

December 2006

# BANK SECRECY ACT

## FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts





Highlights of [GAO-07-212](#), a report to congressional committees.

## Why GAO Did This Study

In 2005, over 16 million Bank Secrecy Act (BSA) reports were filed by more than 200,000 U.S. financial institutions. Enacted in 1970, BSA is the centerpiece of the nation's efforts to detect and deter criminal financial activities. Treasury's Financial Crimes Enforcement Network (FinCEN) and the Internal Revenue Service (IRS) play key roles in BSA compliance, enforcement, and data management. GAO was asked to describe FinCEN's and IRS's roles and assess their effectiveness at ensuring BSA compliance and efforts to reengineer BSA data management.

## What GAO Recommends

To strengthen BSA compliance, GAO recommends the Secretary of Treasury direct FinCEN and IRS to develop a documented and coordinated strategy that includes priorities, time frames, and resource needs. The strategy should cover implementing specific GAO recommendations, such as clarifying regulations and measuring the compliance rate. To strengthen BSA data management reengineering, GAO is recommending FinCEN develop a long-term plan that includes coordination with IRS.

In commenting on a report draft, the Director of FinCEN and the Commissioner of Internal Revenue agreed with our recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-07-212](http://www.gao.gov/cgi-bin/getrpt?GAO-07-212).

To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-5594 or [whitej@gao.gov](mailto:whitej@gao.gov).

# BANK SECRECY ACT

## FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts

### What GAO Found

FinCEN and IRS have distinct roles, but share some responsibilities in implementing BSA. FinCEN's role is to oversee the administration of BSA by numerous agencies including IRS. IRS's role is to (1) examine nonbank financial institutions (NBFI), such as money transmitters and check cashers, for compliance with BSA; (2) investigate potential criminal BSA violations; and (3) collect and store BSA reported data by all financial institutions.

IRS continues to face challenges in identifying NBFIs subject to BSA and then using its limited resources to ensure compliance.

- IRS has identified approximately 107,000 potential NBFIs, yet FinCEN, IRS, and others agree there is a portion of the NBFI population IRS has not identified. Identifying NBFIs is inherently challenging and made even more difficult because FinCEN regulations about who is covered are confusing, especially for smaller businesses.
- IRS currently lacks, but is working to develop, a statistically valid risk-based approach for selecting NBFIs for compliance examinations. IRS only examines a small fraction of NBFIs, less than 3.5 percent in 2005, highlighting the need for building risk into the selection process. IRS is statistically validating a risk-based approach for targeting compliance examinations on certain NBFIs suspected of noncompliance. IRS's validation study is a step in the right direction, but IRS's approach will continue to have limitations because the study was not designed to be representative of all potential NBFIs.
- IRS established a new office accountable for BSA compliance, and is working to improve examination guidance. However, IRS's management of BSA compliance has limitations, such as a lack of a compliance rate measure and a comprehensive manual that NBFIs can use to develop anti-money laundering programs compliant with BSA.

Addressing program challenges, such as identifying NBFIs and examining those of greatest risk of noncompliance will take time and require prioritizing actions and identifying resource needs. However, FinCEN and IRS lack a documented and coordinated strategy with time frames, priorities, and resource needs for improving NBFI compliance with BSA requirements.

FinCEN has undertaken a broad and long-term effort to reengineer, and transition from the IRS, all BSA data management activities. FinCEN, however, missed opportunities to effectively plan this effort and to coordinate its implementation with IRS. For example, FinCEN began making significant investments in information technology projects before a comprehensive plan to guide the reengineering effort was in place. When a key project—BSA Direct Retrieval and Sharing—failed, it jeopardized the future of the broader reengineering effort. After investing over \$14 million (nearly \$6 million over the original budget) in a failed project, FinCEN is now reassessing BSA Direct but does not yet have a plan for moving forward with the broader effort to reengineer BSA data management activities.

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**Abbreviations**

BSA	Bank Secrecy Act
BSA Direct R&S	BSA Direct Retrieval and Sharing
CBRS	Currency and Banking Retrieval System
CFTC	Commodity Futures Trading Commission
CIMIS	Criminal Investigation Management Information System
CI	IRS Criminal Investigations Division
CIO	chief information officer
CTR	currency transaction report
DEA	Drug Enforcement Administration
DHS	Department of Homeland Security

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ECC-DET	Enterprise Computing Center at Detroit
FBI	Federal Bureau of Investigation
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FinCEN	Financial Crimes Enforcement Network
FRB	Federal Reserve Bank
FTE	full-time equivalent
ICE	Immigration and Customs Enforcement
IRS	Internal Revenue Service
MITS	IRS Modernization and Information Technology Services
MOU	memorandum of understanding
MSB	money service business
NBFI	nonbank financial institution
NCUA	National Credit Union Administration
NRP	National Research Program
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
SAR	suspicious activity report
SB/SE	Small Business Self-Employed Division
SEC	Securities and Exchange Commission
TIGTA	Treasury Inspector General for Tax Administration
WebCBRS	Web-based Currency and Banking Retrieval System

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United States Government Accountability Office  
Washington, DC 20548

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December 15, 2006

The Honorable Christopher Bond  
Chairman  
The Honorable Patty Murray  
Ranking Minority Member  
Subcommittee on Transportation, Treasury, the Judiciary,  
Housing and Urban Development and Related Agencies  
Committee on Appropriations  
United States Senate

The Honorable Joe Knollenberg  
Chairman  
The Honorable John W. Olver  
Ranking Minority Member  
Subcommittee on Transportation, Treasury, Housing and Urban  
Development, the Judiciary, District of Columbia, and Independent  
Agencies  
Committee on Appropriations  
House of Representatives

Criminals frequently use the financial system in attempts to conceal illegal or untaxed proceeds from a variety of activities, including narcotics trafficking, arms trafficking, extortion, and public corruption. Laundering money, evading taxes, and financing a terrorist plot can involve many of the same methods. For example, they may use third-party nominees, currency, wire transfers, multiple bank accounts, or international “tax havens” to avoid detection. Attempts to convert criminal income into legitimate assets or conceal the use of legitimate assets in criminal activity jeopardize not only the security of our financial system but also our national security.

The Bank Secrecy Act (BSA) establishes the framework used to combat these activities and prevent the exploitation of our financial system.<sup>1</sup> BSA requires financial institutions to report certain financial transactions made by their customers. For example, in 2005, U.S. financial institutions filed

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<sup>1</sup> Bank Secrecy Act, titles I and II of Pub. L. No. 91-508, 84 Stat. 1114 (1970), as amended, codified at 12 U.S.C. §§ 1829b, 1951-1959, and 31 U.S.C. §§ 5311-5322.

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over 16 million BSA reports. These reports provide information used by law enforcement to detect and prevent a wide range of financial crimes.

At the federal level, many agencies have some responsibility for protecting our financial system, but a key role is played by the Department of the Treasury (Treasury). Within Treasury, the Financial Crimes Enforcement Network (FinCEN) oversees the administration of BSA and the Internal Revenue Service (IRS) has responsibility for ensuring non bank financial institutions (NBFI), not otherwise subject to examination by another federal functional regulator, comply with BSA requirements. NBFIs include, in part, casinos and state-chartered privately insured credit unions and money service businesses (MSB), such as money transmitters and check cashers. In addition, IRS's Criminal Investigation Division (CI) is responsible for the investigation of criminal BSA violations and money laundering crimes, including those related to taxes.

In the Senate Appropriations Committee Report, the Committee expressed considerable concern over FinCEN's and IRS's management of BSA compliance efforts.<sup>2</sup> As proposed by the Senate, the conference agreement mandated that we review the effectiveness of the roles played by FinCEN and IRS in those areas for which they share responsibility for carrying out the BSA legislation.<sup>3</sup> As agreed with your Subcommittees this report

- describes IRS's and FinCEN's roles and responsibilities for BSA compliance, criminal investigations, and data management;
- assesses IRS's effectiveness in managing its BSA compliance program and coordinating with FinCEN;
- describes the BSA enforcement efforts of CI; and
- assesses the effectiveness of FinCEN's efforts to reengineer BSA data management activities.

To address these objectives, we reviewed relevant legislative and regulatory authorities. We analyzed data on program performance and compared estimates of the NBFI population. We compared IRS's approach for selecting NBFIs for compliance examinations to the approach it uses for examining individual tax returns, as well as to guidance from the Office of Management and Budget (OMB), GAO, and others. We applied our

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<sup>2</sup> S. Rep. No. 108-342 (2004) and Consolidated Appropriations Act, 2005. Pub. L. No. 108-447.

<sup>3</sup> H.R. Rep. 108-792 (2004).

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criteria for internal controls to the Title 31 database IRS used to house and store data for BSA examination cases. We analyzed BSA Direct planning and implementation documents and compared cost, schedule, and performance plans against actual progress. We also compared FinCEN's approach to GAO's investment management framework. We examined the memorandums of understanding (MOU) established between FinCEN and IRS, FinCEN and the states, and IRS and the states. We interviewed FinCEN officials in Washington, D.C., and Vienna, Virginia, and IRS Small Business Self-employed Division (SB/SE) officials in Washington, D.C.; New Carrollton, Maryland; and Detroit, Michigan. We also interviewed officials from the Treasury Office of Inspector General (OIG) and the Treasury Inspector General for Tax Administration (TIGTA), and officials from the Conference of State Banking Supervisors. Appendix I provides a more detailed scope and methodology for this review. We conducted our review from July 2005 through November 2006 in accordance with generally accepted government auditing standards.

Earlier this year, we provided detailed briefings on the interim results of our work to the Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and related agencies, Senate Committee on Appropriations. Further, because FinCEN experienced problems with development and implementation of the retrieval and sharing component of BSA Direct, we provided our observations on this project in July of this year.<sup>4</sup>

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## Results in Brief

FinCEN and IRS have distinct roles in implementing BSA, but share some responsibilities. FinCEN's role is to oversee the administration of BSA by numerous agencies, including IRS. In this role, FinCEN develops policy and provides guidance to both federal financial regulators and financial institutions and also controls access to BSA data by law enforcement agencies. IRS has three roles. First, IRS is one of eight federal financial regulatory agencies that conduct BSA compliance examinations— in IRS's case, examinations of NBFIs. Second, CI investigates potential criminal BSA violations. Third, IRS collects and stores the reports of financial transactions required by BSA and filed by financial institutions.

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<sup>4</sup> See GAO, *Information Technology Management: Observations on the Financial Crimes Enforcement Network's (FinCEN's) BSA Direct Retrieval and Sharing (BSA Direct R&S) Project*, [GAO-06-947R](#) (Washington, D.C.: July 14, 2006).

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IRS lacks an effective BSA compliance program, despite several recent improvements. IRS faces challenges in identifying NBFIs subject to BSA and then using its limited resources to ensure compliance.

- IRS is aware of approximately 107,000 potential NBFIs, yet one study commissioned by FinCEN estimates there are up to 200,000 of these businesses in the United States. Identifying NBFIs, and particularly MSBs, is difficult especially for businesses, such as grocery stores, where financial transactions are not the primary business activity. FinCEN and IRS could take additional steps to identify NBFIs, but some steps are of unproven benefit and would require adjusting priorities. Some IRS BSA officials told us that tax return information might help identify potential NBFIs, but IRS is prohibited by law from disclosing tax information for nontax purposes, with some exceptions. The disclosure provisions in the Internal Revenue Code do not currently include an exception for BSA compliance examinations. IRS does not have evidence about the value of tax return information for identifying NBFIs and has not made a decision about whether it would be worth pursuing a legislative change. Treasury's OIG found that FinCEN's regulations and guidance for MSBs can be confusing and easily misinterpreted. FinCEN agreed, but officials said verifying MSB registrations is a higher priority than revising these instructions.
- IRS lacks a statistically valid risk-based approach for selecting NBFIs for compliance examinations but is working to make improvements. A risk-based approach is important because IRS has limited examination resources, highlighting the need for building risk into the audit selection process. In 2005, IRS completed 3,712 examinations— 3.5 percent of the approximately 107,000 potential NBFIs currently in its database. IRS is conducting a study to validate the risk factors it is using to select MSBs for examination by randomly sampling from a group of MSBs that have filed, are required to file, or are the subject of filed BSA reports. This study is a step in the right direction, but IRS's approach will continue to have limitations, in part, because the study only addresses a segment of NBFIs identified by IRS. In the future, IRS can improve its risk-based approach for targeting examinations of NBFIs by studying the compliance risks posed by the broader population of known NBFIs.
- IRS has established a new Office of Fraud/BSA accountable for BSA enforcement, improved examination guidance, and tracking referrals to law enforcement agencies; however, management limitations remain. For example, IRS lacks a measure of NBFIs' rates of compliance with BSA and thus cannot track program effectiveness over time. IRS also lacks a comprehensive examination manual that NBFIs can use to develop anti-money laundering programs that satisfy BSA requirements. In addition, FinCEN and IRS lack a documented and coordinated strategy that lists

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priorities, time frames, and resource needs for addressing BSA compliance program limitations.

As IRS's law enforcement arm, CI dedicates a portion of its resources to investigating criminal BSA and money laundering violations. CI's direct investigative time for BSA investigations has remained relatively constant for the past 5 years at about 12 percent of total investigative resources. BSA convictions have increased during the same period, from 240 in fiscal year 2002 to 296 in fiscal year 2006.

FinCEN missed opportunities to effectively plan and coordinate early efforts to reengineer BSA data management activities and experienced poor project management and oversight of the BSA Direct Retrieval and Sharing (BSA Direct R&S) project. Specifically, FinCEN did not develop a comprehensive long-term plan for reengineering BSA data management responsibilities before investing in new information systems. Instead, FinCEN began development on BSA Direct R&S before a plan was in place. This project—on which work was eventually stopped, in part, because of poor project management and oversight—was expected to be the cornerstone of the broader reengineering effort. In addition, FinCEN did not do an adequate job of communicating and coordinating the reengineering effort with IRS, which resulted in the development of new systems with some duplicative capabilities. With the failure of BSA Direct R&S, FinCEN is now reassessing the future of BSA Direct, but does not yet have a plan for moving forward with the broader effort to reengineer BSA data management activities.

We are recommending that FinCEN and IRS develop a documented and coordinated strategy for improving NBFI compliance with BSA. We are making a number of specific recommendations to be incorporated into this strategy, such as making a decision about whether to pursue accessing taxpayer data to identify NBFIs and developing a NBFI compliance manual. We are also recommending FinCEN develop a comprehensive plan to guide the effort to reengineer BSA data management activities. On December 11, 2006, the Director of FinCEN and the Commissioner of Internal Revenue agreed with all our recommendations. The Director and Commissioner also stated their appreciation that our report notes the steps that FinCEN and IRS have already taken to improve BSA compliance.

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## Background

BSA, enacted by Congress in 1970, authorizes the Secretary of the Treasury to issue regulations requiring financial institutions to retain

records and file reports useful in criminal, tax, and regulatory investigations. Following the September 11, 2001 terrorist attacks, Congress passed the USA PATRIOT Act, which, among other things, amended BSA and expanded the number of industries subject to BSA regulation.<sup>5</sup> Title III of the act expanded BSA powers to combat terrorist financing and required financial institutions to establish proactive anti-money laundering programs. In addition, the act expanded reporting requirements and allowed the records and reports collected under BSA to be used in the conduct of intelligence or counterintelligence activities and to protect against international terrorism.

The BSA framework focuses on financial institutions' record keeping and reporting requirements to create a paper trail of financial transactions that federal agencies can trace to deter illegal activity and apprehend criminals. Under the BSA framework, primary responsibility rests with the financial institutions themselves in gathering information and passing it to federal officials. "Financial institutions" include both banking institutions and NBFIs. Banking institutions include commercial banks and trusts, savings and thrifts, branches of foreign chartered banks doing business in the United States, and credit unions. NBFIs include MSBs, casinos, and some credit unions. MSBs include businesses that transmit money, cash checks, and engage in certain financial transactions. MSBs are the largest and most diverse group of entities that qualify as NBFIs. Table 1 describes the different types of entities that qualify as NBFIs not otherwise regulated by a federal functional regulator.

**Table 1: Types of Entities Qualifying as NBFIs Not Otherwise Regulated by a Federal Functional Regulator**

<b>NBFIs</b>	<b>Description of institution</b>
Casinos	Nevada casinos, state/territory licensed casinos; and gaming operations; tribal casinos; and other gaming organizations, such as card clubs.
State chartered non-federally insured credit unions	Member-owned, member-controlled, not-for profit cooperative financial institutions formed to permit groups of people who share a "common bond" to save, borrow, and obtain related financial services and to participate in their management that are privately insured and state chartered and regulated.
Credit card operators	Business in the United States that operates a system for clearing and settling transactions in which the operator's credit or debit card is used to purchase goods or services or to obtain cash advances.

<sup>5</sup> USA PATRIOT ACT, Pub. L. No. 107-56, 15 Stat. 272 (2001).

NBFIs	Description of institution
MSBs	Businesses that <ul style="list-style-type: none"> <li>• transmit money;</li> <li>• cash checks;</li> <li>• issue, sell, or redeem traveler's checks, money orders, or stored value;</li> <li>• deal or exchange currency; and</li> <li>• conduct more than \$1,000 in the activities mentioned with the same person on the same day, and provide money transfer services in any dollar amount.</li> </ul> The U.S. Postal Service (transactions excluding the sale of postage and philatelic products).
<b>The USA PATRIOT ACT Expanded The Types of Entities That Qualify As NBFIs</b>	
Dealers in precious metals and jewels	Manufacturers, refiners, wholesalers, certain retailers considered dealers, and any other entities engaged in the business of purchasing and selling jewels, precious metals, precious stones, or jewelry. Ranges from single artisan goldsmiths selling unique and rare gemstones on an individual basis to publicly traded commercial manufacturers producing millions of pieces each year.
Insurance companies	Insurance companies that issue permanent life insurance policies, annuity contracts, and any other insurance products with features of cash value or investment. The companies are to integrate agents and brokers who sell these products under the insurance companies into their program requirements and ensure policies and procedures are followed.
Loan/finance companies	FinCEN has not adopted any rules defining which businesses are to be included in these sectors.
Travel agencies	
Real-estate closing professionals	
Sellers of vehicles	
Unregistered investment companies.	

Sources: FinCEN and the Financial Action Task Force.

All financial institutions subject to BSA requirements must implement internal controls, policies, and procedures; maintain records of transactions; and file reports of cash transactions over the \$10,000 dollar threshold and suspicious activities. The USA PATRIOT Act required all financial institutions to develop written anti-money laundering compliance programs that detail internal policies, procedures and internal controls. Each program must designate a compliance officer, provide ongoing employee training of pertinent personnel, and provide for independent reviews whose scope and frequency is commensurate with the risk of the financial services provided.

Registration, record keeping, and reporting are the core elements of anti-money laundering requirements for MSBs. Certain MSBs are required to register with the Secretary of the Treasury and renew those registrations every 2 years. In addition, MSBs that sell money orders, travelers' checks, or other instruments for cash must verify the identity of each customer and create and maintain a record of each purchase when the purchase is

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cash from \$3,000 to \$10,000.<sup>6</sup> Also, financial institutions and certain types of businesses are required to submit reports on cash transactions over the \$10,000 threshold and transactions of a suspicious nature. Millions of these reports are filed each year. For example, in 2005 over 16 million BSA reports were filed by financial institutions. Certain civil and criminal penalties can be levied against financial institutions for violating BSA reporting requirements, with fines ranging from \$500 for negligence to \$500,000, 10 years in jail, or both for certain willful violations.<sup>7, 8</sup> Appendix III discusses the compliance reporting responsibilities in more detail.

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## FinCEN and IRS Have Distinct Roles in Implementing BSA, but Share Some Responsibilities

FinCEN's role is to oversee administration of BSA government wide. In this role, FinCEN develops policy and provides guidance to other agencies, as shown in figure 1. However, FinCEN also relies on other agencies in implementing the BSA framework, including (1) ensuring compliance with BSA requirements to report certain financial transactions, (2) conducting investigations of criminal financial activity, and (3) collecting and storing the reported information IRS is involved in all three of these areas.

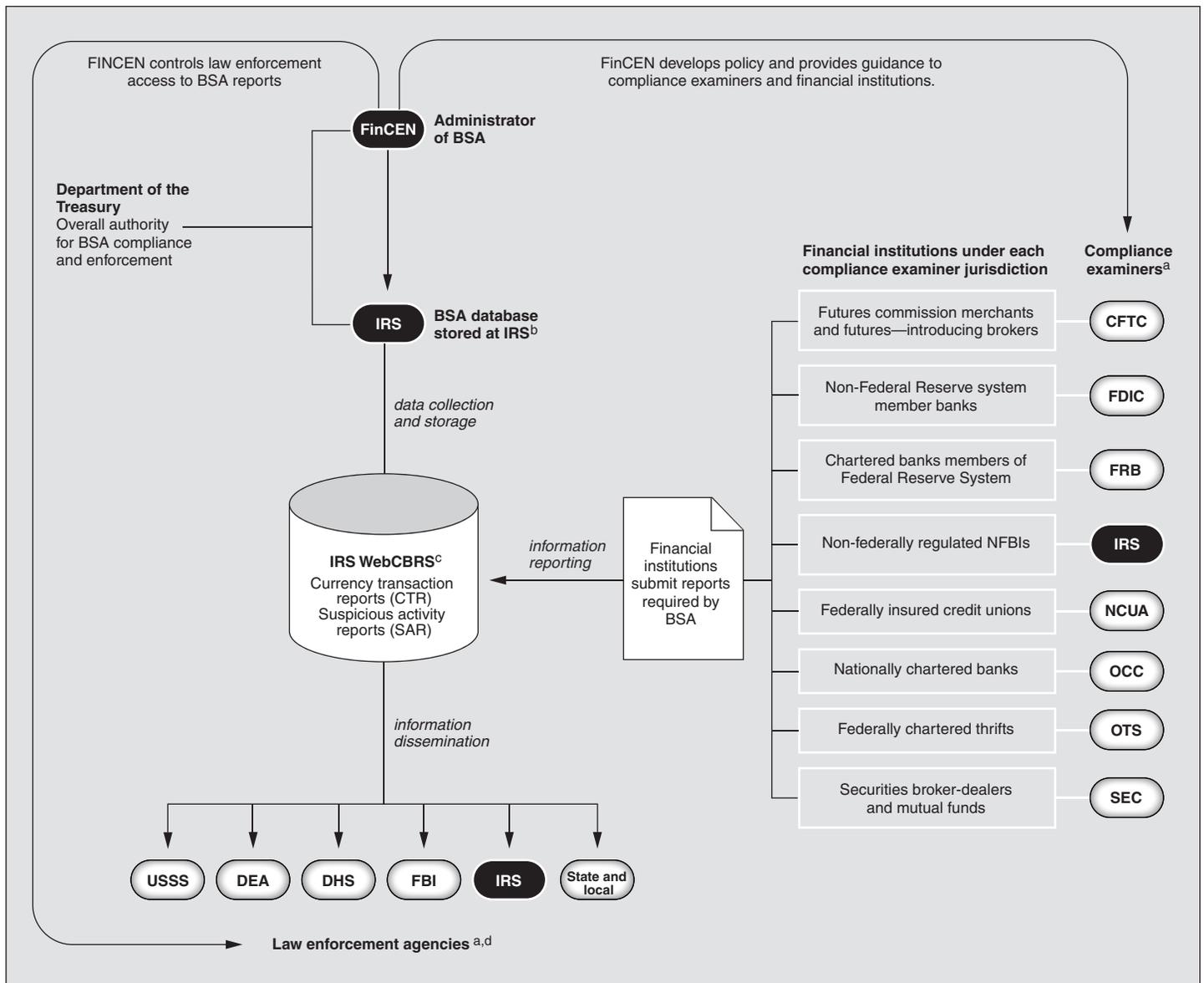
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<sup>6</sup> 31 C.F.R. § 103.29.

<sup>7</sup> 31 C.F.R. § 103.57(h).

<sup>8</sup> 31 U.S.C. § 5322(b).

**Figure 1: BSA Framework**



Source: GAO.

<sup>a</sup>Agency names are listed in the list of acronyms located at the front of this report.

<sup>b</sup>FinCEN collects some BSA information directly through its E-filing system; however, this information is then provided to IRS and stored with all other BSA information in IRS's WebCBRS system.

<sup>c</sup>CTRs and SARs are only examples of the types of BSA reports stored on IRS's Web-based Currency and Banking Retrieval System (WebCBRS). See App. II for the complete list.

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<sup>4</sup>There are 215 agencies with access to IRS WebCBRS. This is only a partial list of these agencies. Additionally, some agencies have duplicate copies of the information that are incorporated into other data systems; therefore some agencies do not always have to access WebCBRS to review BSA data.

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### **FinCEN Oversees the Government wide BSA Compliance Program, While IRS Conducts Compliance Examinations of NBFIs**

As administrator of BSA, FinCEN's compliance role is to develop regulatory policies for agencies that examine financial institutions and businesses for compliance with BSA laws, and when appropriate, assess civil penalties against noncompliant institutions. FinCEN develops and issues BSA regulatory requirements and provides guidance to financial institutions that are subject to those requirements. FinCEN is also responsible for overseeing agency compliance examination activities and provides these agencies with assistance in educating institutions on their BSA responsibilities.

As highlighted in the compliance examiners section of figure 1, IRS is one of eight agencies that actually conduct the compliance examinations that FinCEN oversees. The Office of Fraud/BSA, within SB/SE, conducts examinations of NBFIs, including MSBs, which are not regulated by another federal agency. Appendix III discusses the compliance responsibilities of MSBs in more detail.

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### **FinCEN Is Responsible for Supporting and Networking the Law Enforcement Community, Including CI**

FinCEN is responsible for supporting and networking law enforcement at the federal, state, and local levels. FinCEN's network exceeds 180 law enforcement agencies, and includes CI, the Federal Bureau of Investigation, the Drug Enforcement Administration, Immigration and Customs Enforcement, state and local police departments and investigative bureaus, attorney general and district attorney offices, and foreign authorities. FinCEN provides investigative leads to support financial criminal investigations and offers a variety of analytical products on trends and patterns that can be used by law enforcement to more effectively target their investigations.

As the enforcement arm of IRS, CI has the authority to investigate criminal violations of BSA laws. Like other law enforcement agencies, CI uses financial intelligence, including data provided on BSA reports, to build investigations and prepare cases for prosecution. The law enforcement section of figure 1 highlights how FinCEN, IRS CI, and the broader law enforcement community fit into the BSA framework.

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## FinCEN Relies Heavily on IRS for the Collection, Storage, and Maintenance of BSA Data

FinCEN has responsibility for overseeing the management of BSA data, but from an operational standpoint does not collect, store, or maintain the official data that are reported by financial institutions. IRS's Enterprise Computing Center at Detroit (ECC-DET), under a long-standing cooperative arrangement with FinCEN, has been the central point of collection and storage of these data. ECC-DET maintains the infrastructure needed to collect the reports, convert paper and magnetic tape submissions to electronic media, and correct errors in submitted forms through correspondence with filers. As illustrated in the data management section of figure 1, BSA data are processed and warehoused in IRS's Currency Banking and Retrieval System are accessed through a Web-based interface. The system is called WebCBRS. IRS examiners and investigations officials access WebCBRS directly through IRS's intranet. Non-IRS law enforcement users access BSA data through FinCEN's Gateway computer system. Secure Outreach functions as a portal through FinCEN's information technology infrastructure to BSA data housed at ECC-DET.

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## IRS Lacks an Effective BSA Compliance Program, Despite Several Improvements

Despite many improvements, IRS does not yet have an effective BSA compliance program. An effective IRS compliance program would require identifying the population of NBFIs and then periodically testing whether these NBFIs are complying with their reporting and other BSA requirements.

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## FinCEN and IRS Continue to Face Challenges in Identifying the Population of NBFIs Subject to BSA Requirements

Several efforts have been made to estimate the NBFIs population, but all of these estimates have weaknesses. However, IRS and other knowledgeable observers agree that IRS has only identified a portion of the population. No recent studies have been conducted that estimate the total population of NBFIs; however, a number of efforts have been made to estimate the number of MSBs, the largest group of NBFIs subject to BSA requirements. A 1997 study conducted by a FinCEN consultant estimated the existence of approximately 158,000 MSBs.<sup>9</sup> One IRS official within the Office of Fraud/BSA estimates there may be approximately 160,000 MSBs. In 2005,

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<sup>9</sup> The study reported the total number of NBFIs is estimated at 158,000. The study conducted a discovery process to identify businesses that provided services involving (1) check cashing, (2) money orders, (3) money transmission, (4) retail foreign currency exchange, and (5) travelers checks.

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another FinCEN study estimated the population to be as high as 200,000.<sup>10</sup> Officials from FinCEN, IRS, Treasury, TIGTA, and Treasury's OIG agree that IRS has only identified part of the NBFIs population.

Several factors contribute to IRS's difficulty in identifying NBFIs. NBFIs, especially MSBs, are inherently difficult to identify because of the wide range of sizes, structures, and financial activities they conduct. Unlike traditional financial institutions, such as federally insured banks, many MSBs are small, independently owned businesses in which financial services are offered as a secondary business activity. For example, many grocery stores, convenience stores, gas stations, and liquor stores would be considered MSBs because they offer check cashing, money order, or wire transfer services, even though the primary activity of these businesses is the sale of consumer goods. In a 2005 report, the OIG cited language barriers and the limited financial proficiency of some business owners as reasons many MSBs are not registered,<sup>11</sup> and therefore have not been identified.<sup>12</sup>

The OIG also found that regulations and guidance for MSBs can be confusing and easily misinterpreted, thus contributing to the challenge of identifying MSBs. The report states that the distinction FinCEN makes between a MSB principal and an agent of that principal is not always understood by the MSB population and is difficult to verify other than through an on-site examination. Some BSA rules, such as the registration requirement, are applicable to principals—the entities issuing financial instruments—and some are applicable to agents—businesses authorized to sell the issuers' financial instruments. Another confusing aspect of the MSB requirements is that businesses whose daily money services

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<sup>10</sup> The study reported the total number of MSBs nation wide is estimated to be 203,207 with a 95% confidence interval. The study conducted a survey of a representative sample of 24,000 potential MSBs and got a 10 percent response rate. The MSBs provided services involving (1) check cashing, (2) money orders, (3) money transmission (domestic and international), (4) foreign currency exchange, (5) stored value, and (6) traveler's checks.

<sup>11</sup> Each business (not including branches) that fits within the definition of an MSB is required to register with FinCEN, except for the U.S. Postal Service and other agents of the federal, state, or local government and those businesses that are considered MSBs only because they (1) act as agents for other MSBs or (2) act as issuers, sellers, or redeemers of stored value.

<sup>12</sup> Department of the Treasury, Office of the Inspector General, *Bank Secrecy Act: Major Challenges Faced by FinCEN in Its Program to Register Money Service Businesses*, OIG-05-050 (Washington, D.C.: Sept. 27, 2005).

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transactions are less than \$1,000 per day per person are generally not considered MSBs. As with the agent exemption, the dollar threshold is difficult to verify other than through an on-site examination. The OIG found that FinCEN had plans to assess whether agents of MSBs should be required to register; however, FinCEN has not taken action to implement these plans. IRS officials in the Office of Fraud/BSA support a change that requires all MSBs to register, regardless of whether they are principals or agents, because it would make identification easier. FinCEN officials, however, said that their first priority is to ensure that the current list of MSB registrations is accurate. Therefore, FinCEN does not have a time-frame for revising MSB regulations and guidance, including registration requirements.

Identifying NBFIs, and particularly MSBs, is challenging and resource intensive—both FinCEN and IRS have responsibility in this area. IRS uses CBRS, public and commercial databases, Internet searches, and the yellow pages to identify potential MSBs. FinCEN searches past BSA reports and gets referrals from other law enforcement officials about potential NBFIs and MSBs. However, not all businesses identified from these sources as potential NBFIs are actually subject to BSA requirements. IRS has identified 107,000 potential NBFIs, but has not been able to determine how many of these businesses are subject to BSA. Whenever IRS identifies a new business it believes may be an NBFI, it sends the business a letter. This letter explains that IRS believes the business is engaged in an activity that qualifies it as an NBFI subject to BSA requirements. IRS officials said they are uncertain about the effectiveness of this letter and that some businesses do not reply. Further, these officials said often the only way to confirm whether a business is subject to BSA requirements is to conduct an on-site examination, a labor-intensive and time-consuming process.

IRS officials in the Office of Fraud/BSA told us that accessing IRS's tax return databases might help identify additional potential NBFIs. The Office of Fraud/BSA is currently unable to use tax return information to identify businesses that may be subject to BSA requirements because IRS is prohibited by law from using tax return information for nontax purposes, with only a few exceptions.<sup>13</sup> The confidentiality of tax information is

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<sup>13</sup> I.R.C. § 6103 provides that tax returns and return information are confidential and may not be disclosed by IRS, other federal employees, state employees, and certain others having access to the information except as provided in I.R.C. § 6103. I.R.C. § 6103 allows IRS to disclose taxpayer information to federal agencies and authorized employees of those agencies for certain specified purposes.

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considered crucial for promoting voluntary compliance by taxpayers, and legislative proposals for exceptions have been strictly scrutinized by Treasury before submission to Congress. IRS currently lacks empirical evidence that would support making a case to grant an exception (for example, evidence on the number of potential NBFIs that could be identified from tax data but not from other sources), and IRS has not decided whether it should pursue obtaining access in an effort to develop this evidence. Appendix IV provides more detail on taxpayer disclosures and the criteria the executive branch considers before submitting a proposal to Congress for granting exceptions.

In another effort to identify potential NBFIs, FinCEN and IRS have recently agreed to a number of MOUs with state financial regulators to improve coordination and information sharing.<sup>14</sup> Almost all MOUs are less than 2 years old, and according to IRS, FinCEN, and officials representing the states that have signed MOUs, it is still too early to tell how effectively they will be carried out. Successfully implementing these MOUs and sustaining the partnerships they establish will be an ongoing challenge for IRS, FinCEN, and the states involved. For example, states have differing definitions and licensing requirements for MSBs, which can make it difficult to ensure consistency in the reporting of information. Additionally, IRS officials said that meeting the information-sharing requirements in the MOUs is time intensive because it requires manually gathering large amounts of information from different parts of the organization. The benefits to IRS and the states, thus far, have not been determined. IRS, FinCEN, and the states have only recently begun to implement the agreements in the MOUs. Therefore, little has been done to evaluate the usefulness of the information that is being shared. Appendix V provides additional information on the MOUs.

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<sup>14</sup> Some states incorporate BSA compliance reviews as part of safety and soundness examinations they conduct on certain MSBs.

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## IRS Is Developing a Statistically Valid Risk-Based Approach to Selecting Businesses for Compliance Examinations, but Limitations Will Continue to Exist

IRS does not have a statistically valid risk-based approach for targeting NBFIs for BSA compliance examinations, but it is working on developing such an approach for a segment of MSBs. A risk-based approach is important for selecting NBFIs for compliance examinations because IRS only has resources to examine a small fraction of NBFIs each year. For example, in 2005, IRS completed 3,712 examinations— 3.5 percent of the 107,246 potential NBFIs in its database.

A risk-based approach uses statistically valid risk factors to select NBFIs for compliance examinations. Statistically valid risk factors can be used to better target examinations on those businesses that pose the greatest risk for noncompliance with BSA requirements. As a result, IRS would devote fewer of its scarce resources to examining compliant NBFIs. One approach to statistically validating the risk factors involves testing them on a sample of NBFIs representative of the population and determining the extent to which the results correlate with businesses' actual noncompliance with BSA requirements.<sup>15</sup> IRS already uses a risk-based approach when selecting individual tax returns for audit. Its approach involved statistically validating a set of risk factors using a relatively small but representative sample of individual tax returns.<sup>16</sup> IRS now uses those risk factors to select individual tax returns for audit from the entire population.

We, as well as OMB and TIGTA, have recognized the value of risk-based approaches. Earlier this year, we reported that risk management, including risk assessment, is a widely endorsed strategy for helping managers and policymakers make decisions about allocating finite resources and taking actions under conditions of uncertainty.<sup>17</sup> OMB also recommends making decisions based on risk assessments. As far back as 1986, we concluded that BSA regulators would use their resources better by targeting

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<sup>15</sup> Successfully completing a validation study offers assurance that the final results are sufficiently robust and that the method can be relied on for reproducible results. For an example, see GAO, *Anthrax Detection: Agencies Need to Validate Sampling Activities in Order to Increase Confidence in Negative Results*, [GAO-05-251](#) (Washington, D.C.: Mar. 31, 2005).

<sup>16</sup> The most recent such assessment was called the National Research Program. See GAO, *Tax Administration: IRS Is Implementing the National Research Program as Planned*, [GAO-03-614](#) (Washington, D.C.: June 16, 2003).

<sup>17</sup> GAO, *Risk Management: Further Refinements Needed to Assess Risks and Prioritize Protective Measures at Ports and Other Critical Infrastructure*, [GAO-06-91](#) (Washington, D.C.: Dec. 15, 2005).

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examinations on entities with a high potential for problems.<sup>18</sup> In 2004, TIGTA reported that a risk-based, data-driven process to select the potentially most noncompliant MSBs for compliance checks could be a more effective selection method than IRS's existing process.<sup>19</sup>

IRS's approach for selecting NBFIs for examination is based mainly on the judgment and experience of IRS managers and examiners. Based on that judgment and experience, IRS's Office of Fraud/BSA has developed a set of risk factors that assist in prioritizing and selecting NBFIs for examination. However, the judgment and experience of managers and examiners is based on past compliance cases that are not a representative sample of NBFIs. Further, IRS studied the risk factors to help develop rules for case selection and used experienced examiners to score these factors based on their potential for producing cases involving noncompliant businesses. IRS has not conducted a test to statistically validate these risk factors.

IRS recognizes that its risk factors have not been tested and validated. It has a research project under way to test whether the current risk factors are more effective than chance at identifying noncompliant MSBs. IRS selected a random sample of potential MSBs from CBRS. Then each MSB in the sample was scored for risk of noncompliance using the risk factors. Beginning in January 2007, IRS will examine each MSB in the sample to determine whether actual noncompliance exists. The examination results will be compared to the risk scores to determine the effectiveness of the risk factors at predicting noncompliance. The results could also be used to make improvements to the factors. The research project is slated for completion in December 2007. If the project is completed on time, IRS officials expect any changes made to the risk factors would go into effect in time to guide the selection of cases for examination in calendar year 2008.

IRS's research project is a step in the right direction. For MSBs in CBRS, it will provide empirical validation for IRS's current risk factors or a basis

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<sup>18</sup> GAO, *Bank Secrecy Act: Financial Institution Regulators' Compliance Examinations*, GAO/GGD-86-94 (Washington, D.C.: Aug. 1, 1986).

<sup>19</sup> See Treasury Inspector General for Tax Administration, *Additional Efforts Are Needed to Improve the Bank Secrecy Act Compliance Program*, 2004-30-068 (Washington, D.C.: Mar. 12, 2004).

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for improving them. However, this risk-based approach will continue to have limitations, including the following.

*IRS's research study was not designed to be representative of all the potential MSBs identified by IRS.* IRS is testing the validity of the risk-based selection process by sampling from a subpopulation of potential MSBs, not the entire population. The study samples from a list of 59,701 potential MSBs entered into CBRS in 2004 or 2005 because they either filed BSA-required reports, such as MSB registrations, CTRs, and SARs, or were named in such reports by third parties. However, the population of potential MSBs that IRS has identified is larger. IRS has approximately 105,710 potential MSBs in the Title 31 database and is responsible for determining whether all of them are complying with BSA.<sup>20</sup> According to IRS officials, IRS did not draw from the Title 31 database to conduct this study because inconsistency in the quality and completeness of the information it contains on NBFIs limited its usefulness as a reliable source. IRS's decision to use CBRS as the source of the study is a valid one. However, because the research study does not address the entire known population, IRS will not know how useful the risk factors are for producing cases within the segment of the population it did not study. IRS does not have plans for validating the risk factors for the entire known population of MSBs.

*IRS's risk-based approach to selecting MSBs for compliance examinations necessarily ignores the unknown part of the population.* As discussed previously, there is widespread agreement that despite its efforts to date, IRS has not identified all MSBs. As IRS uses new information sources and methods to identify additional MSBs, the risk factors may not take into account the characteristics of these previously unidentified MSBs. The only way to ensure IRS is adapting its risk-based selection process to reflect changes in the identified population of MSBs is to continue updating its risk assessments. IRS does not have plans for reassessing the validity of the risk factors as additional MSBs are identified.

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<sup>20</sup> The Title 31 database is the primary source of data for building cases for BSA examination because it contains all the information IRS has on NBFIs and potential NBFIs. The database includes business names, owners, employees, addresses, and types of financial services offered. It is also where IRS documents the status of compliance examination activity, such as case summaries and results of past examinations. Therefore, there is the potential for the same NBFIs to be identified in both the Title 31 database and CBRS.

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*IRS's study and the risk factors applied are only applicable to MSBs and do not take into account the risks of other NBFIs.* IRS does not have a statistically validated risk-based approach for selecting casinos, wholesale jewelers, or insurance agents for examination. In addition, as more types of NBFIs are required to comply with BSA requirements, IRS will be required to incorporate those businesses into its compliance examination efforts. From a long-term perspective, a risk-based approach that looks across the different segments of the NBFIs population could result in a more effective use of resources for compliance examination. IRS does not have plans for a risk assessment of the full range of NBFIs.

Addressing the limitations in IRS's current risk-based approach for targeting NBFIs for examination will require time and resources. Identifying unknown NBFIs is inherently challenging and gradual—no easy solution exists for addressing this problem. Compliance research is costly; IRS estimates the research that is currently under way will cost approximately \$1.7 million. Furthermore, IRS's ability to mount separate efforts to deal with the range of limitations will be constrained by management capacity and research capacity.

The benefits of a statistically valid risk-based approach to ensuring compliance are potentially very great. The nation would have data-based assurance that the NBFIs compliance examination program is targeting its resources where the risks of NBFIs noncompliance, and the resulting lack of reporting about suspicious financial transactions, are known to be greatest.

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## Although Compliance Challenges Continue to Exist, the Establishment of an Office of Fraud/BSA Has Resulted in Some Improvements

In October 2004, IRS established the Office of Fraud/BSA within SB/SE. This office is responsible for ensuring NBFIs comply with BSA requirements. IRS appointed an executive to oversee the office. This executive reports directly to the SB/SE Commissioner. The establishment of this office came, in part, in response to TIGTA findings that IRS needed to strengthen oversight of the BSA compliance program.<sup>21</sup> For example, prior to reorganizing, IRS did not have examiners dedicated specifically to conducting BSA compliance examinations. Instead, according to IRS officials, examinations were conducted by tax examiners who split their time among tax examinations, BSA examinations, and collections activities.

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<sup>21</sup> Treasury Inspector General for Tax Administration.

With the establishment of the Office of Fraud/BSA, IRS dedicated over 300 staff in 33 field offices specifically to conducting BSA compliance examinations. The dedication of these staff reflects IRS's decision to place a greater priority on meeting its BSA examination responsibilities. Since establishing the Office of Fraud/BSA and dedicating staff specifically to BSA issues, IRS has centralized and increased uniformity of BSA compliance examinations. However, the program still has management limitations and the improvements do not address the significant problems that IRS has in identifying NBFIs and targeting compliance examinations. Table 2 shows the improvements IRS management has made and some remaining management limitations.

**Table 2: Summary of BSA Compliance Program Improvements and Limitations**

<b>Program area</b>	<b>Improvements</b>	<b>Limitations</b>
Compliance examination policies and procedures	IRS has centralized, more fully documented, and better implemented policies and procedures for conducting examinations of NBFIs for compliance.	IRS's Internal Revenue Manual, the resource for IRS's official policies and procedures, has not been amended since January 2003.
Education and outreach to NBFIs	FinCEN and IRS have expanded and better coordinated education and outreach efforts directed to the NBFIs community.	Unlike the agencies that examine banks for BSA compliance, IRS lacks a comprehensive manual that NBFIs can use to develop anti-money laundering programs that are compliant with BSA requirements.
Information management	IRS has centralized and taken steps to improve the accuracy and reliability of all data on NBFIs and information used to manage examination resources.	IRS's Title 31 database, which contains IRS's information on NBFIs, is labor intensive to maintain and has limited functionality and security and stability concerns.
Performance measurement	IRS has established and benchmarked a number of performance measures of program activities.	IRS lacks a way of measuring the extent to which known NBFIs comply with BSA requirements.

Source: GAO.

## Compliance Examination Policies and Procedures

Before establishing the Office of Fraud/BSA, IRS did not have centrally managed, or consistently implemented, BSA examination policies and procedures. IRS lacked formal guidance for documenting BSA compliance examinations and determining whether a case warranted referral for civil or criminal enforcement by FinCEN or CI, respectively. Since establishing the Office of Fraud/BSA, IRS has established uniform instructions that compliance examiners use for requesting records and examining institutions for compliance with BSA requirements. Additionally, IRS has developed better procedures for determining whether a case has enough support to warrant a referral for civil enforcement by FinCEN or criminal enforcement by CI. According to FinCEN officials, the documentation for cases referred for civil penalty assessment has improved significantly as a

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result of these changes. CI officials have also noticed improvements in case documentation and referrals that they attribute to the establishment of the new organization.

However, many of the changes to the processes and guidance have not been incorporated into the Internal Revenue Manual—IRS’s official internal policies and procedures document resource. Instead, many of IRS’s new or revised policies and procedures are distributed to compliance examiners via memorandums and electronic mail. Distributing guidance in this manner makes it difficult to keep track of the changes and ensure consistent understanding and implementation over the long term. IRS recognizes these challenges and has slowly made progress in generating an update, but this process began in 2004 and was not complete as of November 2006. IRS could not provide a definitive deadline for when the updated Internal Revenue Manual would be published.

#### Education and Outreach to NBFIs

IRS’s outreach is conducted by the SB/SE Stakeholder Liaison Office. The liaison office works with FinCEN in coordinating the development and distribution of standardized and consistent information through brochures, newsletters, presentations, and other materials.

However, IRS has not provided the NBFI community with a comprehensive source of information that can be used to guide efforts to develop a program that meets BSA requirements. In June 2005, the Federal Financial Institutions Examination Council (FFIEC) addressed this issue for the agencies responsible for conducting BSA examinations of banks and similar financial institutions.<sup>22</sup> FFIEC, with support from FinCEN, developed the *Bank Secrecy Act/Anti-Money Laundering Examination Manual*.<sup>23</sup> Although this manual is intended to guide examiners when examining financial institutions for compliance with BSA requirements, the banking industry has applauded its development and publication

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<sup>22</sup> FFIEC’s five member agencies are the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

<sup>23</sup> This FFIEC *Bank Secrecy Act/Anti-Money Laundering Examination Manual* was published on June 30, 2005. It provides guidance to examiners for carrying out compliance and Office of Foreign Assets Control examinations. An effective compliance program requires sound risk management; therefore, the manual also provides guidance on identifying and controlling risks associated with money laundering and terrorist financing. The manual contains an overview of compliance program requirements, risks and risk management expectations, industry sound practices, and examination procedures.

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because it makes examination procedures transparent and provides excellent guidance on what is expected of banks.

Despite agreement by FinCEN and IRS that a similar manual is needed for the NBF community, such a manual has not been developed. According to IRS officials, they have recently hired a training coordinator who will be responsible for developing this manual. However, no timeline has been established for when the process for developing this manual will begin.

## Information Management

Prior to the establishment of the Office of Fraud/BSA, the management of BSA compliance program information was decentralized. Each of the 16 field offices maintained its own, separate lists of potential NBFs and information on the examinations it was conducting. Once the new office was established, IRS took steps to combine all of this information into one centralized database, the Title 31 database.

The Title 31 database, however, was not built using a disciplined systems development process and is not supported by IRS Modernization and Information Technology Services (MITS). As a result, the database potentially contains duplicate, outdated, and sometimes inaccurate information from the 16 merged systems. IRS officials believe it has addressed many of these issues but could not validate that all have been addressed. Further, IRS officials stated that the database has other limitations, including (1) limited capacity to handle the number of fields required to maintain and close cases, (2) issues with connectivity across field locations, (3) limited controls to prevent the entry of invalid information, and (4) system instability. IRS has obtained MITS support in creating a new system to maintain the information in the Title 31 database. However, IRS will continue operating within existing system constraints until the new system is fully operational.

## Performance Measurement

IRS has made progress in tracking and measuring program activities, but lacks a measure of the extent to which NBFs comply with BSA requirements. Prior to the new organization, IRS had only one consistently measured performance goal for the BSA compliance program—delivery of direct examination staff years. In a 2004 review, TIGTA found that IRS needed to establish performance indicators that measure case results and their cumulative impact on compliance. For fiscal year 2005, IRS established a suite of measures that it is using to track and assess program performance. Table 3 lists these measures and the fiscal year 2005 results and fiscal year 2006 goals and results.

**Table 3: BSA Performance Measures Established to Track Program Activities in Fiscal Years 2005 and 2006 and Compared to Performance Information Available for Fiscal Year 2004**

BSA performance measure	Fiscal year 2004	Fiscal year 2005	Fiscal year 2006 through May	Fiscal year 2006 target/goal
Number of closures	3,481	3,712	3,681	6,427
Hours per case	<sup>a</sup>	49	44	50
Cycle time	<sup>a</sup>	218	219	<sup>b</sup>
Cases in inventory				
Assigned to examiner—examination not started	<sup>c</sup>	<sup>c</sup>	2,593	<sup>b</sup>
Assigned to examiner—examination started	<sup>c</sup>	<sup>c</sup>	2,754	<sup>b</sup>
Net number of new starts	<sup>c</sup>	<sup>c</sup>	4,837	<sup>b</sup>
Referrals to CI	9	21	10	<sup>b</sup>
Referrals to FinCEN	8	10	4	<sup>b</sup>
Referrals to tax examiners	1,663	1,572	471	<sup>b</sup>

Source: IRS Office of Fraud/BSA.

<sup>a</sup>Information on hours per case and cycle time was not captured until January 2005.

<sup>b</sup>No targets and goals have been identified.

<sup>c</sup>Information not provided for fiscal years 2004 and 2005.

IRS performance measures in table 3 do not provide information on the rate of NBF1 compliance. Although measuring compliance rates can be challenging, IRS has done so for taxpayer compliance of individuals under Title 26. IRS's research to validate the risk factors it uses to target MSB examinations could also be used to estimate a compliance rate for MSBs in CBRS. This compliance rate would not be generalizable to the entire MSB or NBF1 population; however, it would allow IRS to get a better understanding of the extent to which the MSB population captured within CBRS complies. Without a measure of the compliance rate, IRS and external parties such as Congress will not know the effect, over time, of IRS's efforts to ensure compliance. IRS has no plans to measure the NBF1 compliance rate.

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## FinCEN and IRS Lack a Documented and Coordinated Strategy for Improving NBFIs Compliance with BSA Requirements

FinCEN and IRS have taken a number of steps to improve efforts to ensure that NBFIs comply with BSA, but they lack a documented and coordinated strategy for moving forward. Our previous discussion shows that many additional steps could be taken to identify the population of NBFIs, ensure compliance of those NBFIs that have been identified, and strengthen management of IRS's BSA compliance program. Addressing these limitations will be challenging and will take time. The challenges are compounded by the fact that the types of NBFIs that are IRS's responsibility under the law are growing. Some actions to address these challenges could be taken by the agencies individually, but others will require a coordinated approach to be effective. Further, limited resources and time constraints mean that additional actions will have to be prioritized, alternatives will need to be considered, and trade-offs may need to be made. FinCEN and IRS do have some elements of a strategy to guide future efforts.<sup>24</sup> However, FinCEN and IRS do not have a documented and coordinated strategy that prioritizes actions, lists time frames, and explains resource needs over multiple years.

Without a strategy that prioritizes and guides IRS and FinCEN's collective efforts to improve NBFIs compliance, the risk is greater that noncompliance will go undetected and uncorrected. Noncompliance by NBFIs means that suspicious financial transactions, such as money laundering and terrorist financing that occur at these institutions, might go undetected.

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## CI Investigates BSA Criminal Violations and Uses BSA Information Extensively

CI investigates individuals and businesses, including financial institutions, for BSA and money laundering violations, usually in conjunction with other tax law violations.

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<sup>24</sup> Both FinCEN and IRS have developed some elements of a strategy. IRS has a Concept of Operations for the Office Fraud/BSA that describes the strategic objectives, goals, and outcomes of the program, as well as an annual program letter that describes the program priorities for the fiscal year. FinCEN has a strategy to improve MSB compliance.

## CI Dedicates a Portion of Its Resources to Investigate Criminal BSA Violations

BSA investigations constituted roughly 12 percent of CI's direct investigative time in fiscal year 2006. Full-time equivalents (FTE) dedicated to BSA enforcement from 2002 to 2006 remained relatively unchanged, as shown in table 4.

**Table 4: CI's BSA Investigative Time, FTEs, and Costs for Fiscal Years 2002 through 2006**

	Fiscal year 2002	Fiscal year 2003	Fiscal year 2004	Fiscal year 2005	Fiscal year 2006
Direct investigative time	11.1%	12.3%	12.4%	12.0%	11.8%
Total FTEs	450	478	474	453	451
BSA costs	\$56,684,148	\$63,760,525	\$69,183,775	\$66,516,938	\$68,286,292

Source: IRS's Criminal Investigation Management Information System.

CI highlighted enhancing BSA compliance in its strategy and program plan for fiscal years 2005 through 2006. In the plan, CI outlines its strategies to support IRS's strategic plan goal to enhance enforcement of tax laws. One of CI's major compliance strategies involves effectively working with Treasury, the Department of Justice and other law enforcement partners among other things, to enhance BSA compliance efforts.<sup>25</sup> CI recently introduced new performance measures based, in part, on a previous TIGTA report and an OMB review. During the OMB review, Treasury, CI, and OMB jointly determined that the old measure of completed investigations was insufficient to measure program effectiveness. As a result, CI introduced three new annual performance measures: the number of convictions (a measure of impact on compliance), the conviction rate (a measure of quality of investigations), and conviction efficiency (a measure of cost efficiency). CI reported 296 convictions for BSA violations during fiscal year 2006. From fiscal years 2002 through 2006, convictions increased about 23 percent.

CI investigates individuals and businesses for BSA or money laundering violations, but according to CI officials, agents do not typically investigate many financial institutions for Title 31 violations. Generally, if an

<sup>25</sup> In GAO, *Bank Secrecy Act: Opportunities Exist for FinCEN and the Banking Regulators to Further Strengthen the Framework for Consistent BSA Oversight*, [GAO-06-386](#) (Washington, D.C.: Apr. 28, 2006), we reported on some of the BSA criminal cases pursued by the Justice Department.

institution is the subject of an investigation, it is for failure to have an anti-money laundering program in place or because an individual within the institution is causing the institution to not file required forms. According to CI officials, structuring is the most common type of BSA violation CI investigates among individuals. Structuring occurs when a person conducts or attempts to conduct currency transactions at financial institutions for the purposes of evading the reporting requirements of BSA. Many BSA investigations involve structuring, failure to file reports on transactions or bulk cash, and smuggling activities, according to CI officials.

BSA criminal violations are usually investigated in conjunction with other tax violations, according to CI officials. In one recent case, a sales executive for an international telecommunications company was sentenced to 24 months in prison and fined \$20,000 in a money laundering case involving cash deposits. The sales executive structured bank deposits and made 31 cash deposits totaling over \$250,000 to accounts in two different banks to avoid currency transaction reports being filed to IRS. The sales executive forfeited \$59,400 and filed amended income tax returns to report an additional \$250,000 in income that he was attempting to hide with his structuring activity. The case was developed from information reported in SARs.

**CI Statistics Show  
Increases in Enforcement  
Activity for BSA Violations**

BSA convictions increased from fiscal years 2002 through 2006. Likewise, investigations completed and prosecutions recommended increased during the same period. Table 5 shows CI's BSA investigations initiated, investigations completed, prosecutions recommended, and convictions.

**Table 5: BSA Investigations Initiated, Investigations Completed, Recommendations for Prosecutions, and Convictions for Fiscal Years 2002 through 2006**

	Fiscal year 2002	Fiscal year 2003	Fiscal year 2004	Fiscal year 2005	Fiscal year 2006
Investigations initiated	563	525	523	546	554
Investigations completed	418	513	700	546	628
Prosecutions recommended	292	322	501	379	437
Convictions	240	239	310	343	296

Source: IRS's Criminal Investigation Management Information System.

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## CI Is a Large Consumer of BSA Data

CI is a big user of BSA data and IRS's database that stores the data—CBRS. CI's enforcement mission coupled with being organizationally located within IRS places it in a unique position for utilizing BSA data. CI queries CBRS more than any other federal, state, or local agency. During fiscal year 2005, CI made about 57 percent of the over 1.5 million queries made of the system. Additionally, CI was responsible for more than 66 percent of the document viewing activity in CBRS.

During 2006, CI transitioned to a new Web-based version of CBRS. CI officials reported the system has advantages for improving CI's ability to develop investigative leads. One advantage is the ability to conduct searches within narratives on BSA reports. Analysts and investigators can now search narratives on SARs, for instance, for specific words and were unable to do so under the old CBRS system. Another advantage cited is the ability to better use downloads of SAR data. With the Web-based system, an analyst or investigator can put downloads in Access or Excel. Once the data are in a spreadsheet or database management applications program, analysts or investigators can easily look for trends in certain addresses or occupations. With the old CBRS system, the analyst had to print out downloads and manually look at the different fields of information from SARs.

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## Missed Opportunities for Effective Planning and Poor Project Management and Oversight Have Hampered FinCEN's Efforts to Reengineer BSA Data Management Activities

In 2003 FinCEN began an effort to reengineer BSA data management activities. However, the cornerstone of FinCEN's reengineering effort, BSA Direct R&S, was permanently halted because of a multitude of problems.

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FinCEN Missed Opportunities to Effectively Plan, and Coordinate with IRS, Early Efforts to Reengineer BSA Data Management

FinCEN made two mistakes in the early stages of its effort to reengineer BSA data management activities: it began reengineering without a comprehensive implementation plan and did not adequately communicate and coordinate with IRS.

FinCEN Began Reengineering BSA Data Management Activities without a Comprehensive Implementation Plan

According to our Business Process Reengineering Assessment Guide, before an agency initiates business process reengineering, a comprehensive implementation plan should be developed that spells out the work that needs to be done.<sup>26</sup> This plan should include time frames, milestones, decision points, and resource allocations. Although FinCEN commissioned a series of studies to examine and recommend an approach to reengineering BSA data management activities, these studies were only recommendations and did not constitute a comprehensive plan for conducting the reengineering effort. Instead, FinCEN made the decision to move forward with one aspect of the broader reengineering effort, BSA Direct R&S, before establishing a comprehensive plan. FinCEN commissioned the MITRE Corporation to develop a comprehensive reengineering plan that would serve as a road map for the reengineering effort after the BSA Direct R&S project was well under way. Further, this plan was developed under the assumption that BSA Direct R&S would be completed successfully. FinCEN expected BSA Direct R&S to be the center of FinCEN's broader reengineering effort and serve as the catalyst for its execution.

FinCEN intended to establish the technology for implementing the reengineering effort before establishing the reengineering plan itself. We have found in examining reengineering and technology acquisition efforts that technology is an enabler of process reengineering, not a substitute for it. We have also found that acquiring technology in the belief that its mere presence will somehow lead to process innovation is a root cause of bad investments in information systems. FinCEN's decision to implement one aspect of the reengineering effort, BSA Direct R&S, before developing a comprehensive plan for conducting the broader effort exemplifies this

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<sup>26</sup> GAO, *Business Process Reengineering Assessment Guide*, GAO/AIMD-10.1.15 (Washington, D.C.: May 1997), provides a general framework for assessing a reengineering project, from initial strategic planning and goal setting to post-implementation assessments.

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**FinCEN Did Not Adequately Communicate and Coordinate Reengineering Efforts with IRS**

problem. FinCEN viewed BSA Direct R&S as a strategic initiative, as it was intended to eventually interface with other systems in order to facilitate all BSA reporting and data related processes from IRS to FinCEN over time.

FinCEN did not adequately communicate and coordinate its BSA data management reengineering efforts with IRS, namely efforts to develop new information systems used to house and disseminate BSA data. Had better communication and coordination occurred, a more effective technology and business solution might have been achieved. The cornerstone of FinCEN's effort to take control of all BSA data management responsibilities was the development of BSA Direct R&S, a new information system that was to store and disseminate all BSA data. At the same time, IRS developed its own system, WebCBRS, with many of the same capabilities. FinCEN did not actively engage in discussions with IRS about WebCBRS as it was being developed. FinCEN, IRS, and Treasury all have a role in the reengineering effort. However, FinCEN's goal is to take over all BSA data management responsibilities currently conducted by IRS. Therefore, FinCEN is driving the reengineering effort and has responsibility for communicating and coordinating its activities to the other agencies. Key moments in the development of these two systems are documented in figure 2.

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**Figure 2: Key Moments in the Development of New BSA Data Management Systems**

October 2001	April 2002	February 2003	March 2003	June 2003	September 2003
USA PATRIOT Act mandates Treasury to reexamine IRS's BSA related roles and responsibilities, including management of the data.	Treasury responds to mandate by issuing a report recommending IRS maintain its current role as manager of BSA data.	FinCEN issues requests for information on strategies to reengineer BSA data management activities.	IRS provides FinCEN with a schedule for new systems development efforts that projects 2009 completion based on a static funding plan.  WebCBRS systems development effort begins.	Gap analysis is provided to FinCEN with options for reengineering.	BSA Direct project is launched.

October 2003	February 2004	May 2004	July 2004	December 2004	April 2005	October 2005	March 2006	April 2006	July 2006	August 2006
Based on new funding priorities, IRS informs FinCEN that WebCBRS would be completed in April 2006 and not in 2009, as previously estimated.	Request for Proposals (RFP) on BSA Direct is issued.	FinCEN Director visits IRS's ECC/DET to view WebCBRS and get information on time frames.	FinCEN awards contract for BSA Direct.	Treasury Chief Information Officer issues a memorandum describing current operations and agency agreements moving forward.	IRS submits Request for Information Services for continued development of WebCBRS.	<b>BSA Direct R&amp;S does not meet scheduled delivery date.</b>	BSA Direct R&S is placed under a temporary "stop-work" order.  IRS and FinCEN begin efforts to transition non-IRS users onto WebCBRS.	IRS transitions all IRS users to WebCBRS.	BSA Direct R&S is permanently halted.	WebCBRS is fully implemented and made available to all users.

- Key events affecting IRS and FinCEN
- Key events at FinCEN
- Key events at IRS

Source: GAO.

In examining the above timeline, we identified at least three missed opportunities early in the implementation of the two projects where better planning and coordination might have resulted in more effective and efficient systems development efforts:

- In April 2002, Treasury, with FinCEN's input, recommended IRS maintain its role in BSA data management; yet over the next 2 years FinCEN decided to pursue alternative approaches while IRS initiated the transfer of BSA data to WebCBRS, a new system.
- In the fall of 2003, FinCEN decided to launch the BSA Direct project just a month before ECC-DET at IRS secured additional funding and accelerated the development of WebCBRS with an anticipated completion of 2006 instead of 2009. FinCEN, however, justified the need for BSA Direct without fully accounting for (1) the expected capabilities that IRS's WebCBRS system would provide and (2) IRS's revised and more

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aggressive conversion schedule. For example, part of FinCEN's justification to OMB for BSA Direct was that it would allow IRS to discontinue the development of WebCBRS, potentially resulting in financial savings for the agency. However, officials at both FinCEN and IRS said no discussion on discontinuing IRS's effort ever took place before this justification was presented.

- In December 2004, the Chief Information Officer (CIO) of Treasury issued a memorandum documenting key agreements between the department, IRS, and FinCEN on the future of BSA data management, but it is unclear how some of these agreements were actually implemented. For example, an agreement stated that IRS would be a preferred user of FinCEN's system, yet IRS officials stated that they remained uninformed throughout the process about their current and future access to BSA data. Additionally, an agreement stated that the Treasury CIO would lead a joint effort to identify, eliminate, and prevent any potential duplication of efforts. However, no information was provided to demonstrate how this agreement was to be carried out.

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### Poor Project Management and Oversight Contributed to the Failures of BSA Direct R&S

BSA Direct R & S failed, in part, because project management issues continued throughout the project's life and were not adequately addressed by agency executives. On March 15, 2006, the Director of FinCEN placed the BSA Direct R & S project under a temporary "stop work" order because of significant cost, schedule, and performance issues. Over the following 4 months, FinCEN reassessed the project with the assistance of two outside consultants. Then, on July 12, 2006, the Director decided to permanently halt the project because of a multitude of problems. Among these were inadequate project governance and a lack of demonstrated project management expertise by the project contractor and FinCEN.

In a previous review we found that FinCEN did not always apply effective investment management processes to oversee the BSA Direct R&S project.<sup>27</sup> This, in part, contributed to the problems experienced by the project, because issues that occurred at the project management level continued and were compounded, yet were not addressed at the executive level. For example, the MITRE Corporation—the organization assisting FinCEN with project monitoring—identified multiple occasions where FinCEN did not take action to mitigate project risks or address significant descoping of project functionality.

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<sup>27</sup> [GAO-06-947R](#).

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BSA Direct R&S repeatedly missed program milestones and performance objectives and exceeded the project budget. The original cost estimate of \$8.9 million for the prime contract increased to \$15.1 million. Of that amount, \$14.4 million was spent. FinCEN estimates that an additional \$8 million would be required for operations and maintenance. Also FinCEN could not ensure that any additional investment would achieve the desired product. Therefore, FinCEN terminated the project and is currently

- formalizing a replanning effort for BSA Direct R&S, to include strategic, technical, and resource planning issues, as well as stakeholder analysis;
- evaluating the discrete elements of BSA Direct R&S for salvageability; and
- developing a road map to achieve BSA Direct R&S in steps, as a program with multiple projects, both business and technology oriented.

In our previous review we noted that the problems with BSA Direct R&S indicate systemic problems with FinCEN's management and oversight of information technology projects. As a result, the Subcommittee on Transportation, Treasury, Housing and Urban Development, the Judiciary, and Related Agencies, Senate Committee on Appropriations, directed FinCEN to ensure it has an executive-level review process for information technology projects.<sup>28</sup> We also recommended that FinCEN develop a plan for managing BSA Direct that focuses on establishing policies and procedures for executives to regularly review investments progress against commitments and take corrective actions when these commitments are not met. In October 2006, FinCEN developed an interim information technology management improvement plan that acknowledges that these and other actions are needed to build its information technology management capabilities. However, the plan focuses on improving FinCEN's information technology management capabilities but does not address FinCEN's broader efforts to reengineer BSA data management activities.

Based on past issues, FinCEN will continue to face challenges in building information technology management capability, while at the same time continuing efforts to reengineer and transition BSA data management processes. The MITRE Corporation, prior to the failure of the BSA Direct project, characterized reengineering of BSA data management as a daunting effort, in part, because it involved highly interdependent tasks that must be conducted under short implementation time frames. The

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<sup>28</sup> S. Rep. No. 109-293 (2006).

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decision to discontinue the BSA Direct R&S project provides FinCEN with an opportunity to take a more deliberate and disciplined approach to implementing the effort to reengineer BSA data management activities.

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## Conclusions

FinCEN and IRS play important roles in the national effort to combat money laundering and terrorist financing activity. Both have recently taken significant steps to make their efforts more effective; however, a great deal more could and should be done.

FinCEN and IRS have taken action to improve NBFIs compliance with BSA requirements, but making significant progress in identifying NBFIs and ensuring that they comply with BSA requirements is a long-term effort with no simple solutions. In some cases, IRS, FinCEN, or both have actions under way but no timetable for finishing. In other cases, action has yet to begin. Some of these actions include deciding whether to pursue gaining access to taxpayer information, clarifying the definition of an MSB, updating the Internal Revenue Manual, developing an NBFIs compliance examiner's manual, creating a more functional and secure mechanism for storing NBFIs data, and developing a NBFIs BSA compliance measure. These actions have not been completed, in part, because of competing priorities. However, without a coordinated, documented strategy that guides the agencies' approach over time, the agencies do not have assurance they are moving in the right direction and are limited in their ability to measure progress in achieving improvements. Furthermore, Congress and the public will have difficulty understanding the overall approach that IRS and FinCEN are taking to ensure that NBFIs are complying with BSA.

To date, FinCEN's effort to reengineer and transition BSA data management activities has not been successful. The failure of BSA Direct R&S was a considerable setback in this effort. However, FinCEN is now in a position to reassess the goals of the reengineering effort and develop a comprehensive long-term strategy. FinCEN and IRS must also find ways to improve communication and coordination as FinCEN proceeds with its effort to reengineer BSA data management activities. Moving forward, FinCEN will need to take a measured and disciplined approach to strengthening its ability to oversee and manage information technology projects. Significant changes, such as FinCEN's data management reengineering effort, are complex and slow to implement, requiring a long-term, but flexible, strategy and a strong and consistent focus to be successful.

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## Recommendations for Executive Action

To improve BSA compliance, we are making the following 8 recommendations.

The Secretary of the Treasury should direct the Director of FinCEN and the Commissioner of Internal Revenue to develop a documented and coordinated strategy that outlines priorities, time frames, and resource needs for better identifying and selecting NBFIs for examination. This strategy should include the full complement of actions that FinCEN and IRS can take to build a more effective BSA compliance program, including the specific compliance program recommendations we make below.

The Director of FinCEN should establish a time frame for revising MSB regulations and guidance, including registration requirements.

The Commissioner of Internal Revenue should decide whether to pursue gaining access to taxpayer data for better identifying NBFIs.

The Commissioner of Internal Revenue should direct the Office of Fraud/BSA to

- build upon the study to validate compliance risk factors by developing a plan to assess the noncompliance risks posed by all NBFIs;
- establish time frames for finalizing and publishing the Internal Revenue Manual with updated BSA compliance program policies and procedures;
- develop a NBFIs compliance examiner's manual that examiners can use to guide examinations and businesses can use to ensure they are in compliance with BSA requirements, and establish time frames for its publication;
- create a more functional and secure mechanism for storing and accessing the information contained in the Title 31 database; and
- use the results of the forthcoming risk factor validation study to estimate the compliance rate for the population of MSBs from which the study sample was drawn.

To improve BSA data management, we recommend the following:

The Director of FinCEN, in cooperation with the Commissioner of Internal Revenue, should develop and implement a comprehensive and long-term plan for reengineering BSA data management activities before moving forward with the BSA Direct R&S project. This plan, at a minimum, should

- take a broad and crosscutting approach to the reengineering effort, and not focus solely on one component, such as BSA Direct;

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- include short- and intermediate-term goals for reengineering BSA data management processes, including the transition of IRS's data management responsibilities to FinCEN; and
  - incorporate collaboration strategies into the plan by clearly defining the role of IRS's ECC-DET in the transition process and more actively involving it as a key stakeholder in the reengineering effort.

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## Agency Comments and Our Evaluation

The Director of FinCEN and the Commissioner of Internal Revenue jointly provided written comments on a draft of this report in a letter dated December 11, 2006 (which is reprinted with its enclosures in app. VI). FinCEN and IRS agreed with all our recommendations. The Director and Commissioner also stated their appreciation that our report notes the steps that FinCEN and IRS have already taken to improve BSA compliance. They highlighted staff attrition as another challenge faced by the program. The Director and Commissioner also raised some issues about the difficulty in drawing a correlation between IRS's process for selecting tax returns for audit and selecting NBFIs for BSA compliance examination, but we view IRS's tax audit case selection process as a potentially useful model for selecting cases—even if the audits are for other purposes.

While agreeing with our first recommendation, the Director and Commissioner expressed concern that we did not recognize the efforts that they have already taken to better identify and select NBFIs for examination. However, IRS's Workload Identification Process, which they cite, has not yet been funded. Further, our report recognizes the use of BSA information in the CBRS system—which includes SARs. Additionally, we acknowledge efforts to improve coordination of BSA activities with the states through MOUs.

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If you or your staff has any questions, please contact me at (202) 512-5594 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VII.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, looped initial "J".

James R. White  
Director, Tax Issues  
Strategic Issues Team

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# Appendix I: Objectives, Scope, and Methodology

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To describe the Internal Revenue Service's (IRS) and the Financial Crimes Enforcement Network's (FinCEN) Bank Secrecy Act (BSA) related roles and responsibilities, we reviewed and summarized relevant legislative and regulatory authorities. We also reviewed BSA rules and guidance, agency reports, and strategic planning documents. Further, we interviewed officials at FinCEN and IRS Small Business Self-Employed Division (SB/SE) and IRS Criminal Investigations Division (CI), and the IRS Enterprise Computing Center at Detroit (ECC-DET). We examined the information obtained to determine the BSA roles and responsibilities at FinCEN and IRS, changes to these roles over time, and the potential for overlap and duplication of responsibilities.

To determine the extent to which IRS has been effective in managing its BSA compliance program and coordinating with FinCEN, we reviewed relevant legislative and regulatory authorities. We analyzed data on program performance and compared estimates of the nonbank financial institutions (NBFIs) population. We compared IRS's approach for selecting NBFIs for compliance examinations to the approach it uses for examining individual tax returns, as well as to guidance from the Office of Management and Budget, GAO, and others. We applied our criteria for internal controls to the Title 31 database IRS used to house and store data for BSA examination cases. We reviewed strategic planning documents related to BSA compliance examination and program management, including the Internal Revenue Manual, FinCEN and IRS strategy and program plans, and expenditure documents. We reviewed Treasury Inspector General for Tax Administration (TIGTA) and the Department of the Treasury (Treasury) Office of Inspector General (OIG) reports and Treasury's response and disposition on recommendations made. We also reviewed the Federal Financial Institutions Examination Council manual established for federal banking supervisors to ensure that the banks have consistent application of BSA requirements. To obtain information on the total population of NBFIs in the United States for which IRS has BSA compliance examination responsibility, we reviewed reports from Coopers & Lybrand, KPMG, and Treasury's OIG and Federal Register notices of the interim and final reports that contained information on the additional BSA industries IRS will be responsible for regulating. We also reviewed documentation on IRS's examination and referral processes and IRS's performance measures, including the number of cases closed, number of referrals, cycle time, hours per case, number of new cases initiated, and cases in inventory. We examined IRS's BSA case selection criteria and the Title 31 database used to house and store data for BSA examination cases. We examined the memorandums of understanding (MOU) established between FinCEN and IRS, FinCEN and the states, and IRS and the states.

We used our report on key collaboration practices as criteria for assessing IRS's and FinCEN's efforts to collaborate with each other and the states. We interviewed IRS SB/SE officials involved with BSA examinations; BSA case selection; and the SB/SE Stakeholder Liaison office involved in outreach and education for NBFIs, FinCEN regulatory policy officials, officials from Treasury's OIG and TIGTA, and officials from the BSA Advisory Group and the Conference of State Banking Supervisors.

To describe CI's BSA role, we reviewed legislative and regulatory authorities, agency reports, strategic planning documents, internal policies and processes for conducting investigations and making BSA case referrals, and the 1999 Webster Commission Report. We also reviewed CI's statistics for BSA-related staffing resources and caseload, including full-time equivalents, closed cases, cases with violations, and referrals to FinCEN. We interviewed officials from CI, SB/SE, FinCEN, the Department of Justice Asset Forfeiture and Money Laundering Section, and the Department of Homeland Security Immigration and Customs Enforcement on use of BSA data and access to BSA data. We assessed the reliability of IRS's Criminal Investigation Management Information System—a database containing nationwide data on the status of CI investigations: how CI agents use direct investigative time; the number and type of staff on board; and the inventory of equipment. Our assessment included reviewing existing information about the data and the system that produced them and interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

To assess the effectiveness of FinCEN's efforts to reengineer BSA data management activities, we reviewed and analyzed BSA Direct planning and implementation documents and interviewed agency officials at IRS and FinCEN and some users of BSA information, such as federal law enforcement agencies. We also reviewed project documents such as the Office of Management and Budget Exhibit 300, the original BSA Direct contract and revisions, progress reports, interim briefings, and project assessments conducted by the MITRE Corporation. We also interviewed FinCEN officials responsible for investment management and the BSA Direct project, the contractor conducting the BSA Direct project, and MITRE Corporation officials involved in the project. In a previous review, we also examined FinCEN's application of information technology investment management processes to the retrieval and sharing component of the BSA Direct project using our guide, *Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity*. We did not conduct a comprehensive review of

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FinCEN's investment management practices. We focused on critical processes associated with stage 2 of the five-stage framework because they represent the practices needed for basic project-level control.

We performed our review from July 2005 through November 2006 in accordance with generally accepted government auditing standards.

# Appendix II: Reports Required by BSA Regulations

Report	Description	Who is required to file	Reports filed in 2005
Money Service Business Registrations (RMSB)	Form used by certain MSB to register with FinCEN.	Businesses that offer money orders, traveler's checks, check cashing, currency dealing or exchange, and stored value, and such businesses that conduct more than \$1,000 in MSB activity with the same person on the same day, or money transfers in any amount. <sup>a</sup>	16,329
Bank Suspicious Activity Reports (SAR-DI)	Reports that describe insider abuse of financial transactions of any amount and type that financial institutions suspect may be unusual or irregular, violations of \$5,000 or more where a suspect can be identified or involve potential money laundering, violations aggregating \$25,000 or more regardless of a potential suspect, and computer intrusion.	Financial/depository institutions.	525,750
MSB Suspicious Activity Reports (SAR-MSB)	Reports that describe financial transactions that are conducted or attempted by, at, or through an MSB, involve or aggregate funds or other assets of at least \$2,000, and the MSB knows, suspects, or has reason to suspect that the transaction (or pattern of transactions of which the transactions are a part) involves funds derived from an illegal activity, is designed to evade reporting requirements, has no reasonable purpose or explanation, or involves the use of the MSB to facilitate criminal activity.	Money transmitters; issuers, sellers, and redeemers of traveler's checks and money orders; and the U.S. Postal Service.	381,304
Casino Suspicious Activity Reports (SAR-C)	Reports that describe financial transactions conducted by, at, or through a casino involving at least \$5,000 if they are suspected to derive from illegal activity, are conducted to hide or disguise funds, are designed to evade reporting requirements, have no reasonable purpose or explanation, or involve the use of the casino to facilitate criminal activity.	Casinos and card clubs.	5,865
SAR Securities and Futures Industries (SAR-SF)	Reports that describe financial transactions conducted by, at, or through a broker or dealer in securities involving at least \$5,000 if they are suspected to derive from illegal activity, are designed to evade reporting requirements, have no reasonable purpose or explanation, or involve the use of the broker or dealer in securities to facilitate criminal activity.	Brokers and dealers in securities, futures commission merchants, and futures introducing brokers.	6,897

**Appendix II: Reports Required by BSA  
Regulations**

<b>Report</b>	<b>Description</b>	<b>Who is required to file</b>	<b>Reports filed in 2005</b>
Currency Transaction Report (CTR)	Reports that describe each deposit, withdrawal, exchange of currency, or other payment or transfer by, through, or to a financial institution, which involves a transaction in currency of more than \$10,000. Transactions reported include those conducted by, or on behalf of the same person, conducted on the same business day, and either a single or multiple currency transaction.	Financial and nonfinancial institutions.	14,228,961
Casino Currency Transaction Report (CTR-C) and Nevada Casino (CTRC-N)	Reports that describe transactions greater than \$10,000 in currency as well as suspicious transactions. In addition, casinos must report suspicious transactions and activities on FinCEN SAR-C. Nevada casinos must file Form 103N, Currency Transaction Report by Casinos - Nevada (CTRC-N)—reports that describe transactions involving more than \$10,000 in cash. Also, smaller transactions occurring within a designated 24-hour period that aggregate to more than \$10,000 in cash are reportable if the transactions are the same types of transactions within the same monitoring area or if different types of transactions occur within the same visit at one location.	Casinos and card clubs and Nevada casinos with greater than \$10,000,000 in annual gross gaming revenue and with over \$2,000,000 of table games statistical winnings.	634,912
Form 8300	Reports of cash payments over \$10,000 received in a trade or business.	Individuals involved in trades or businesses that are not financial institutions.	157,920
Foreign Bank and Financial Account Report (FBAR)	Annual reports of financial interest in foreign accounts if the aggregated value of a foreign financial account exceeds \$10,000 at any time during the calendar year.	Individuals or depository institutions having an interest in, and signature or other authority over, one or more bank, securities, or other financial accounts in a foreign country.	281,762
Designation of Exempt Person (DOEP)	Reports banks file to exempt eligible customers from currency transaction report reporting requirements. Exempt customers include banks, government agencies/authorities, listed companies and subsidiaries, eligible nonlisted businesses with a history of frequent currency transactions, and payroll customers.	Depository institutions.	105,775
Report of International Transportation of Currency or Monetary Instrument (CMIR)	Reports the transportation (physically, or mailing and shipping or receipt) of currency into or out of the United States and certain other monetary instruments on any one occasion in excess of \$10,000.	Individuals, corporations, partnerships, trusts or estates, and associations.	NA <sup>b</sup>

Source: GAO analysis.

<sup>a</sup>Exceptions include (1) businesses serving as agents of another MSB; (2) businesses whose only MSB activity is the issuance, sale, or redemption of stored value; (3) the U.S. Postal Service or agencies of the United States, a state, or a political subdivision of any state; and (4) MSB branch offices.

<sup>b</sup>Information is processed and kept by Immigration and Customs Enforcement.

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# Appendix III: Responsibilities of MSBs under BSA

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Included within the BSA reporting and record-keeping requirements are MSBs. A business is generally considered to be an MSB if (1) it offers one or more of the following services: money orders, traveler's checks, check cashing, currency dealing or exchange, and stored value and (2) the business either conducts more than \$1,000 in these activities with the same person in one day or provides money transfer services in any amount.

Each business (not including branches) that fits within the definition of an MSB is required to register with FinCEN, except for the U.S. Postal Service and other agents of the federal, state, or local governments, and those businesses that are considered MSBs only because they (1) act as agents for other MSBs or (2) act as issuers, sellers, or redeemers of stored value. Certain MSBs are required to file suspicious activity reports for transactions involving at least \$2,000 in which the MSB believes or has reason to believe that the transaction (1) involves funds derived from illegal activity or is intended to hide such activity; (2) is otherwise designed to evade the reporting requirements under BSA; (3) has no business or apparent lawful purpose or is not the type of transaction in which the customer would normally be expected to engage; or (4) involves the use of an MSB to facilitate criminal activity.

All MSBs are required to develop and implement risk-based BSA compliance programs. MSBs are also required to file currency transaction reports for cash transactions of over \$10,000, and must maintain information pertaining to the sale of and verify the identity of those purchasing certain monetary instruments (e.g., money orders and traveler's checks) valued from \$3,000 to \$10,000. MSBs must also maintain information on funds transfers of \$3,000 or more.

# Appendix IV: Access to Taxpayer Information for BSA Examinations

One way to improve the IRS's knowledge of the NBFIs population subject to BSA requirements would be to access specific identifying information reported on income tax returns. However, the IRS Office of Fraud/BSA is unable to use taxpayer information to identify businesses that may be subject to BSA requirements. Section 6103 of the Internal Revenue Code, which prohibits IRS from disclosing returns or return information unless a statutory exception applies, does not currently specifically allow disclosure for Title 31 examinations. Over the years, however, Congress has amended section 6103 to allow access to taxpayer information for specific purposes, including disclosure to federal officials for the administration of certain federal laws not relating to tax administration. According to Treasury, the burden of supporting an exception to the section 6103 prohibition should be on the requesting agency, in this case IRS, to make the case for disclosure and provide assurances that the information will be safeguarded appropriately. To date, IRS has not done so. Table 6 lists the criteria Treasury and IRS have applied when evaluating specific legislative proposals.

**Table 6: Criteria Applied by Treasury and IRS When Evaluating Specific Proposals for Governmental Disclosures**

Criteria to be addressed by the requesting agency	<p>Is the requesting information highly relevant to the program for which it is to be disclosed?</p> <p>Are there substantial program benefits to be derived from the requested information?</p> <p>Is the request narrowly tailored to the information actually necessary for the program?</p> <p>Is the same information reasonably available from another source?</p>
Criteria to be addressed by the requesting agency and Treasury/IRS	<p>Will the disclosure involve significant resource demands on IRS?</p> <p>Will the information continue to be treated confidentially within the agency to which it is disclosed, pursuant to standards prescribed by IRS?</p> <p>Other than I.R.C. § 6103, are there any statutory impediments to implementation of the proposal?</p>
Criteria to be addressed by Treasury/IRS	<p>Will the disclosure have an adverse impact on tax compliance or tax administration?</p> <p>Will the disclosure implicate other sensitive privacy concerns?</p>

Source: Office of Tax Policy, Department of the Treasury.

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# Appendix V: MOUs on BSA Compliance

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FinCEN and IRS are forging a more collaborative approach to implementing BSA compliance efforts. FinCEN and IRS recognize that a more collaborative approach to BSA compliance will allow them to better leverage interagency and intergovernmental resources. Since 2005, FinCEN and IRS have begun to formalize more collaborative relationships with each other and a number of state regulatory/banking agencies that examine NBFIs for BSA compliance. The principle vehicle for developing these relationships has been the MOUs. These MOUs provide formalized procedures for coordinating BSA activities and sharing information. Separate MOUs between FinCEN and IRS, FinCEN and 42 state regulatory/banking agencies and Puerto Rico, and IRS and 34 state regulatory/banking agencies and Puerto Rico have been signed.

- The MOU between FinCEN and IRS establishes procedures for the exchange of information between the two agencies with the goal of enforcing BSA compliance. The MOU dictates that IRS provide a wide range of information to FinCEN through quarterly and annual reports, including new or revised examination policies, procedures, or guidance and quantitative data on examinations conducted, violations discovered, and referrals made. The MOU dictates that FinCEN will provide IRS with information on enforcement actions and analytical products on patterns and trends as well as provide technical and analytical assistance in overseeing industry compliance.
- MOUs between FinCEN and 42 states and Puerto Rico have been signed in an attempt to advance the sharing of information and enhance uniform application of BSA. FinCEN expects to receive information on businesses examined and enforcement actions taken. In exchange, the states expect to receive analytical tools from FinCEN that will maximize resources and highlight areas and businesses with higher risk for money laundering. Both FinCEN and the states expect the agreements to help them improve the coordination of collective actions and concerns by providing a clearer picture of the various financial industries regulated.

IRS has signed MOUs with 34 states and Puerto Rico to establish information sharing to assist in the examination of MSBs and other NBFIs. The IRS/State MOUs involve the coordination of examination activities and the sharing of examination procedures, schedules, and lists of MSBs. These MOUs are different from the MOUs between FinCEN and the states because FinCEN's agreement involves FinCEN sharing analytical information gathered from various regulators. By collaborating with the states, IRS hopes to improve the quality and coverage of compliance examinations and make better use of examination resources. The agreements established in the MOUs are intended to eliminate duplicative

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examination efforts and regulatory requirements, and build greater quality and consistency through training. IRS, FinCEN, and the states have only recently begun to implement the agreements in the MOUs.

# Appendix VI: Comments from the Financial Crimes Enforcement Network and Internal Revenue Service



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 11, 2006

Mr. James R. White  
Director, Tax Issues  
Strategic Issues Team  
United States Government Accountability Office  
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to respond to your draft report entitled "Bank Secrecy Act: FinCEN and IRS Need to Improve and Better Coordinate Compliance and Data Management Efforts" (GAO-07-212).

Your report offers two primary recommendations: 1) that the Financial Crimes Enforcement Network (FinCEN) and IRS develop a documented and coordinated strategy for improving Non-Bank Financial Institutions' (NBFIs') compliance with Bank Secrecy Act (BSA) requirements; and 2) that FinCEN strengthen its BSA data management reengineering by developing a long-term plan that includes coordination with the IRS. As your report notes, most of these efforts are already underway.

The IRS BSA Program, established in 2005, has built a business process for assessing Title 31 noncompliance. The IRS is dedicated to seeking enhancements to this new program and welcomes the recommendations outlined in this report for improvements in training, procedural guidance, case identification and selection capabilities, as well as database capacity and program measures.

One of the challenges facing the IRS BSA Program that was not identified in the draft report is staffing attrition. As of October 1, 2005, the IRS employed 305 BSA field examiners with a goal of employing 385 examiners by September 30, 2006. The IRS hired an additional 101 BSA field examiners during FY 2006, but due to attrition retained only 349 examiners as of October 1, 2006. In order to address the staffing challenge, the IRS has increased its staff recruitment efforts for FY 2007 by collaborating closely with recruiters, participating in an internship program, and offering recruitment bonuses in certain hard to fill locations.

Similar to your July 2006 report, "Observations on the Financial Crimes Enforcement Network's (FinCEN's) BSA Direct Retrieval and Sharing Project" (GAO-06-947R), this report concludes that FinCEN's failed attempt at reengineering BSA data management was due to poor project management and oversight. FinCEN acknowledges these project management deficiencies and, as a result, has developed a comprehensive Information Technology (IT) Management Improvement Plan that emphasizes continued

**Appendix VI: Comments from the Financial  
Crimes Enforcement Network and Internal  
Revenue Service**

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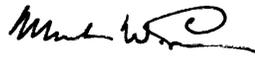
maturity of the bureau's IT governance processes and project management capabilities. In addition, FinCEN and the IRS also agree with the report's recommendation to develop a long-term plan that includes coordination between FinCEN and the IRS while the future of BSA Direct is reevaluated.

We appreciate that your report notes the significant steps that FinCEN and the IRS have taken to improve Bank Secrecy Act compliance by NBFIs. As your report correctly states, the actions needed to improve compliance will require a long-term effort. Accordingly, we concur with your recommendation that FinCEN and the IRS work jointly to develop and document a coordinated strategy to improve BSA compliance by NBFIs.

While we share your concern with the current approach to selecting individual NBFIs for compliance examinations, we believe that it is difficult to draw a correlation to the IRS process for selecting individual income tax cases for examination, due to the differing missions of the individual taxpayer examination program and that of the BSA compliance program. The IRS BSA program does not enforce tax filing or payment compliance and does not usually generate federal revenue; instead, its purpose is to safeguard the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity. As we move forward, the IRS will continue to work on a better selection process for BSA compliance examinations while FinCEN continues to evaluate the appropriateness of current regulations for the money services business industry and considers potential changes to the regulatory framework.

Responses to specific recommendations are enclosed. If you have any questions, please call us or a member of your staff may contact Eileen Mayer, Director for BSA/Fraud, Small Business/Self-Employed Division, Internal Revenue Service, at (202) 283-2426 or Jamal El-Hindi, Associate Director for Regulatory Policy and Programs, Financial Crimes Enforcement Network, at (703) 905-6414.

Sincerely,



Mark W. Everson  
Commissioner of Internal Revenue



Robert W. Werner  
Director, Financial Crimes Enforcement  
Network

Enclosure

Enclosure

To improve BSA compliance, GAO recommends:

**Recommendation:**

The Secretary of Treasury direct the Director of Financial Crimes Enforcement Network (FinCEN) and the Commissioner of the Internal Revenue Service (IRS) to develop a documented and coordinated strategy outlining priorities, timeframes, and resource needs for better identifying and selecting NBFIs for examination. This strategy should include the full complement of actions that FinCEN and IRS can take to build a more effective BSA compliance program, including the specific compliance program recommendations we make below.

**Response:**

While we agree that development and coordination of plans between FinCEN and IRS would be beneficial in maximizing compliance with the BSA and USA PATRIOT Act, the report fails to recognize significant efforts IRS and FinCEN have taken to better identify and select Non-Bank Financial Institutions (NBFIs) for examination. The IRS's initiative to secure funding for the BSA Workload Identification Process (WIP), as explained below, is representative of IRS efforts. In addition, FinCEN and IRS are using Suspicious Activity Report (SAR) information to assist in identifying unregistered Money Services Businesses (MSBs). FinCEN and IRS are also coordinating with various law enforcement and state regulatory agencies to identify these unregistered entities through a variety of means. Once identified, IRS is providing outreach activities which include educating these unregistered MSBs on their potential obligations under the BSA.

In October 2005, the IRS BSA Program participated in the IRS's Modernization Vision and Strategy (MV&S) process to identify and fund critical business automation needs. The BSA WIP Project request was submitted for FY 2008 funding. This project has two components - workload identification and an electronic case file. WIP would provide automated risk-based classification of IRS BSA Title 31 and Title 26 inventory and use third party data from federal, state, and commercial sources to identify entities operating outside of federal regulatory programs. Electronic case files would automate the reengineered BSA examination process and reduce case building and cycle time.

Since the WIP request for \$2.65 million from the FY 2008 IRS Modernization account was not among the 24 funded projects, a revised WIP proposal was submitted in October 2006, requesting funding for FY 2009 and FY 2010. The needs are estimated at \$2.937 million for FY 2009 and \$1.743 million for FY 2010. WIP Release #1 would include workload identification features and Release #2 would include an electronic case file process. Later releases might also provide the ability to attach scanned documents to an electronic case file. If this project is funded as a Modernization

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initiative in FY 2009 and FY 2010, a request will be submitted for additional IRS BSA funds to support a full-time project manager, refine requirements, plan security needs, and begin Enterprise Life Cycle documentation before modernization money becomes available in FY 2009. A decision is expected on modernization funding in February 2007.

**Recommendation:**

The Director of FinCEN establish a timeframe for revising MSB regulations and guidance, including registration requirements.

**Response:**

As stated in your report, FinCEN's first priority is to make improvements in ensuring the current list of MSB registrants is accurate. IRS and FinCEN are, however, in the process of evaluating the current regulatory regime as it applies to the MSB industry taking into consideration the impact of any proposed rule change on all relevant entities. For example, the IRS supports a regulatory change that will increase information available to them for the purpose of identifying and examining NBFIs. One alternative might be requiring the registration of MSB agents who are not presently required to register. Although this is one of many regulatory options currently being explored, FinCEN continues to receive feedback on other alternatives that require careful consideration before a definitive timeframe is established as to how we will proceed.

**Recommendation:**

The Commissioner of the IRS decide whether to pursue gaining access to taxpayer data for better identifying NBFIs.

**Response:**

We agree that access to some taxpayer data may be beneficial in assisting IRS to more effectively and efficiently identify NBFIs. Because the confidentiality of tax data is critical to voluntary compliance, Treasury policy requires a business case to support exceptions to disclosure. IRS will take actions in order to determine whether a business case exists for pursuing legislative change to allow Title 26 information to be used for Title 31 purposes. IRS will establish a working group to determine the merit of the initiative. IRS Office of Disclosure will provide oversight and guidance in this effort.

**Recommendation:**

The Commissioner of the IRS directs the Office of BSA/Fraud to build upon the study to validate compliance risk factors by developing a plan to assess the noncompliance risks posed by NBFIs.

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**Response:**

We agree that this recommendation would benefit the IRS BSA Program. After evaluating the results of the current study, IRS will consider the feasibility of preparing the recommended plan.

**Recommendation:**

The Commissioner of the IRS directs the Office of BSA/Fraud to establish timeframes for finalizing and publishing the Internal Revenue Manual with updated BSA compliance program policies and procedures.

**Response:**

IRS is finalizing an update of the Internal Revenue Manual (IRM). IRM 4.26 Sections 1, 2, 4, 6, 7, 13, 14 and 15 were published on November 17, 2006. IRM 4.26 Sections 8 through 12 have been update and forwarded for publishing. The IRM 4.26 Sections 3, 5 and 17 are undergoing final internal review and will be forwarded for publishing within the next 30 days. Section 4.26.16, FBAR Law, is currently being revised and will be forwarded for publishing within the next 90 days.

**Recommendation:**

The Commissioner of the IRS directs the Office of BSA/Fraud to develop a NBF compliance examiner's manual that examiners can use to guide examinations, and businesses can use to ensure they are in compliance with BSA requirements, and establish timeframes for its publication.

**Response:**

We agree with this recommendation. This task has been assigned to an IRS BSA Senior Manager. By December 31, 2006, IRS BSA management will issue a plan to develop and deliver a compliance examiner's manual.

**Recommendation:**

The Commissioner of the IRS directs the Office of BSA/Fraud to create a more functional and secure mechanism for storing and accessing the information contained in the Title 31 database.

**Response:**

We agree with this recommendation and have taken significant steps to implement a functional and secure mechanism for information contained in the Title 31 database.

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IRS's Modernization and Information Technology Services (MITS) began developing a new Title 31 database in September 2006 and will enter the test production stage in December 2006. The new database will continue to be fully supported by MITS. The server on which the new database will reside has been in operation for the past two years, handling various other IRS applications which are considerably larger than the new Title 31 database. The server capacity is three terabytes. Current users of the server have not experienced any connectivity problems to date.

**Recommendation:**

The Commissioner of the IRS directs the Office of BSA/Fraud to use the results of the forthcoming risk factor validation study to estimate the compliance rate for the population of MSBs from which the study sample was drawn.

**Response:**

We concur with this recommendation. After concluding the current risk factor validation study, the IRS BSA management and Research functions will work to estimate a compliance rate for the MSB population.

**Recommendation:**

To improve BSA data management, GAO recommended that the Director of FinCEN, in cooperation with the Commissioner of IRS, develop and implement a comprehensive, long-term plan for reengineering BSA data management activities before moving forward with the BSA Direct R&S project. This plan, at a minimum should:

- Take a broad and cross-cutting approach to the reengineering effort, and not focus solely on one component, such as BSA Direct;
- Include short-and-intermediate-term goals for reengineering BSA data management processes, including the transition of IRS's data management responsibilities to FinCEN; and
- Incorporate collaboration strategies into the plan by clearly defining the role of IRS's Enterprise Computing Center at Detroit in the transition process and more actively involving them as key stakeholders in the reengineering effort.

**Response:**

We concur with the report's recommendation to develop a long-term plan that includes coordination between IRS and FinCEN as they reevaluate the future of BSA Direct. In fact, preliminary planning is already underway and IRS and FinCEN anticipate meeting within the next 60 days to begin developing a comprehensive strategy for BSA data management that takes into consideration the new capabilities of the web-based Currency and Banking Retrieval System (WebCBRS).

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# Appendix VII: GAO Contact and Acknowledgments

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## GAO Contact

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## Acknowledgments

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