

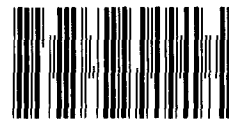
GAO

Report to the Chairman, Permanent
Subcommittee on Investigations,
Committee on Governmental Affairs
United States Senate

August 1986

BANK SECRECY ACT

Financial Institution Regulators' Compliance Examinations



130896

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August 1, 1986

The Honorable William V Roth, Jr
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr Chairman.

This letter is in response to your March 19, 1985, request for GAO to study how regulatory agencies assure compliance with the Currency and Foreign Transactions Reporting Act (also called the Bank Secrecy Act). It updates the preliminary results we provided in testimony before your Subcommittee on October 29, 1985, and provides our final conclusions and recommendations.

Generally, we found that regulatory agencies placed low priority on Bank Secrecy Act requirements during the agencies' examinations of financial institutions. This led to several problems which diminished the regulatory agencies' abilities to assure compliance with the act. We believe these agencies could improve their ability to assure compliance by

- better targeting of institutions to be examined,
- improving model examination procedures for depository institutions,
- consistently applying the model depository institution examination procedures,
- improving Securities and Exchange Commission (SEC) examination procedures, and
- preparing sufficient documentation to support examination performance

We also found that the Internal Revenue Service (IRS), which had good examination procedures and documentation, had difficulty identifying institutions for its examinations.

We are making several recommendations to the Treasury Department and regulatory agency heads to improve the compliance examination process within current resource and priority limits. Some of these are already being considered by the Treasury Department, in consultation with the regulatory agencies. The proposed improvements are similar to points we made in our October testimony. We are still making these recommendations because the proposed improvements have not been

implemented, and we believe they will better assure compliance with Bank Secrecy Act requirements.

Background

The Bank Secrecy Act and its implementing regulations require various financial institutions—banks, credit unions, savings and loans, securities brokers, and others—to report each currency transaction of more than \$10,000. The act is a key tool in the investigation and prosecution of drug traffickers and other criminals who depend on cash and its free movement.

The Department of the Treasury is responsible for assuring that financial institutions comply with the act's requirements. Treasury has delegated this authority to the five depository institution regulatory agencies—the Federal Reserve System (FRS), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Home Loan Bank Board (Bank Board), and the National Credit Union Administration (NCUA)—and to IRS and SEC. The first five agencies are members of the Federal Financial Institutions' Examination Council (Council), which was created in 1979 to coordinate their regulatory policies.

The Bank Secrecy Act requires financial institutions to maintain records of all currency transactions of more than \$10,000 and international transportation of currency and/or monetary instruments over \$10,000. This information must be reported to IRS and the U.S. Customs Service, respectively. The regulatory agencies periodically examine these records to determine if required reports are being made and if financial institutions have operating procedures and controls to assure that such transactions are properly recognized and reported.

Objectives, Scope, and Methodology

As you requested, we evaluated the seven regulatory agencies' efforts to assure Bank Secrecy Act compliance. We discussed examination procedures with top level regulatory agency officials and field examiners and officials of the National Association of Securities Dealers (NASD) and the New York and American Stock Exchanges. In addition, we reviewed a random sample of 1,485 of the 5,302 examinations conducted in calendar year 1984 by the seven agencies. We concentrated on 1984 because it was just before the revelations of currency transaction reporting violations at several banks which led to your Subcommittee's Bank Secrecy hearings and to increased attention to the reporting

problem. We limited our study to institutions in eight states that regulators agree have a high potential for money-laundering. We discuss our sampling methodology in detail in appendix III. Also, as you requested, we reviewed the training and experience of the examiners who perform Bank Secrecy Act examinations. As agreed, we assessed neither the quality of that training and experience nor the causal relationships between them and the effectiveness of an examination. Our results are included in appendix II.

We conducted this review in accordance with generally accepted government auditing standards. Our work was performed between March 1985 and February 1986.

Regulators Give Low Priority to Bank Secrecy Act Compliance Examinations

Regulatory agency officials told us they see the primary role of their agencies to be the preservers of the safety, soundness, and integrity of the financial system. Because their examination resources are limited, they have given Bank Secrecy Act examinations a low priority. They have also stated this position in congressional testimony and policy directives. The five depository institutions' regulators give greatest attention to monitoring for safety and soundness, especially given the increase in the number of problem banks and savings institutions. SEC's primary mission is to maintain the integrity of the financial marketplace and to protect the financial interests of investors in these markets. IRS' primary objective is enforcing compliance with the tax laws. Along with these primary objectives, the regulatory agencies perform other types of compliance examinations at their constituent institutions, with Bank Secrecy Act compliance being but one of several.

Better Targeting of Examinations Needed

According to regulatory agency officials, Bank Secrecy Act monitoring could be improved if targeting information (such as intelligence and transaction data) and appropriate cash flow information were made available to them. Access to this type of data would enable regulators to direct their Bank Secrecy examinations at institutions with a high potential for violating the act.

FRS has current, nationwide data regarding depository institutions' cash transactions and flow. FRS regards this information as being highly sensitive because its unauthorized use could affect the Nation's economic stability. However, it would be useful to the Treasury Department in targeting geographic areas and institutions where the potential for Bank Secrecy violations is high. Accordingly, while we don't suggest routine

release of such information to the regulators, we do believe that FRS should provide this information for targeting purposes on an exception basis—for example, when it detects significant changes in cash flow patterns.

In our 1981 report on the Bank Secrecy Act,¹ we recommended that the regulators comprehensively examine, using the Council's procedures, a geographically dispersed, random sample of institutions scheduled for examinations. This approach is similar to IRS' tax audit compliance approach, whereby the potential for being examined induces voluntary compliance by institutions. We believe that in addition to better targeting, random examinations could enhance monitoring and enforcing of compliance, because institutions would be induced to comply and regulators could use this approach to better focus their limited examination resources.

Although bank regulators objected to the random approach in 1981, revised guidelines now being considered by an interagency working group (see p. 9) identify it as an alternative to performing comprehensive examinations at all institutions.

Model Examination Procedures Could Be Strengthened for Depository Institutions

In 1981, the Council, in cooperation with the Treasury Department, developed model procedures for depository institutions to use in Bank Secrecy Act examinations.

The Council's procedures involve a series of worksteps which the Council has divided into two modules:

- The objective of the worksteps in Module I is limited in scope and is designed to ascertain if a financial institution has adequate operating standards and internal audit procedures.
- The objective of the worksteps in Module II is to perform expanded, more detailed procedures that, for example, test specific teller transactions involving the deposit and withdrawal of cash.

Module II is used only if the examiner deems it necessary. However, if Module II is not used, the examiner is required to prepare a Module I summary explaining why.

¹Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need For Amendment (GAO/GGD-81-80, July 23, 1981)

These procedures could be improved in two areas. First, under the current procedures, an examiner is required to determine if Currency Transaction Reports and Reports of International Transportation of Currency or Monetary Instruments are properly completed and filed with IRS or the U.S. Customs Service, respectively, within 15 days of the former transaction and 30 days from receipt of the latter. The examiner is to accomplish this by reviewing the institution's copies of the completed forms. However, the examiner is not assured that these reports were, in fact, filed by the institution and received by the IRS or Customs, because no procedure requires the examiner to verify their filing at those agencies

Secondly, the procedures include reviews of teller transactions, but there is no requirement to review transactions which occur at such facilities as cash control centers and foreign exchange units. As a recently publicized Bank Secrecy related case demonstrated, not all reportable transactions occur through a teller's window. In this case, many of the unreported transactions were related to cash transfers received from foreign banks. In May 1985, the Federal Reserve Bank of New York informed its examiners that Bank Secrecy Act procedures should include an analysis of currency flows at all currency-handling facilities to ensure coverage of all reportable transactions.

Model Depository Institutions' Examination Procedures Need to Be Consistently Applied

Three depository institution regulators (FRS, OCC, and FDIC) apply the Council's model examination procedures inconsistently. NCUA does not use the Council's detailed procedures, and the Bank Board leaves the use of Bank Secrecy Act procedures to the examiners' discretion

During 1984, the period we reviewed, FRS, OCC, and FDIC officials required their examiners to use the Council's model procedures. At four of the six FRS locations² we visited, we found sufficient evidence to show that basic Module I procedures had been consistently performed (app. I, table I.8). However, at the other two FRS and all FDIC and OCC locations we visited, we found little such evidence.

With regard to Module I procedures, 12 of the FRS, OCC, and FDIC locations did not check currency shipments for the required 6-month period preceding the examination, while 6 other locations did. Further, at 2 locations, we found that examiners reviewed banks' standard operating procedures, while at 16 locations we found no such evidence. As another

²For clarity, the agencies' district or regional offices are referred to as locations

example, we found that only 59 of the 702 examination reports we reviewed at these 3 agencies contained the required written summaries explaining why Module II procedures were not performed. Tables I.1 through I.6 in appendix I show different categories of examination worksteps by agency and variances in the extent to which examiners performed the steps. The variances show how inconsistently the worksteps were applied.

As an indicator of the extent to which Module II procedures were used, we examined the requirement to test-check teller transactions for a minimum of 5 days. This teller transaction testing is a procedural requirement to verify that all transactions over \$10,000 have been reported. Except for four locations (underlined in app. I, table I.7), the evidence indicates this test was rarely performed. In our opinion, transaction testing is needed to verify the adequacy of an institution's internal control processes. Unless testing is routinely performed, the strength of the internal control process is unknown.

The Bank Board adopted the Council's model procedures but suspended the mandatory use of all examination procedures in 1982. Although the Bank Board advised its offices to consider the Council's procedures as the model to use if they performed Bank Secrecy Act examinations, it permitted its examiners to use them at their discretion. At the Bank Board, our review of the examination reports revealed little evidence that examiners performed Module I procedures. As appendix I, table I.4 shows, only 5 percent of the worksteps performed were fully supported, and only 4 percent showed some evidence of performance, with no support for that performance.

Also, as table I.5, appendix I shows, there was evidence that NCUA examiners performed relatively few Module I procedures (4 of 5,160 worksteps). In February 1981, the agency adopted procedures which were similar in concept to the Council's. However, in October 1982, in order to increase its safety and soundness examinations of credit unions, NCUA adopted a scaled-down version of the procedures that permitted examiners to vary the scope of examinations according to the financial condition of the credit union being examined. NCUA's examiners were not specifically required to address Bank Secrecy matters.

According to NCUA officials, many credit union customers make deposits through payroll deductions. The Council's procedures were designed to test for large cash transactions and as a result, NCUA does not believe they were appropriate for credit union examinations. However, we

believe the basic procedural worksteps are appropriate for any depository institution because they assess the adequacy of the institutions' own internal controls over compliance. Moreover, even though credit unions process relatively few incoming cash transactions, we believe the Module II procedures should be used to test (for example) whether credit union employees could be depositing large amounts of cash. Our belief is bolstered by the results of an internal NCUA study performed in mid-1985, which disclosed that a number of credit unions were found to have violated Bank Secrecy Act requirements. At one institution, an official was being investigated for illegal drug-trafficking and possible money-laundering.

SEC Procedures Need More Detail

SEC examiners' procedures consist of a six-point checklist. Typically, the SEC examination checklists were filled in, but in all instances, as shown below, we found insufficient documentation to indicate an examination's scope. We and the Treasury Department official who was responsible for Bank Secrecy oversight believe SEC's checklist lacks sufficient detail when compared to other examination procedures and thus could result in inconsistent and inadequate examinations.

We reviewed 183 Bank Secrecy examinations performed by SEC examiners in 1984. Because of a lack of specific procedures and supporting workpapers, we were unable to assess either the extent of the examinations or the examiners' performance. In order to adequately assess Bank Secrecy compliance by securities institutions, SEC should use an objective standard to ensure that its examiners adequately perform appropriate Bank Secrecy procedures. A specific set of procedural worksteps provides an objective standard for examination officials to use to determine the extent of examiners' performance. SEC's current six-point checklist leaves specific Bank Secrecy examination worksteps up to the examiners, and assessing performance is a subjective judgment by the examiners' supervisors.

SEC has pointed out that many of the broker dealers it examines do not routinely handle cash, so this portion of the examination is not applicable to them. However, we believe more detailed procedures are necessary for those 700 or so institutions where cash transactions are routinely processed.

Better Documentation Needed to Support Performance of Procedures

In many of the examinations we reviewed, we could not determine to what extent Bank Secrecy procedures were performed because examiners did not prepare comprehensive supporting workpapers. Although there were check marks, tick marks, or short narrative statements in the examination reports signifying that the Bank Secrecy Act procedures were addressed, we found no complete workpapers to support the extent of work performed. For instance, of the 30 depository institution regulators' locations we visited, only 4 FRS locations³ had sufficiently documented the use of Module I Bank Secrecy Act procedures according to our evaluation (see app.III, table III.4). Also, of the 183 SEC examinations we reviewed, 163 had insufficient workpapers to support procedural performance. All of the 48 IRS examinations we reviewed had complete workpapers.

Without this documentation, any evaluation of the work done by examiners is hindered; thus performance and, ultimately, accountability cannot be established. We have published a guide entitled Standards For Audit Of Governmental Organizations, Programs, Activities And Functions, which requires, among other things, that a written record of the auditor's work shall be retained in the form of workpapers. Workpapers are the link between the examination work done and the report, and they should contain the evidence to support the findings, judgments, and conclusions in the report. As a general guideline, workpapers should be complete and accurate, understandable, legible and neat, and relevant to the objectives of the assignment. We believe this guide, with respect to workpapers, is applicable to examinations.

IRS' Potential Examination Targets Are Hard to Identify

IRS has detailed review procedures and documented support for its examinations. However, according to IRS officials they have difficulty identifying those financial institutions they should review for compliance with the act.

IRS cannot always easily identify the institutions under its jurisdiction because they are a diverse group defined in the Bank Secrecy Act and the Treasury Department's implementing regulations. The regulations delegate responsibility for specific types of organizations to the depository and securities regulators. The IRS, however, is responsible for all those organizations remaining, a group of financial institutions not always easily identified. Even once the types of institutions are identified, IRS has difficulty discovering all the specific financial institutions

³Massachusetts/Rhode Island, Illinois, New York/New Jersey, and California

or businesses it should monitor in a given geographical area. IRS compiles listings of the businesses subject to its examinations (pawn shops, currency exchange dealers, etc.) by having IRS agents research the yellow pages of telephone directories

Recent Actions by Agencies to Improve Compliance

The Treasury Department is sponsoring efforts to improve compliance with the Bank Secrecy Act. Treasury officials organized an interagency working group to modify and develop new Bank Secrecy examination procedures. The group includes representatives from FRS, FDIC, OCC, FILBB, NCUA, SEC, and IRS.

In December 1985, the interagency group met to discuss various recommendations to improve Bank Secrecy compliance examinations. Although formal approval is pending, the proposed recommendations are

- to broaden the Module II procedures to review a greater number of cash transactions and those at currency handling facilities other than tellers,
- to develop improved examination guidelines,
- to include procedures to review exempt lists,⁴ and
- to include independent verification of institutions' copies of currency transaction reports.

In addition, the group will recommend an expanded set of procedures to be performed at all financial institutions. The FRS recommended that both Module I and Module II procedures be performed universally, but as an alternative the group suggested "periodic random or scientific sample selections" of institutions to receive Module II procedures. Also, the group believed that Module II should be applied to those institutions designated as having potential for noncompliance.

One purpose of the working group is to develop better communication and coordination in order to share information that could be used for targeting purposes

Some of the regulatory agencies have made a variety of changes to improve their Bank Secrecy Act operations. For example, the Bank Board now requires its examiners to randomly sample cash deposits,

⁴Treasury regulations allow financial institutions to exempt legitimate, high cash-volume customers from the Bank Secrecy reporting requirements. The IRS is required to assess the eligibility of these customers for exemption.

and it requires its constituent institutions to maintain a system of internal controls, which are periodically tested by the institutions' internal auditors.

IRS is attempting to improve its process of identifying secondary financial institutions. IRS plans to examine thrifts, private banks, and credit unions which are not examined by federal regulatory agencies. Also, during its examinations of identified financial institutions, IRS' examiners will scrutinize filed exempt lists and currency transaction reports to identify additional institutions for Bank Secrecy examinations. In order to support IRS' capability in this regard, the Treasury Department increased IRS' authority to perform Bank Secrecy examinations of financial institutions. Under Treasury Order 105-13 (dated September 6, 1985), IRS is delegated the following

- (1) Authority to initiate investigations of banks and brokers or dealers in securities for possible criminal violations of the Bank Secrecy Act.
- (2) Authority to grant exemptions from the Bank Secrecy Act requirements.
- (3) Authority to issue requests for lists of financial institution customers whose currency transactions have been exempted from the reporting requirement.
- (4) Authority to direct banks to file currency transaction reports with respect to customers whose transactions had been previously exempted.
- (5) Responsibility to assure compliance by all banks not currently examined by federal bank supervisory agencies for safety and soundness.

Conclusions

Assuring compliance with the Bank Secrecy Act is a priority for financial institution regulators. However, they use their limited resources to pursue their primary missions, such as assuring the safety and soundness of financial institutions. Nevertheless, the resources that regulators do devote to Bank Secrecy Act violations could be better used by

- targeting examinations to institutions with a high potential for problems by developing and sharing information, such as cash flows, among the responsible agencies;

- using random sampling procedures to help enhance voluntary compliance; and
- improving existing examination procedures and including more testing of currency transactions.

The new initiatives being considered by the Treasury Department and the regulatory agencies which include some of these ideas should be implemented.

Recommendations

We recommend that the Secretary of the Treasury

- initiate a program to compile and analyze targeting information, including cash flow data on an exception basis from FRS, and share the results with the regulatory agencies, and
- develop with the regulatory agencies an improved set of examination procedures, including tailored examinations for broker-dealers and credit unions, verification that reports are being filed, and review of cash transactions at all currency-handling facilities examined.

We also recommend that the Chairman of the Board of Governors of FRS, the Chairman of FDIC, the Comptroller of the Currency, the Chairman of FHLBB, the Chairman of the Board of NCUA, the Chairman of SEC, and the Commissioner of IRS

- institute policies to comprehensively examine constituent institutions on a random basis; and
- direct field examiners to fully document the examinations performed, using our Standards For Audit Of Governmental Organizations, Programs, Activities And Functions as a guide.

Agency Comments

We obtained comments from the Treasury Department; the Internal Revenue Service; the three federal bank regulatory agencies—the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of The Currency—the Federal Home Loan Bank Board, and the National Credit Union Administration. The full texts of these comments appear in appendices IV through X. Although we requested written comments from the Securities and Exchange Commission, we had not received them at the time this report was printed.

The Treasury Department generally agreed with our report and cited actions that have been taken which are consistent with our recommendations. Because of the technical nature and length of the Treasury Department's enclosure, it was not reprinted in the report. However, the enclosure is available upon request to this office.

FRS' response is generally consistent with our recommendations. However, FRS stated that in light of current limitations on reporting cash and currency flow data, it would prefer to have its own examiners examine constituent banks more comprehensively during compliance examinations, rather than using a random sampling approach. While comprehensively examining all banks is theoretically preferable, we believe a sampling approach is an appropriate alternative, and it should be considered in light of the scarcity of examination resources.

FDIC agreed that better targeting information would be useful, and it pointed out that it has recently taken various measures which it believes will respond to the recommendations in the report. OCC concurs with our recommendations and is implementing numerous changes to improve compliance. Also, OCC made suggestions for technical improvements, which have been incorporated throughout the report. NCUA stated that the report is accurate and that it is taking action to improve compliance. IRS generally agreed with the report.

FHLBB concluded that the report is essentially accurate but made suggestions for technical improvements, many of which have been incorporated throughout the report. FHLBB stated that the report would provide a more complete picture if it were to explain the extreme limitations on staff resources that were faced during the period reviewed.

We agree that FHLBB, along with the other agencies we reviewed, experienced staff limitations which affected its examination capabilities. We did not attempt to evaluate the specific extent to which each agency was affected by limited examination resources. FHLBB states that it has increased its examination staff. However, as we point out in this report, the agencies prioritize their examinations on the basis of mission objectives. In that context, we recommend that FHLBB examine for Bank Secrecy Act compliance using a targeted approach where there is reason to believe violations have occurred, and it should comprehensively examine institutions on a random basis to help alleviate this resource problem.

FILBB stated that the report does not address the distinction between regularly scheduled and special limited examinations. By including special limited examinations in our evaluation, FILBB believed that the report would inaccurately portray compliance efforts because these types of examinations would not be expected to cover the Bank Secrecy Act.

We evaluated only those files in which the agencies agreed that Bank Secrecy Act examinations were expected to have been performed—regularly scheduled examinations in FILBB's case.

As arranged with your office, unless you publicly announce its contents earlier, we will make no further distribution until 30 days from the date of this report. At that time, copies of this report will be provided to the Treasury Department, FRS, FDIC, OCC, FILBB, NCUA, SEC, IRS, and the Examination Council.

Sincerely yours,



William J. Anderson
Director

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Abbreviations

FDIC	Federal Deposit Insurance Corporation
FHLBB	Federal Home Loan Bank Board
FRS	Federal Reserve System
GAO	General Accounting Office
IRS	Internal Revenue Service
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
SEC	Securities and Exchange Commission

Summary Tables Describing Examiner Performance by Depository Institution Regulatory Agencies

The tables in this appendix describe the results of our analyses to determine to what extent examiners for the five depository institution regulatory agencies had performed the Module I (Tables I.1 through I.6) Bank Secrecy procedures and the primary worksteps in Module II—testing teller transactions (Table 7).

Module I contains 20 worksteps which are summarized in 8 categories of examination procedures as follows.

Checklist	Require a financial institution official to complete a checklist questionnaire that is designed to ascertain compliance with the act.
SOPs	Determine whether the institution has established standard operating procedures (SOPs) to ensure compliance with Bank Secrecy reporting and recordkeeping requirements.
Exempt Lists	Review the exempt lists to determine if the exemptions appear reasonable, required information has been obtained, and, in granting the exemption, if the institution adhered to its established policies
IRS/Customs Forms	Review submitted reports (forms 4789 and 4790) to determine if they were properly completed and filed
Employee Education	Ascertain if an employee education program has been established and interview personnel to determine if they are sufficiently aware of the regulations and procedures to assure compliance.
Internal Audit	Test the institution's audit procedures and determine if the audit function covers the reporting, recordkeeping, exemptions, and foreign accounts sections of the regulations.
Prior Report	Review the results of the prior examination report and follow up on deficiencies

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Currency Level

Review cash shipped to and/or received from the Federal Reserve Bank or correspondent banks for the last 6 months.

We evaluated examiner performance of the 20 worksteps in each examination file and summarized the results for the 8 categories. (See tables I.1 - I.5.) We also evaluated the examiners' performance of the written summary required if Module II is not performed. (See table I.6.)

To facilitate our analysis of the 20 worksteps, we classified the examiners' levels of performance into the following 7 categories and employed them in tables I.1 through I.5.

- 1) Yes, this workstep was addressed (narrative statement, check marks), and workpapers fully support extent of performance (audit trail, schedules, analysis, interviews).
- 2) Yes, this workstep was addressed (narrative statements, check marks), and some support exists in workpapers regarding extent of performance (exempt lists, forms 4789 and 4790, but no support of analysis, review, interviews, etc.).
- 3) Yes, this workstep was addressed (narrative statement, check marks), but there is no support in workpapers to show extent of performance
- 4) No evidence in workpapers or report that this workstep was performed.
- 5) Not performed; workpapers or report document this fact.
- 6) Not applicable
- 7) Other. (E g., the agency could not provide the examination we selected for review)

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Table I.1: Summary of Performance of Module I Examination Procedure Worksteps^a—Federal Reserve System

Worksteps		Yes performed fully supported		Yes performed some support		Yes performed no support		No evidence performed		Not performed		Not applicable		Other		Total	
		#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Checklist	(1) ^b	155	83	0	0	0	0	22	12	2	1	0	0	8	4	187	100
SOPs	(2)	35	9	11	3	239	64	72	19	1	0	6	2	10	3	374	100
Exempt lists	(3)	66	12	34	6	86	15	83	15	0	0	279	50	13	2	561	100
IRS/ Customs forms																	
4789	(2)	47	13	14	4	166	44	37	10	2	1	98	26	10	3	374	100
4790	(2)	0	0	0	0	116	31	98	26	0	0	150	40	10	3	374	100
Employee education	(4)	30	4	32	4	261	35	361	48	1	0	43	6	20	3	748	100
Internal audit	(4)	48	6	27	4	177	24	62	8	5	1	425	57	4	1	748	100
Prior report	(1)	12	6	3	2	19	10	11	6	1	1	136	73	5	3	187	100
Currency level	(1)	0	0	8	4	49	26	62	33	41	22	22	12	5	3	187	100
Total and percent of total worksteps (20)		393	11	129	3	1,113	30	808	22	53	1	1,159	31	85	3	3,740	100

^aCovers 20 worksteps in 187 examinations reviewed at the 6 locations visited

^bNumber of worksteps per category

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Table I.2: Summary of Performance of Module I Examination Procedure Worksteps^a—Office of Comptroller of Currency

Worksteps		Yes performed fully supported		Yes performed some support		Yes performed no support		No evidence performed		Not performed		Not applicable		Other		Total	
		#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Checklist	(1) ^b	185	71	0	0	0	0	71	27	5	2	0	0	0	4	261	100
SOPs	(2)	20	4	24	5	241	46	229	44	6	1	0	0	2	3	522	100
Exempt lists	(3)	52	7	69	9	214	27	223	28	6	1	216	216	216	2	783	100
IRS/ Customs forms																	
4789	(2)	36	7	27	5	186	36	194	37	10	2	67	13	2	0	522	100
4790	(2)	4	1	12	2	84	16	188	36	8	2	226	43	0	0	522	100
Employee education	(4)	22	2	26	2	215	21	759	73	18	2	0	0	4	0	1,044	100
Internal audit	(4)	16	1	35	3	361	35	249	24	8	1	371	36	4	0	1,044	100
Prior report	(1)	11	4	0	0	19	7	10	4	0	0	221	85	0	0	261	100
Currency level	(1)	4	2	4	2	77	30	139	53	27	10	4	2	6	2	261	100
Total and percent of total worksteps (20)		350	7	197	4	1,397	27	2,062	39	88	2	1,105	21	21	0	5,220	100

^aCovers 20 worksteps in 261 examinations reviewed at the 6 locations visited

^bNumber of worksteps per category

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Table I.3: Summary of Performance of Module I Examination Procedure Worksteps^a—Federal Deposit Insurance Corporation

Worksteps		Yes performed fully supported		Yes performed some support		Yes performed no support		No evidence performed		Not performed		Not applicable		Other		Total	
		#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Checklist	(1) ^b	236	93	0	0	0	0	16	6	0	0	0	0	2	1	254	100
SOPs	(2)	7	1	40	8	83	16	378	74	0	0	0	0	0	0	508	100
Exempt lists	(3)	47	6	72	9	99	13	309	41	0	0	235	31	0	0	762	100
IRS/Customs forms																	
4789	(2)	31	6	34	7	131	26	293	58	0	0	19	4	0	0	508	100
4790	(2)	0	0	0	0	16	3	248	49	0	0	244	48	0	0	508	100
Employee education	(4)	8	1	43	4	155	15	810	80	0	0	0	0	0	0	1,016	100
Internal audit	(4)	10	1	17	2	23	2	832	82	0	0	134	13	0	0	1,016	100
Prior report	(1)	13	5	7	3	30	12	39	15	0	0	164	65	1	0	254	100
Currency level	(1)	8	3	6	3	11	4	224	88	2	1	1	0	2	1	254	100
Total and percent of total worksteps (20)		360	7	219	4	548	11	3,149	62	2	0	797	16	5	0	5,080	100

^aCovers 20 worksteps in 254 examinations reviewed at the 6 locations visited

^bNumber of worksteps per category

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Table I.4: Summary of Performance of Module I Examination Procedure Worksteps^a—Federal Home Loan Bank Board

Worksteps		Yes performed fully supported		Yes performed some support		Yes performed no support		No evidence performed		Not performed		Not applicable		Other		Total	
		#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Checklist	(1) ^b	206	82	0	0	0	0	35	14	3	1	0	0	8	3	252	100
SOPs	(2)	6	1	10	2	26	5	442	88	8	2	0	0	12	1	504	100
Exempt lists	(3)	1	0	0	0	22	3	287	38	12	2	416	55	18	2	756	100
IRS/ Customs forms																	
4789	(2)	14	3	8	3	81	16	325	64	6	1	58	12	12	2	504	100
4790	(2)	0	0	0	0	10	2	204	40	6	1	272	54	12	2	504	100
Employee education	(4)	1	0	0	0	33	3	933	93	16	2	1	0	24	2	1008	100
Internal audit	(4)	0	0	0	0	30	3	839	83	24	2	91	9	24	2	1008	100
Prior report	(1)	2	1	0	0	8	3	3	1	0	0	229	91	10	4	252	100
Currency level	(1)	0	0	0	0	0	0	241	96	3	1	2	1	6	2	252	100
Total and percent of total worksteps (20)		230	5	18	0	210	4	3,309	66	78	2	1069	21	126	2	5,040	100

^aCovers 20 worksteps in 252 examinations reviewed at the 6 locations visited

^bNumber of worksteps per category

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

Table I.5: Summary of Performance of Module I Examination Procedure Worksteps^a—National Credit Union Administration

Worksteps		Yes performed fully supported		Yes performed some support		Yes performed no support		No evidence performed		Not performed		Not applicable		Other		Total	
		#	%	#	%	#	%	#	%	#	%	#	%	#	%	#	%
Checklist	(1) ^b	0	0	0	0	0	0	0	0	0	0	300	100	0	0	300	100
SOPs	(2)	0	0	0	0	0	0	600	100	0	0	0	0	0	0	600	100
Exempt lists	(3)	0	0	0	0	0	0	900	100	0	0	0	0	0	0	900	100
IRS/ Customs forms																	
4789	(2)	0	0	2	0	1	0	595	100	0	0	2	0	0	0	600	100
4790	(2)	0	0	0	0	0	0	596	99	0	0	4	1	0	0	600	100
Employee education	(4)	0	0	0	0	0	0	1200	100	0	0	0	0	0	0	1200	100
Internal audit	(4)	0	0	0	0	1	0	966	81	0	0	233	19	0	0	1200	100
Prior report	(1)	0	0	0	0	0	0	0	0	0	0	300	100	0	0	300	100
Currency level	(1)	0	0	0	0	0	0	299	100	0	0	1	0	0	0	300	100
Total and percent of total worksteps (20)		0	0	2	0	2	0	5,156	86	0	0	840	14	0	0	6,000	100

^aCovers 20 worksteps in 300 examinations reviewed at the 6 locations visited

^bNumber of worksteps per category

Table I.6: Number of Cases Where Examiners Prepared Written Summaries at the End of the Module I Examination Procedures

Locations	OCC	FDIC	FRS	FHLBB	NCUA
MA/RI	2	2	1	0	0
Illinois	0	0	11	0	0
NY/NJ	2	3	1	0	0
Florida	0	0	0	1	1
California	25	1	1	0	0
Texas	8	0	2	0	0
Total	37	6	16	1	1
Number of agency cases reviewed	261	254	187	252	300
Percent of agency cases	14	2	8	004	003

**Appendix I
Summary Tables Describing Examiner
Performance by Depository Institution
Regulatory Agencies**

**Table I.7 Number and Percent of Total
Examinations in Which 5 Days of Teller
Transactions Were Reviewed**

Locations	OCC		FDIC		FRS		FHLBB		NCUA	
	#	%	#	%	#	%	#	%	#	%
MA/RI	0	0	0	0	0	0	0	0	0	0
Illinois	0	0	0	0	0	0	0	0	0	0
NY/NJ	0	0	2	4	21	55	0	0	0	0
Florida	4	11	4	14	24	48	0	0	0	0
California	2	4	14	32	8	38	0	0	0	0
Texas	4	8	1	2	5	10	0	0	0	0
Total	10	4%	21	8%	58	32%	0	0	0	0

**Table I.8 Number of Locations Where
Evidence Showed Module I Procedures
Sufficiently Performed**

Locations	OCC	FDIC	FRS	FHLBB	NCUA
MA/RI	.	.	x	.	.
Illinois	.	.	x	.	.
NY/NJ	.	.	x	.	.
Florida
California	.	.	x	.	.
Texas
Total	0	0	4	0	0

Description of Training and Experience in Federal Agencies Responsible for Bank Secrecy Act Compliance

Training

The majority (110 out of 195) of examiners we interviewed told us that they received their Bank Secrecy Act compliance training through self-study, informal lectures, and on-the-job training. Agency officials said that formal classroom training on this topic is very limited. Furthermore, the examiners told us that by virtue of their education and experience, they are adequately prepared to perform Bank Secrecy Act compliance examinations.

At the time of our review the seven agencies differed in the degree of formal Bank Secrecy Act training given to their examiners. For example:

- Neither NCUA nor SEC offered formal Bank Secrecy training
- The Bank Board offered one classroom course which very briefly addressed (about 10 minutes) Bank Secrecy.
- OCC offered two courses that briefly addressed Bank Secrecy issues
- FRS offered one course for new examiners which devoted 1 hour to Bank Secrecy and an advanced course which briefly described this subject.
- FDIC devoted 1 hour to Bank Secrecy in a course for more senior examiners.
- IRS offered 2 hours of formal classroom training for excise tax examiners.

In order to supplement the formal training, OCC used training teams that provided lectures covering Bank Secrecy issues. For its more experienced examiners, FRS offered continuing education programs which addressed the Bank Secrecy Act. The other agencies provided Bank Secrecy Act seminars and on-the-job training.

We were unable to evaluate SEC's Bank Secrecy training. Two SEC officials told us that training for new examiners is provided by NASD. However, NASD officials told us they rarely provide Bank Secrecy training to SEC's examiners, and when they do, it is on an ad hoc basis. One NASD official estimated that in a typical year, two or three SEC examiners participate in NASD classes.

Experience

The experience of examiners performing Bank Secrecy examinations varied widely. Some agencies delegated this part of an examination to junior examiners, because it is generally considered one of the less difficult examination segments. Other agencies made no distinction on the basis of experience and assigned that segment to the examiner who could most easily complete the work. When possible, FDIC typically had its senior examiners complete the Bank Secrecy examinations. FDIC's

**Appendix II
Description of Training and Experience in
Federal Agencies Responsible for Bank
Secrecy Act Compliance**

examinations for compliance with laws and regulations were normally performed by a special core of examiners who had successfully completed the agency's Consumer Protection School.

Statistical Sampling Methodology

The original objective of this portion of the review was to determine, for each of the seven regulatory agencies, at each of six locations (encompassing eight states), the extent to which they had and applied Bank Secrecy Act examination procedures in calendar year 1984. After we began our review it became clear that we would have to conduct our review of SEC and IRS differently because they are not members of the Council and have unique examination requirements. Our treatment of these two agencies' examinations follows our discussion of the other five agencies.

We found it impractical to review all examinations for each depository institution regulator's agency/location combination; therefore, we decided to review a simple random sample of examination reports for each of these 30 combinations (five agencies at six locations). Initially, we decided to review a simple random sample of size 50 from each of the 30 combinations. This allowed us to limit our sample size (for time and resource purposes) and still have a representative sample from each location. When a universe size was less than 50, we reviewed all available examination reports. The universes and sample size for each combination are shown in table III.1.

Table III.1: Universes and Sample Sizes for Five Agencies

Location	FRS	OCC	FDIC	FHLBB	NCUA	Total
Mass/R.I.						
Universe	5	24	31	6	190	256
Sample	3	24	31	6	50	114
NY/NJ						
Universe	38	86	56	135	975	1290
Sample	38	50	50	50	50	238
Illinois						
Universe	26	112	220	159	181	698
Sample	26	50	50	50	50	226
Florida						
Universe	74	37	29	46	206	392
Sample	50	37	29	46	50	212
Texas						
Universe	49	455	217	117	466	1304
Sample	49	50	50	50	50	249
California						
Universe	21	63	44	107	524	759
Sample	21	50	44	50	50	215
Total						
Universe	213	757	597	570	2542	4699
Sample	187	261	254	252	300	1254

We followed the same procedure for the SEC examinations in our sample. In this area, the SEC examiners perform two types of examinations—

cause and oversight. We eliminated the cause examinations from our sample universe, because they are initiated for specific reasons, which generally do not include Bank Secrecy Act compliance. Within this limitation, none of the universe sizes exceeded 50 examinations; therefore, we selected all available examinations. The universe sizes for examinations in each of the six locations are shown in table III.2.

Table III.2: SEC Examination Sample

SEC Examination Sample		
Location	Universe	Sample
Mass/R I	18	18
NY/NJ	49	49
Illinois	33	33
Florida	32	32
Texas	16	16
California	35	35
Total	183	183

The IRS used a total of approximately 3 staff years for Bank Secrecy Act examinations in calendar year 1984. Therefore, to minimize our resource investment, we selected examinations in the districts where the highest proportion of those examinations were performed. The highest amount of IRS' resources were used in the four districts as shown in table III.3. We sampled examinations on an ad hoc basis at these locations.

Table III.3 IRS Examination Sample

IRS Examination Sample		
District Location	Universe	Sample
Manhattan, NY	101	10
Brooklyn, NY	32	10
Illinois	269	18
Dallas	18	10
Totals	420	48

In evaluating the examination files, we looked for an indication, such as use of a checklist, that Bank Secrecy Act procedures were applied. We also looked for supporting workpapers describing the nature and extent of the work performed by the examiners. The presence or absence of supporting workpapers in any given examination does not conclusively prove that procedures were or were not applied. However, on the basis of our discussions with the examiners, we believe it reasonable to conclude that variations in the quality of supporting evidence indicate variations in the application of procedures.

Sufficiency of
 Documentation
 Methodology

In order to assess the sufficiency of documentation used to support the performance of Module I procedures by agency/location, we computed a score on the performance of Module I examination procedures for each examination we reviewed. We assigned points to each workstep, on the basis of the level of support used to document the extent of performance. We assigned each workstep 100 points if addressed and fully supported, 66 points if addressed with some support, 33 points if addressed and no support, 0 points if there was no evidence the workstep was performed, and 0 points if documentation was found supporting the non-performance of the workstep. Those worksteps that were classified in the "not applicable" or "other" categories were not included in the computation. The total points for each examination were divided by the applicable number of worksteps to determine a score. We considered 33 points to be the minimum acceptable passing score; i.e., on average, all applicable worksteps were addressed, but no support exists regarding extent of performance. The scores by agency and location are shown in table III.4

Table III.4 Sufficiency of Documentation

Location	Sufficiency of Documentation Scores		
	OCC	FDIC	FRS
Mass/R I	27	12	37
Illinois	21	13	38
NY/NJ	18	13	44
Florida	24	15	23
California	24	32	39
Texas	27	12	30

None of the six OCC locations received a passing score, while only one FDIC location, California, came close to passing. Four of the six FRS locations received passing scores

Advance Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

MAY 12 1986

Dear Mr. Anderson:

Thank you for the opportunity to review and comment on GAO's draft to the Permanent Subcommittee on Investigations entitled "Letter Report on How Well Financial Institution Regulatory Agencies Assure Compliance Under the Bank Secrecy Act."

We agree with your recommendation that a program to compile and analyze targeting information, including cash flow data on an exception basis from the Federal Reserve be initiated and shared with the regulatory agencies. The Customs Service is currently involved in conducting an analysis on the compliance of banks in Texas. The analysis consists of comparing currency flow data of banks who deposit and withdraw currency at the Houston Branch of the Federal Reserve Bank with the currency transaction report filings of those banks. This study, when released to the regulatory agencies, will indicate that a number of banks in the Houston area may be noncompliant. A similar analysis of banks in the New Orleans area targeted about 20 banks which was supplied to the bank regulatory agencies. The Customs Service has plans to conduct a similar analysis for New York and other Federal Reserve Districts.

The kind of targeting analysis being conducted currently by the Customs Service was used for Florida banks in 1980-1981 by Treasury. This resulted in Operation Greenback. In 1983, Treasury conducted an analysis of the Boston Federal Reserve District, concentrating on banks in Massachusetts. In this study, twenty banks were targeted for possible noncompliance.

With regard to your recommendation that we develop, along with the regulatory agencies, an improved set of examination procedures, we have completed a revision of the Title 31 bank examinations procedures. To supplement the procedures, we also developed guidelines for examiners to use uniformly when reviewing currency transaction reports for accuracy and completeness and to instruct banks in the proper method of completing the Form 4789 (Currency Transaction Report). These guidelines (copy enclosed) were supplied to the regulatory agencies on March 11, 1986.

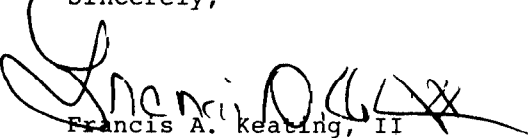
**Appendix IV
Advance Comments From the Department of
the Treasury**

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To further supplement the revised procedures, we are in the process now of developing guidelines for examiners to use when reviewing bank exempt lists. A draft of the guidelines is currently circulating among the bank regulatory agencies for comment. We expect to implement these guidelines on or about May 30, 1986. We also plan to work with the SEC and the IRS to review their examination procedures and to recommend revisions and enhancements where appropriate.

We generally agree with the thrust of the draft report. We hope that our comments will be useful for the preparation of your final report.

Sincerely,


Francis A. Keating, II
Assistant Secretary
(Enforcement)

Mr. William J. Anderson, Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Enclosure

The following are GAO's comments on the Department of the Treasury's letter dated May 12, 1986.

GAO Comments

1. Names of open banks were contained in the letter from the Department of the Treasury. Pursuant to 31 U.S.C. 714(c)(1), which prohibits disclosure in a GAO report of any information identifying specific open banks or bank holding companies, except as otherwise provided, those names were deleted from the letter.

The following are GAO's comments on the Board of Governors of the Federal Reserve System's letter dated May 15, 1986.

GAO Comments

1. We do not propose a random sampling approach for institutions with a high probability of noncompliance. The random sampling approach would randomly select institutions from the universe of all depository and other financial institutions for comprehensive examinations. We believe a sampling approach is a viable alternative to comprehensively examining all constituent institutions, and it should be considered in light of the lack of availability of examination resources

Appendix V
Advance Comments From the Board of
Governors of the Federal Reserve System

Mr. Anderson

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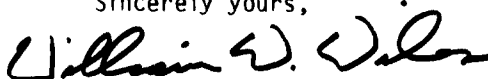
Further, the Federal Reserve is currently developing automated reports in currency flow data for specific depository financial institutions (DFI) that order and deposit directly with Reserve Banks, although it should be noted that these represent only a fraction of the total number of DFIs in the nation. Three Reserve offices are conducting a special pilot program on specific DFI currency shipments in support of the U.S. Customs Service, which in turn provides analyses of the data to other investigative agencies. The Federal Reserve will continue supplying aggregate cash flow information on a geographical basis and, to a lesser degree, some local cash flow information on a DFI basis.

See comment 1

In light of the current limitations on cash and currency flow data, a random sampling approach in targeting examinations of financial institutions which are suspected of having a higher probability of noncompliance with the Bank Secrecy Act's reporting requirements may not be an effective means of detecting violations. We have, however, instructed our examiners to employ more comprehensive examination procedures in all Bank Secrecy Act compliance reviews. We believe the use of more extensive compliance review techniques will remedy the examination deficiencies noted in your report. We will, of course, continue to develop, as part of our work with the interagency working group, an effective methodology for targeting financial institutions for compliance examinations.

In closing, we note that the Federal Reserve recently issued a policy statement to examiners emphasizing the need to properly document all examination work performed in accordance with the existing workpaper requirements detailed in the System's Commercial Bank Manual. We believe these workpaper requirements are thorough and comply with the objectives of the GAO's published guide entitled, Standards for Audit of Governmental Organizations, Programs Activities and Functions. The Board believes the measures taken to strengthen and improve our effectiveness in monitoring financial institutions compliance with the Bank Secrecy Act is fully consistent with the recommendations made by the GAO.

Sincerely yours,



William W. Wiles
Secretary of the Board

**Appendix VI
Advance Comments From the Federal Deposit
Insurance Corporation**

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The FDIC currently uses targeting information received from the U.S. Customs Service in selecting banks for special BSA compliance reviews when such information is available. In a similar vein, the FDIC would use targeting information from the Federal Reserve System on currency flows to the extent that might become available. As a matter of current practice, BSA compliance reviews are included in all regular compliance examinations, selected safety and soundness examinations, some follow-up examiner visitations, and special visitations. The targeting information received to date has identified a relatively small number of suspect banks subject to FDIC examinations. Nevertheless, we strongly support this type of targeting and are encouraging Customs to do more work in this area. We are also exploring the possibility of using random sampling to select banks for BSA compliance reviews although we continue to have some reservations regarding this approach since most BSA violations are not deliberate and our current examination program already contains an element of surprise as to timing.

The model examination procedures in use since 1981 have been reviewed and revised by a working group chaired by a representative of the Department of Treasury. The revised and enhanced procedures recently received Treasury's final approval and are in the process of being distributed to examiners. The new procedures emphasize, among other things, international transactions, wire transfer operations and trust department activities. Examiners are also instructed to review more closely exempt lists, interview bank employees concerning BSA procedures, and look for unusual currency flows.

Although the regulatory agencies have adopted the same model examination procedures, the report notes some inconsistencies among the agencies in their application. Inconsistencies are also reported within the agencies. While it is virtually impossible to eliminate all inconsistencies, the FDIC has increased its examiner training in an effort to correct the problem. Formal BSA training at FDIC's Consumer Protection School has been expanded to two hours, BSA training at the regional level is being expanded and a white collar crime course development group chaired by a representative from FDIC has proposed a two-hour segment on the Bank Secrecy Act and money laundering in a new FFIEC White Collar Crime School.

One reason for some of the inconsistencies in the application of the model examination procedures has been the lack of any definitive guidelines for reviewing CTRs filed by the institutions and for reviewing exempt customer lists. Guidelines covering these two areas have been drafted by the Treasury Department and will be made a part of the revised examination procedures. It is anticipated that specific guidelines covering other areas subject to review during an examination will also be included in future versions of the examination procedures.

The instructions for the revised examination procedures will direct examiners to keep better workpapers. Documentation is being emphasized at BSA training sessions. The possible use of a "work program," with specific documentation requirements to support certain steps in the examination procedures, is also being considered. These actions should help to improve the documentation of the examination procedures and also to achieve more uniformity in the application of the procedures.

Advance Comments From the Federal Deposit Insurance Corporation



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington D C 20429

OFFICE OF DIRECTOR - DIVISION OF BANK SUPERVISION

May 7, 1986

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Your letter of April 8 enclosed for our review and comment copies of your draft letter report to the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, on how the financial institution regulatory agencies are assuring compliance with the Currency and Foreign Transactions Reporting Act (Bank Secrecy Act or BSA). The report discusses primarily how the Treasury Department and the financial institution regulatory agencies implement examinations to assure compliance and contains recommendations to each agency.

The report indicates that the financial institution regulatory agencies, including the FDIC, place a low priority on Bank Secrecy Act examinations, preferring instead to focus their limited resources more on assuring the safety and stability of the banking system, and that current examination policies and procedures need improvement. Suggested improvements include:

- (1) Better targeting of institutions to be examined,
- (2) Improving model examination procedures,
- (3) Consistently applying model examination procedures, and
- (4) Preparing sufficient documentation to support examination performance.

Specific GAO recommendations to the FDIC and the other financial institutions regulatory agencies are:

- (1) To institute policies to comprehensively examine constituent institutions on a random basis, and
- (2) To direct field examiners to fully document the examinations performed, using GAO's "Standards For Audit of Governmental Organizations, Programs, Activities and Functions" as a guide.

Advance Comments From the Comptroller of the Currency

Note GAO comments supplementing those in the report text appear at the end of this appendix



Comptroller of the Currency
Administrator of National Banks

Washington, D C 20219

May 8, 1986

William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Following extensive review of your draft letter report to the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, on how financial institutions regulatory agencies are assuring compliance with the Currency and Foreign Transactions Reporting Act (Bank Secrecy Act), we are pleased to provide this comment letter in response to your request. Our response covers three areas. First, we will comment on your recommendations. Second, we will comment on the factual accuracy of the draft. Third, and most importantly, we will provide a synopsis of the major steps the Office of the Comptroller of the Currency has taken to assure a higher level of national bank compliance with the Bank Secrecy Act (BSA), following the time frame incorporated into the scope of your audit work.

Recommendations

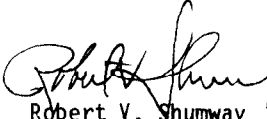
The draft makes recommendations to the Secretary of the Treasury and to the regulatory agencies as a group. You recommend that the Secretary initiate a program to compile and analyze targeting information, including cash flow data on an exception basis from the FRS, and share the results with the regulatory agencies; and develop, with the regulatory agencies, an improved set of examination procedures, including tailored examinations for broker-dealers and credit unions, verification that reports are being filed, and review of cash transactions at all currency-handling facilities examined.

**Appendix VI
Advance Comments From the Federal Deposit
Insurance Corporation**

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We believe the various measures recently taken to revise and enhance current examination procedures and planned future refinements should satisfy the major criticisms presented in the report.

Sincerely,



Robert V. Shumway
Director

Appendix VII
Advance Comments From the Comptroller of
the Currency

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As previously stated, we concur with the use of random sampling and/or targeting techniques to identify banks for BSA compliance examinations.

See comment 1

Documentation in workpapers of financial institution regulatory agencies was found to be less than satisfactory based upon your review of 1984 workpapers. During the past several months, we have directed attention to documenting examinations. For example, the revised examination procedures reiterate the need for examiners to document their work. A recent examining circular also requires examiners to perform certain examination steps and document findings. The Comptroller's Handbook for National Bank Examiners contains guidelines for workpapers and their retention. Our Policies and Procedures Manual establishes guidelines to review examination workpapers on a regular basis. We believe that the standards and procedures already adopted by us incorporate all of the necessary requirements outlined in your standards.

Factual Accuracy

See comment 2

The draft contains inaccurate recitations of the regulations governing BSA compliance.

Reference is made to the \$10,000 reporting requirement as affecting transactions \$10,000 and over. Section 103.22 of the regulation requires reports to be filed on transactions in currency of more than \$10,000.

The section of the draft that discusses improving examination procedures refers to time parameters for filing CTR and Report of International Transportation of Currency or Monetary Instruments (CMIR) forms. The draft states that CTRs and CMIRs are to be filed within 15 days of the transaction. This is true for CTRs; however, CMIRs are to be filed upon entering or departing the United States or within 30 days of receipt of the item(s). The regulation specifies when the different time parameters are invoked.

This section of the draft also implies that copies of CMIRs are available for review. Title 31 is silent on requiring financial institutions to retain copies of CMIRs. For this reason, reviewing CMIRs is not always possible.

Recent Actions

Your draft report references a number of activities that have been going on or are currently underway.

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We agree with the recommendation that Treasury compile and analyze cash flow information for disbursement to the financial institution regulatory agencies. Useful information has been provided by the U.S. Customs Service. In addition, we advocate that cash flow data be provided on a regular basis so that potential noncompliance can be ascertained on an ongoing basis. We also encourage the conduct of periodic nationwide analyses, with intervals between analysis shortened for geographic areas with significant cash flows. We believe that the availability of this information will enable us to target those institutions that should be the subject of more intense examination for compliance with BSA. We also believe that random selection of banks would enhance banks' voluntary compliance with the BSA. We believe that targeting or selecting banks for BSA compliance examinations is an efficient and effective use of our finite resources.

We also see the need to improve existing examination procedures. A Treasury/Financial Institution Regulatory Task Group recently revised the BSA examination procedures. The procedures are being distributed to our examiners and national banks for implementation.

The revised procedures direct users to include all locations where currency may enter or leave a financial institution into a program of compliance management. This is accomplished through review of a financial institution's internal policies and procedures. The bank's failure to adopt appropriate policies and procedures could lead to the use of Module II procedures.

The procedures emphasize the need to ensure that Forms 4789 (CTR) are filed with IRS. To accomplish this, on-line access to the CTR data base is essential. At a recent meeting of the IRS Interagency Task Force, we were informed that examiner access to the CTR data base should soon become a reality at the various Customs field offices located throughout the country. This should significantly improve the ability of the field examiner to obtain this information in a more timely fashion.

To the regulatory agencies, you recommended that they institute policies to comprehensively examine constituent institutions on a random basis and that they direct field examiners to fully document the examinations performed, using your "Standards For Audit Of Governmental Organizations, Programs, Activities And Functions" as a guide.

The following are GAO's comments on the Comptroller of the Currency's letter dated May 8, 1986.

GAO Comments

1. The Comptroller's Handbook for National Bank Examiners contains guidelines for workpapers that meet our standards
2. We revised this report to reflect these observations.

**Appendix VII
Advance Comments From the Comptroller of
the Currency**

- 4 -

Chief among these are the interagency working group to modify examination procedures and recent delegations to the IRS. As already indicated, the revised examination procedures have been completed. Moreover, in testimony before the House Banking Committee on April 17, 1986, Assistant Secretary of the Treasury Keating announced the formation of a permanent interagency working group which will meet on a regular basis to address ongoing concerns. Finally, we believe that the recent delegations to IRS have been a very positive development, as that office seems willing to devote the time, energy and resources to coordinating much of the activity in this area

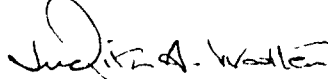
Independently, over the last year, we have focused management control over our BSA program, establishing a central clearinghouse for BSA operations and responsibilities in the Chief National Bank Examiner's office and designating focal points for BSA activities in the districts. We have intensified BSA training of examiners such that over half of our examiners received some BSA training last year. We have made a concerted effort to increase industry awareness of the BSA by participating in meetings to discuss the Act and by helping to develop a training segment for an American Bankers Association teleconference on the subject. And, we have taken an active role in establishing and facilitating interagency task groups on bank-related crime in general and BSA enforcement in particular.

In order to build on the progress that we have made in the BSA area over the past year, we will continue on-going training and efforts to heighten industry awareness. In addition, we will work toward increased interagency coordination and improved utilization of information to target BSA enforcement efforts.

While much has been accomplished since January 1985, more needs to be done. We concur with your recommendations and will do our part in implementing corrective actions. We are committed to our role in ensuring BSA compliance.

Thank you for the opportunity to comment on your draft letter report.

Sincerely,



Judith A. Walter
Senior Deputy Comptroller for National Operations

Advance Comments From the Internal Revenue Service

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

MAY 21 '86

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

We appreciate the opportunity to review your recent draft report entitled "How Well Financial Institution Regulatory Agencies Assure Compliance Under the Bank Secrecy Act."

We generally agree with the thrust of the report. Our comments on the report recommendations directed to the Commissioner (page 16) are listed below:

RECOMMENDATION: Institute policies to comprehensively examine constituent institutions on a random basis.

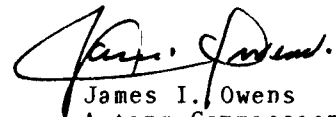
COMMENT: In 1983 IRS began using random sampling methods to select Title 31 compliance targets. Experience has shown that this approach enables more productive utilization of examination resources.

RECOMMENDATION: Direct field examiners to fully document the examinations performed, using our "Standards for Audit of Governmental Organizations, Programs, Activities and Functions" as a guide.

COMMENT: As noted by GAO, IRS already has detailed procedures for documenting and reviewing its examinations. In addition, we are further refining our compliance check procedures and are updating our training for examiners to emphasize the requirements to fully document these checks. We plan to evaluate the effectiveness of the new procedures and training before we consider implementing additional standards as recommended.

We hope these comments are useful in preparing your final report.

Sincerely,



James I. Owens
Acting Commissioner

Department of the Treasury Internal Revenue Service

Advance Comments From the National Credit Union Administration



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

May 7, 1986

Mr. William J. Anderson
Director
United States General Accounting Office
Washington, D.C. 20548


Dear Mr. Anderson:

We have reviewed your draft of the proposed letter report to the Chairman, Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs on the subject of "How Well Financial Institution Regulatory Agencies Assure Compliance Under the Bank Secrecy Act."

We believe that the report accurately reflects the conditions your staff found upon their review of our compliance efforts. We have subsequently taken action to improve our efforts to determine whether or not credit unions we examine are in compliance with the requirements of the Bank Secrecy Act and are in the process of rewriting our examination procedures to incorporate those tasks into our procedures.

If you have any questions concerning this matter you may contact Mrs. Joan Perry on 357-1152 or Mr. D. Michael Riley on 357-1065.

Sincerely,


ROGER W. JEPSEN
Chairman

**Appendix X
Advance Comments From the Federal Home
Loan Bank Board**

- 2 -

underwriting practices, highly inflated appraisals, rapidly falling real estate markets and many indications of gross fraud had the examiners in a backs-to-the-wall battle to protect the FSLIC insurance fund from disaster. We were fighting a raging forest fire with a dribbling garden hose.

2. The first page of Appendix 1 states that Module 1 of the examination procedures requires "a financial institution official to complete a checklist questionnaire that is designed to ascertain compliance with the Act." At the time of GAO's review, in many cases the practice had been for examiners to give the checklist (which at the Bank Board is FHLBB Form 919) to institutions for completion. However, this practice was not sanctioned by the examination procedures. Our procedures have always required that the examiner and not the institution complete the checklists. In 1985, following our discovery that not all examiners were using the correct procedures, the Director of OES issued Alert Bulletin No. 62, that states in part, "Examiners are reminded that in determining institution compliance with the BSA it is their responsibility to (1) personally complete FHLBB Form 919 and to (2) personally verify the representations made by management used in completing the form."
3. On page 3, the report states that GAO reviewed "a random sample...of examinations conducted in calendar year 1984...." GAO did not address the distinction that the Bank Board makes between regularly scheduled and special limited examinations. Regularly scheduled examinations cover all financial and regulatory aspects of an institution, and thus should include a review of the institution's compliance with the Bank Secrecy Act. Special limited examinations, however, are performed as needed in order to examine a specific area or problem at an institution; these examinations would not cover the Bank Secrecy Act and should not be expected to do so, unless a suspected problem with Bank Secrecy Act compliance had triggered the examination.

See comment 2

It is important to be aware of this distinction in evaluating the data that GAO presents. Table 4 in Appendix I reports that in 35 of the 252 examinations that GAO reviewed there was no evidence that the workstep requiring completion of the checklist (FHLBB Form 919) was performed. If these 35 examinations were regularly scheduled examinations, we have no criticism of Table 4. However, if these examinations were special limited examinations, they should be excluded from the table. Therefore, in order for GAO's report to present a fairer and more accurate assessment of the Bank Board's efforts to assure Bank Secrecy Act compliance, we believe that GAO should make clear both on the table and on page 3 the types of examinations that were reviewed and should make any necessary adjustments to Table 4.

Advance Comments From the Federal Home Loan Bank Board

Note GAO comments supplementing those in the report text appear at the end of this appendix

Federal Home Loan Bank Board



1700 G Street N W
Washington D C 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

EDWIN J GRAY
CHAIRMAN

May 14, 1986

The Honorable William J. Anderson
Director
General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Thank you for the opportunity to comment on the draft report evaluating Federal agency efforts to assure compliance with the Currency and Foreign Transactions Reporting Act (also known as the Bank Secrecy Act). We have reviewed that report in our Office of Examinations and Supervision (OES) in Washington and in the six Federal Home Loan Banks whose departments of examinations are covered by the draft report.

Our comments below address: a) the report, b) the recommendations, and c) the Board's recent Bank Secrecy Act activities. Although we make several suggestions for strengthening the draft report, we have concluded that it is essentially accurate.

The Report

1. The report would provide a more complete picture if it were to explain the extreme limitations on staff resources that we faced during the period reviewed. The following comments describe the resource limitations from the perspective of the Federal Home Loan Bank of Dallas; similar situations faced examination staffs in the other Federal Home Loan Banks:

During the period covered by the auditors' review, the examination staff in the Ninth District was so small in size as to be inadequate to cover even half of the necessary examinations. We were forbidden to hire additional examiners because of Federal budget constraints ...We were rapidly losing all of our experienced examiners to much higher paying jobs in the savings and loan industry. This trend was so pronounced that in some areas of the district as much as 85.0 percent of the journeymen and senior level examiners had left the staff in a period of 18 months....We were confronted with asset quality problems of monstrous proportions. There were many associations growing to multi-billion dollar size in periods as short as two years with ultra high risk loans making up 90.0 to 95.0 percent of the portfolio. This coupled with almost nonexistent loan

See comment 1

- 4 -

2. GAO recommends a two-fold approach to improving procedures for selecting institutions for Bank Secrecy Act review: first, that the Treasury Department initiate a program to develop targeting information and share that information with the Board and other regulatory agencies, and second that the Board institute policies to comprehensively examine institutions using a geographically dispersed random sample of institutions scheduled for examination. We would welcome any data the Treasury Department could provide to help us target our examinations. If such data could be made available, it might be possible to combine targeting with random sampling in a way that would be more cost-effective than our current approach, which is to conduct a limited scope review (equivalent to Module 1 of the interagency procedures) of Bank Secrecy Act compliance in every regularly scheduled examination and to conduct expanded scope procedures (equivalent to Module 2) under certain circumstances, i.e., when an institution does not maintain adequate Bank Secrecy Act records, does not have key control procedures in place, does not file the required reports, discloses no transactions subject to the Bank Secrecy Act, exhibits no evidence of the Bank Secrecy Act training of personnel, or exhibits violations of the Bank Secrecy Act that are willful, repetitive or not isolated.

The Board's Activities

We have taken a number of actions to strengthen our examination process in general and with regard to the Bank Secrecy Act in particular, and we are actively in the process of taking a number of other actions that we believe are needed. The following are among these actions and planned actions:

1. As we discussed earlier, the Board has faced severe limitations in staff resources. In 1984, at the time of GAO's review, our examination staff was too small to handle the increased demands imposed by a more complicated thrift environment under deregulation and by the need to review and enforce a multitude of statutory and regulatory requirements, including those of the Bank Secrecy Act. Recognizing these problems, the Bank Board, on July 6, 1985, transferred the Board's 747 examiners from the Federal civil service to the employ of the 12 District Banks. At the same time, the Bank Board delegated responsibility for conducting examinations to the District Banks, under policies and procedures established by the Board. With this reorganization, the examiners and the District Banks' Supervisory Agents became part of the same organizational structure, providing closer coordination and faster response to early warning signals of an institution's financial problems.

Removing the examiners from the civil service system permitted hiring more examiners, raising examiners' salaries, and increasing their benefits. By making compensation competitive, the Board took an important step to reduce the rapid turnover among examiners, and thus ensure that the Bank System would have more and better qualified examiners to meet the increased demands. By December 31, 1985, the Federal Home Loan Banks had increased their examination staffs to 1,003, a more than one-third increase over the July 6, 1985, figure. Moreover, our goal is to reach 1,250 examiners by July 1, 1986, which will be a total staff increase of two-thirds in one year.

- 3 -

4. On page 9, the report states that the Bank Board "suspended the mandatory use of all examination procedures in 1982." While this statement is factually accurate, by itself it may be misleading with respect to the Bank Board's efforts. The mandatory use of the procedures specified in the Manual of Examination Objectives and Procedures (MEOP) was suspended in 1982, due to the severe problem of limited staff resources to combat increasing financial crises in the industry. However, the achievement of the objectives contained in the MEOP was not suspended. The fact that most examiners addressed the issue of Bank Secrecy Act compliance is attested to by the data in Appendix I, Table 4, showing that Form 919 was prepared in at least 82 percent of the examinations GAO reviewed.
5. Appendix II purports to describe Bank Secrecy Act training in the seven agencies covered by the report. The information GAO lists for the Board in this section appears to have been accurate for the period covered by the report. However, the Appendix is written in the present tense and therefore gives the misleading impression that as of spring 1986 it continues to be the case that the Bank Board only "offers one classroom course which very briefly addresses (about 10 minutes) Bank Secrecy." The Appendix should be written in the past tense and make very clear to which time period it refers. Alternatively, the Appendix should list the up-to-date information on training that we provide in the section below on the Board's activities.

See comment 3

GAO Recommendations

1. GAO recommends that the Board, "direct field examiners to fully document the examinations performed, using (GAO's) 'Standards for Audit of Government Organizations, Programs, Activities and Functions' as a guide." These standards recommend that workpapers "serve as a record of the results of the examination and the bases of the auditors' opinions," and state that workpapers should: contain the results and scope of the examination; not require detailed, supplementary, oral explanations; be legible; and restrict information included to matters that are materially important and relevant to the objectives of the examination. We agree with these standards. While we believe we currently require such standards for examiner workpapers, we have nonetheless decided to send a memorandum to our field staff reminding them of the need for such documentation and advising them of the GAO standards. (We presume that GAO is not recommending that we adopt the section in GAO's Audit Standards with regard to sharing workpapers with auditors. It has been our policy to require that audits of insured institutions be independent of examination reports, and we have not permitted our examination reports to be shared with the institutions' auditors.)

See comment 4

Appendix X
Advance Comments From the Federal Home
Loan Bank Board

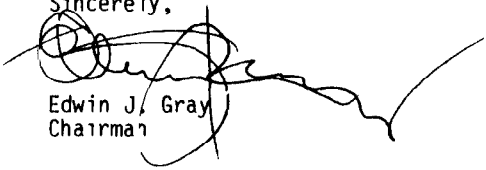
- 6 -

In addition, OES Directors have issued memoranda advising our Federal Home Loan Banks of the Board's efforts to improve its activities with regard to the Bank Secrecy Act and reminding Directors of Examinations that all examinations carry a responsibility to determine compliance with laws and regulations.

4. We are currently revising our Bank Secrecy Act examination procedures:
 - o As part of a revision of our entire Examination Objectives and Procedures Manual to bring the manual up-to-date and improve its utility for examiners;
 - o To encompass all the requirements of the interagency procedures, which have recently been amended; and
 - o To reflect recent recommendations from the Department of the Treasury and the Internal Revenue Service concerning the content of examination procedures.
5. We are also writing Bank Secrecy Act supervisory procedures for the Supervisory Agents in the Federal Home Loan Banks; these procedures will be part of a new Supervisory Objectives and Procedures Manual currently under development.
6. We are also preparing several memoranda distributing recent issuances from the Department of the Treasury. These include the recently revised Currency Transaction Report, joint Treasury/Internal Revenue Service (IRS) guidelines for reviewing Currency Transaction Reports, IRS guidelines for reviewing exemptions from the currency reporting requirements, Treasury's revised definition of willful Bank Secrecy Act violations, and responses by Treasury to financial institutions' questions about the Bank Secrecy Act.

I hope this information is helpful to you. Please feel free to contact me again if we can provide any further information.

Sincerely,



Edwin J. Gray
Chairman

cc: Robert Lawrence
Executive Secretary
Federal Financial Institution
Examination Council

- 5 -

2. In its effort to carry out the enforcement of the Bank Secrecy Act, the Bank Board has been especially concerned with proper training for the examination staff in detecting violations of the Act. All new examiners are required to attend the New Examiners Training School, which includes a 90 minute section on the Bank Secrecy Act as part of its curriculum. Bank Secrecy Act training includes a video tape presentation which combines a video tape we prepared with video material we purchased. The videotape presentation is for use by our Federal Home Loan Banks in a half-day session designed for both newly hired examiners and as a refresher course for all staff members involved in examination or supervision functions relating to the Act. In addition, as part of the training session, examiners are given a copy of the Interim Report to the President and the Attorney General entitled, "The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering."
3. During 1985 and thus far in 1986, we have issued a number of memoranda to our professional staff, including our examiners. For example:
 - o Memorandum # AB 59 advises staff of a memorandum on money laundering sent by the Department of the Treasury to all insured banks and savings and loan associations.
 - o Memorandum # AB 62 reminds examiners of their responsibilities to personally complete FHLBB Form 919; to use expanded scope examination procedures under the circumstances listed in the Bank Secrecy Act examination program; and to prepare interim examination reports in order to expedite the reporting to supervision of material or suspicious Bank Secrecy Act violations.
 - o Memorandum # AB 63 establishes procedures for coordination with the Department of the Treasury with regard to Internal Revenue Service Bank Secrecy Act investigations.
 - o Memorandum # AB-69 provides an Internal Revenue Service news release on IRS' taking over responsibility for reviewing exemption lists and approving or denying individual requests for exemptions from the currency transaction reporting requirements of the Act.
 - o Memorandum # T 53b distributes the amended Bank Secrecy Act regulations in their entirety, summarizes their key provisions, and consolidates several earlier memoranda.
 - o Memorandum # T 53-7 summarizes the requirements for the management of each institution to establish Bank Secrecy Act employee training programs, operating procedures, and compliance guidelines for all employees who come into contact with currency transactions.
 - o Revised Bulletin # PA-7a-3 describes the specific responsibilities of independent public accountants to detect and report money laundering activities.

The following are GAO's comments on the Federal Home Loan Bank Board's letter dated May 14, 1986

GAO Comments

1. We believe that all of the agencies we evaluated experienced staff limitations which affected their abilities to perform Bank Secrecy Act compliance examinations during the period reviewed. Therefore, we recommend that FHLBB and any other agency consider the use of targeting and a random sampling approach for performing these examinations to help alleviate the resource problem.
2. We evaluated only FHLBB's regularly scheduled examinations which were performed during the period reviewed
3. We revised this report to reflect these observations.
4. We do not recommend that FHLBB share workpapers with financial institutions' auditors.

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Washington, D.C. 20548

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Advance Comments From the Board of Governors of the Federal Reserve System

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 15, 1986

Mr. William Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

The Board appreciates the opportunity to comment on the GAO draft report on "How Well Financial Institution Regulatory Agencies Assure Compliance Under the Bank Secrecy Act". This report is a follow-up to your agency's testimony in November 1985 before the Permanent Subcommittee on Investigations of the House Committee on Governmental Affairs.

As part of our effort to maintain the safety and soundness of the banking system, we are fully committed to ensuring that the financial institutions we supervise are in full compliance with the Bank Secrecy Act. Over the past year, we have strengthened our examination procedures for Bank Secrecy Act compliance and have participated in the interagency Bank Secrecy Act working group headed by the Treasury Department. This group has been instrumental in formulating strengthened examination procedures and improving communication and coordination among the agencies. In March 1986, after a careful review of the existing Bank Secrecy compliance review measures, the interagency working group adopted uniform Bank Secrecy Act examination procedures which are now being implemented. The agencies will continue to meet monthly to further improve their examination and communication efforts. Also, bank examiners soon will have another tool to assist them in their review of currency transactions when they gain access to the U.S. Customs Service data base.

Your agency's draft report recommendation that cash flow data be reviewed to identify institutions that have a high potential for violations certainly merits careful consideration. The Federal Reserve has two computer programs in operation which gather statistical data, one of which provides monthly aggregate currency deposit and payment data for each of the 37 Federal Reserve offices. This data indicates where shifts in payments occur geographically. We understand that these trends, combined with other information held by the investigative agencies, may assist in pinpointing where violations may be occurring.