA compliance examiners as quickly as it would like. With a number of the program changes identified above, IRS is increasing its efforts to bring on the additional examiners needed for expanded money services business examinations.

developing specific examination packets to standardize the compliance reviews undertaken by field staff for money services businesses, including the new requirements for registration and suspicious activity reporting. With IRS input, including feedback from field examiners, FinCEN has incorporated relevant factual scenarios into the outreach materials. A number of products of this concerted FinCEN- IRS effort are currently available to the industry, including a new FinCEN website devoted to giving compliance guidance to money services businesses. Other money services business compliance tools soon to be available include posters, videos, educational booklets and quick reference guides.

- **New BSA Requirements – Casino SARs, Anti-Money Laundering Programs.** The IRS and FinCEN are assessing the additional workload requirements that new statutory and regulatory requirements will entail for both the casino and money services business industries as well as other new industries that may come under the purview of the BSA. Requirements for suspicious activity reporting by casinos, recently re-noticed for comment, will present implementation issues regarding outreach to the industry to advise casinos and card clubs of the new requirement and training of the IRS examination force. The statutory requirement, under §352 of the USA PATRIOT Act, that financial institutions implement anti-money laundering programs, will present a new range of issues and challenges to the BSA examination function, especially for those institutions without a federal functional regulator such as the insurance industry. Discussions are currently underway with the IRS as to the impact of bringing this industry, and possibly others, under the IRS examination authorization.
- **Risk-Based Examination Approach.** FinCEN is working with the IRS to develop and adopt an examination strategy that incorporates the unique structure and composition of the money services business and casino industries and applies a risk-based analysis. A risk-based examination process, which would select for examination individual money services businesses and gaming enterprises most vulnerable to money laundering and financial crime or likely to have BSA compliance issues, would help direct and maximize scarce IRS resources. Factors which could be used to select entities for examination based on risk could be high error rates found in the BSA reports filed with the Detroit Computing Center; location of the entity in a HIDTA or HIFCA;<sup>28</sup> unusual currency flows reflected in CTR filings; SAR filings identifying the institution or its customers; and tips regarding noncompliance from law enforcement or regulatory agencies.
- **Database Maximization.** FinCEN and IRS program staff are working closely to evaluate the data and data mining capabilities of several databases which are maintained as part of the administration of the BSA. One project involves the comparison of entries in a registration outreach database, used to contact entities that might need to register as money services businesses, to entries in the database housing data from the registration forms actually filed by money services businesses. A different project involves evaluation of the system used by the IRS field staff to record those financial institutions it identifies as being subject to the BSA, with a view to updating or replacing the system. The focus of these and other projects is to improve the efficiency and efficacy of the examination function by using electronic systems to create a reliable picture of the

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<sup>28</sup> High Intensity Drug Trafficking Area; High Intensity Money Laundering and Related Financial Crimes Area.



entities subject to IRS examination and, by using criteria agreed upon by both FinCEN and the IRS, to focus resources on the highest priority entities.

- **Budget Issues.** Critical to the future success of the administration of the BSA by both the IRS and FinCEN is a mutual understanding of the budgetary processes of each organization – as well as an alignment of goals and priorities with respect to the funding of the examination function. FinCEN and the IRS are in the process of developing a methodology to forecast the need for, and to request, sufficient funding for any of the IRS functions performed to support the administration of the BSA. It is anticipated that there will be continued expansion of the IRS functions brought about by increases in the numbers of money services businesses and casinos, as well as an increase in the number of other types of entities that the IRS will be called upon to examine. Section 352 of the USA PATRIOT Act alone increases significantly the needs of the IRS for qualified examination resources. FinCEN and the IRS are working together to develop a comprehensive budget strategy with respect to present and future program needs.

As can be seen from the foregoing, the BSA examination function, while continuing to perform its mission, is undergoing restructuring as well as enhancements which will position the function to perform even better in the future. The IRS and FinCEN are evaluating and addressing how the funding and program priorities set by Congress under the BSA are able to be met at a time when each organization has scarce resources as well as missions in addition to the administration of the BSA to fulfill. We believe that the initiatives set out above will allow both organizations to develop a more forward thinking agenda that will use existing resources as efficiently and effectively as possible. Furthermore, with the expansion of the BSA, each organization anticipates that additional resources will be needed and the specific need for more resources is being evaluated as the program initiatives move forward. Additional information will be provided to Congress as progress is made.

#### **IV. RECOMMENDATIONS**

In light of the foregoing, the Secretary recommends that both the information processing and the compliance/examination BSA functions remain with the IRS. In support of this recommendation, the Secretary concludes:

- The FinCEN/Detroit Computing Center partnership for information processing has been highly effective and is well on its way to meeting the new challenges and additional tasks imposed by the PATRIOT Act. Therefore, it is not advisable to shift the processing of information reporting to the Department of the Treasury under the BSA to facilities other than those managed by the IRS.
- It remains reasonable and efficient, in light of the objective of both anti-money laundering programs and federal tax administration, for the IRS to retain authority and responsibility for the audit and examination of the compliance of money services businesses and gaming institutions with the BSA, as well as additional industries that may be appropriate as the USA PATRIOT Act provisions are implemented. The IRS possesses an infrastructure and expertise to perform this function, which fit well within its overall mission.

With respect to the functions discussed in this report, the IRS and FinCEN have developed an efficient allocation of responsibilities between them. The IRS is committed to continuing to improve its administration of these functions, and its ongoing efforts should be allowed to come to fruition. Shifting responsibility from the IRS would be disruptive and costly. Moreover, there is not a viable alternative to transfer one or both of these functions to another organization that has similar expertise or sufficient resources. For example, FinCEN, with less than 300 personnel, could not take over the IRS role in the administration of the BSA without a substantial expansion. Undertaking such an expansion would be costly, time-consuming and would detract from FinCEN's ability to fulfill its core mission.

## **V. CONCLUSION**

Section 357 of the USA PATRIOT Act has provided the Department of the Treasury with the opportunity to review the substantial functions that are performed by the IRS to support the administration of the Bank Secrecy Act – specifically, the BSA information processing function and the BSA examination function of money services businesses and the gaming industry. The Department views the partnership between FinCEN and the IRS as the best way to perform these functions, and views building on their ongoing initiatives as the best way to improve the performance of these functions to carry out the goals of the BSA and the USA PATRIOT Act.