

**FinCEN: Reliability of
Suspicious Activity Reports**

OIG-03-035

December 18, 2002



Office of Inspector General

The Department of the Treasury

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Abbreviations

BSA	Bank Secrecy Act
CBRS	Currency and Banking Retrieval System
FinCEN	Financial Crimes Enforcement Network
FMFIA	Federal Manager’s Financial Integrity Act
IRS DCC	Internal Revenue Service Detroit Computing Center
LEA	Law Enforcement Agency
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
PACS	Patriot Act Communications System
SAR	Suspicious Activity Report

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*The Department of the Treasury
Office of Inspector General*

December 18, 2002

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Director
Financial Crimes Enforcement Network

The Financial Crimes Enforcement Network (FinCEN) administers the Bank Secrecy Act (BSA) of 1970, which along with the implementing regulations, requires financial institutions to file Suspicious Activity Reports (SARs). SARs are filed on any transaction relevant to a possible violation of law or regulation. The SARs provide law enforcement agencies (LEAs) with a paper trail to investigate money laundering schemes and other illegal activities. The events of September 11, 2001 intensified the importance of SARs in tracing financial crimes and transactions used to finance terrorist activities.

Our objective was to profile SARs to assess the nature and extent of fraudulent activities affecting institutions regulated by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS). We have deferred this objective to a future period. However, during the course of our fieldwork, a related matter came to our attention that we believe warranted FinCEN's immediate action. It concerns the reliability of the data in the Suspicious Activity Reporting System (SAR System), a single centralized database of all SARs filed by financial institutions and their regulatory agencies. Although we reported on this issue nearly four years ago, the problem has continued.¹

¹ FinCEN's Suspicious Activity Reporting System (OIG-99-032), January 25, 1999.

We conducted fieldwork at FinCEN, OCC and OTS Headquarters in the Washington, D.C. area. We contacted FinCEN, OCC and OTS officials to discuss SARs and obtain reports on SAR data for OCC and OTS regulated institutions. We contacted law enforcement officials at the Federal Bureau of Investigation, the United States Secret Service, and the Internal Revenue Service to find out whether these agencies used the SARs to develop comprehensive analyses of trends and patterns in financial crimes activities.

We originally provided FinCEN a discussion draft of this report in August 2002. At the time, FinCEN officials took issue with the audit finding, foremost suggesting that improvements have been made that the OIG had not considered and FinCEN wanted to show evidence of improvements and actions taken. As a result, we extended the audit fieldwork to corroborate, consider and incorporate any additional information in support of their improvements and corrective actions. This included meetings with FinCEN and Internal Revenue Service Detroit Computing Center (IRS DCC) officials in August and September 2002. See Appendix 1 for a detailed discussion of the audit objectives, scope and methodology.

Results in Brief

SAR data is considered critical to LEAs in identifying money laundering and other financial crimes. The events of September 11, 2001 intensified the importance of SARs in tracing financial crimes and transactions used to finance terrorist activities. Additionally, Congress directed the President to develop a national strategy for combating money laundering and related financial crimes in the Money Laundering and Financial Crimes Strategy Act. The Department of Treasury's 2002 National Money Laundering Strategy reflects two themes in its approach to money laundering enforcement efforts: (1) the need for interagency coordination and cooperation in conducting anti-money laundering policy, and (2) the need to ensure the information financial institutions are required to report is useful, and can be used effectively by the Government.

The regulatory and LEA officials we interviewed believed the SAR System was very useful in identifying suspected bank insider abuse and BSA violations. However, they indicated that the usefulness of the SAR System would be enhanced, if it included more complete and accurate SAR data. The SAR System sometimes lacked critical information and included inaccurate data because SAR filers disregarded SAR form instructions, did not always understand the violations listed on the SAR form, or were concerned with personal liability. Additionally, IRS DCC contracted personnel sometimes made errors while creating electronic databases from paper SARs. Furthermore, the errors and omissions were not always corrected before or after SARs were added to the SAR System. FinCEN required only minimal SAR edits and data perfection routines, and limited contacts with SAR filers.

As previously stated, the subject of SAR data inaccuracy is a repeat condition. In our January 1999 audit report, we advised FinCEN that critical information needed by LEAs was not being captured on the SAR form. We recommended that the Director of FinCEN issue instructions along with the planned revised SAR form to financial institutions requiring critical data fields on the SAR form be completed, and ensure all paper SARs transferred onto magnetic tape were reviewed for accuracy prior to loading the data onto the SAR System.

FinCEN concurred and issued a revised SAR form with instructions for completing the critical data fields. FinCEN further stated, with the assistance of IRS DCC, it had incorporated a process of SAR document editing and error correction. The SARs were being reviewed for specific requirements and accuracy; and in some cases, IRS DCC was calling or writing to the SAR filer for additional information. FinCEN also reported it was producing listings of errors found on the forms, and had already started following up with the pertinent banks through their regulatory agencies.

Despite additions to the SAR form and the reported increase in controls at IRS DCC since the last audit report, regulatory and LEA officials continued to find SARs with incomplete and inaccurate

data. In addition, during a recent OIG audit of a failed bank we found numerous SARs with incomplete and unclear data.

During August and September 2002 we met with FinCEN and IRS DCC officials to solicit input on the discussion draft of this report. Although FinCEN Headquarters personnel believed significant progress had been made in SAR accuracy, operating officials from both organizations agreed there was still an on-going problem with SARs having missing and incomplete data and were working to identify these problems and form corrective actions. FinCEN officials believe the SAR System contains missing and incomplete data because SAR filers make human errors, and the Currency and Banking Retrieval System (CBRS), where the SAR System resides, allows the errors and omissions to go uncorrected.

FinCEN personnel stated they were working on a proposal to improve the data in the SAR System that includes applying additional manual and system edits and data perfection routines, corresponding with filers regarding invalid and missing data, and enhancing outreach efforts. The major objective of the outreach program will be to shift the focus of training from compliance with filing SARs to the importance of the accuracy of the SARs filed. Many of the enhancements discussed by FinCEN and IRS DCC personnel could address some of the weaknesses identified if properly implemented.

In this report we recommend the Director of FinCEN ensure FinCEN, in coordination with IRS DCC and the five Federal regulatory agencies, (1) implements procedures to increase editing, mandatory data, and feedback with financial institutions and regulators, (2) revises the SAR form or find other means to address the problems with narrative write-ups and identifying violations, 3) eliminates duplicate SARs in the system, and 4) addresses the problems arising from SARs filed via the internet. In addition, we also believe that the reported finding warrants management consideration as to whether the reported weaknesses merit the designation as a material weakness under the Federal Manager's Financial Integrity Act (FMFIA), as defined in Office of Management

and Budget Circular A-123, Management Accountability and Control.

In its December 11, 2002 written response to our draft report, FinCEN generally concurred with the reported finding and five recommendations. We believe the FinCEN completed or planned corrective actions, if properly implemented, would address our recommendations to improve the accuracy and completeness of SARs.

Although FinCEN concurred with the finding and recommendations, FinCEN did not agree that the reported finding constituted a material weakness under the FMFIA. FinCEN believes that the data quality has been consistently improving and the current error rate is well within acceptable limits. We are mindful that the FMFIA material weakness designation is the sole responsibility of FinCEN management and not the OIG. However, we believe consideration was and still is warranted because of the vital role that accurate SAR data plays in accomplishing FinCEN's core mission related to BSA and attendant money laundering enforcement programs. See Appendix 2, for the complete text of FinCEN's response.

Background

The Secretary of the Treasury has delegated the duties and powers under the BSA to FinCEN. The authority to examine financial institutions for BSA compliance was delegated to the applicable Federal regulatory agencies. Financial institutions are required to establish and maintain a program to monitor and ensure compliance with BSA and the implementing regulations.

One aspect of BSA requires financial institutions to file a SAR on any transaction relevant to a possible violation of law or regulation. This occurs when a financial institution observes a transaction that has no business or apparent lawful purpose. This also occurs when a transaction is not the type in which a particular customer would normally be expected to engage, and the institution knows of no reasonable explanation for the transaction after examining

the available facts, including the background and possible purpose of the transaction.

Recognizing that an effective regulatory regime depends on the cooperation of the public and private sectors, the Department of Treasury's Under Secretary for Enforcement initiated a joint SAR System feedback program. To implement the initiative, a BSA Advisory Group Feedback subcommittee was created in the Fall of 1999 that included representatives from the banking, law enforcement, and regulatory communities. The subcommittee meets on a regular basis to discuss methods for improving feedback to financial institutions. FinCEN is responsible for coordinating the entire Department of Treasury SAR System feedback initiative.

The subcommittee decided to produce a periodic SAR Activity Review—Trends, Tips and Issues twice a year. The first three SAR Activity Reviews were published in October 2000, June 2001 and October 2001. The SAR Activity Reviews included tips on SAR form preparation and filing to assist in ensuring the accuracy and completeness of SAR filings. FinCEN also released SAR Bulletins that provided guidance to financial institutions that file SARs.

The profits of crime that creep into the United States' financial system each year are staggering. According to FinCEN's responses in its report on Frequently Asked Questions, drug trafficking alone accounts for tens of billions of dollars a year. Their report also discussed the necessity for intense financial investigations as being essential to identifying narcotics trafficking, organized crime, money laundering, and bank fraud.

The events of September 11th intensified the importance of the SAR System in tracing financial crimes and transactions used to finance terrorist activities. In fact, supporting the LEA's counter-terrorism investigations became FinCEN's top priority. The financial data and information contained in FinCEN's databases, from SARs, Currency Transaction Reports, and other required BSA financial transaction reports, became critical to LEA terrorist

investigations in identifying relationships between people, places, organizations, and financial transactions.

The importance of accurate and reliable SAR data has also been heightened with the passage of the USA PATRIOT Act of 2001². Under the act, SAR reporting requirements have been expanded to other financial institutions beyond depository institutions such as money service businesses, insurance companies, securities brokers or dealers, currency exchanges, and investment bankers to name just a few. While the specific implementing regulations for many of these businesses are still being developed, LEAs and FinCEN will ultimately be confronted with a growing volume of SARs.

The SAR System

In 1996, FinCEN, in consultation with each Federal regulator (Federal Reserve Board, OCC, Federal Deposit Insurance Corporation, OTS, and National Credit Union Administration) entered into a partnership agreement with the IRS DCC to establish a SAR System. The SAR System was established by this group on April 1, 1996 to provide a single collection point for all SARs and provide LEAs with critical information to develop comprehensive analyses of trends and patterns in financial crime activity.

FinCEN operates and maintains the SAR System through IRS DCC. FinCEN also determines the number of system edits and data perfection routines. Financial institutions file SARs on paper or magnetic tape with IRS DCC. Upon receipt of the paper SAR at IRS DCC, each is date-stamped, given a document control number, reviewed for errors, consolidated, and sent to a contractor. The contractor creates and electronically transmits the database to IRS DCC, and returns the paper SARs. IRS DCC uses the database to update the SAR System with the most current SAR data. Magnetic tapes of SAR data sent to IRS DCC by financial institutions are loaded directly onto the SAR System. There are no system edits to identify forms with invalid fields or missing data. In October 2002, FinCEN launched the Patriot Act Communications System (PACS),

² 31 U.S.C. 5318 (g), USA PATRIOT Act, Title III, Section 356, and 31 CFR 103

designed to allow financial institutions to file SARs and other BSA reports, over the Internet. SARs filed over the internet can be accomplished either individually or by batch.

SAR System Access

The SAR System on-line database is available to regulatory and LEA personnel by telephone modem hook-up to IRS DCC. The Internal Revenue Service, Criminal Investigation Division, has direct access to the SAR System. OCC and OTS receive periodic downloads from FinCEN on SARs filed for the institutions they regulate. The Federal Bureau of Investigations and the U.S. Secret Service download SAR System data in bulk from IRS DCC onto their individual internal computer systems.

SAR Statistics

The SAR System database is quite large and as of December 31, 2000 it was comprised of more than 505,000 SARs filed since April 1, 1996. OCC-regulated institutions filed 273,760 SARs, or 54 percent of the total, and OTS-regulated institutions filed 54,282 SARs, or 11 percent of the total.

Finding and Recommendations

Finding Data in the SAR System Was Not Always Complete or Accurate

The regulatory and LEA officials we interviewed indicated that the SAR System contained incomplete and inaccurate SAR data. Specifically, SAR filers often left out critical information and included inaccurate data. These errors occurred because filers did not follow SAR form instructions, did not have a clear understanding of the violations listed on the SAR form, were concerned with personal liability, and filers or IRS DCC filing or loading a SAR more than once. Additionally, contractor personnel sometimes made errors while creating electronic databases from paper SARs. Furthermore, these errors and omissions were not always corrected prior or subsequent to SAR inclusions in the SAR

System. FinCEN required only minimal edits and data perfection routines, and only contacted SAR filers for completely unacceptable SARs³.

As a result, the SAR System did not have all of the critical data LEAs needed to identify funds derived from illegal activities, or activities intended or conducted in order to hide or disguise funds or assets derived from illegal activities, as part of a plan to violate or evade any law or regulation, or avoid any transaction reporting requirement under Federal law. Also, because IRS DCC did not routinely correspond with filers concerning the errors made in filing SARs, the filers were not provided feedback and an opportunity to improve on submitting accurate and reliable SARs.

Incomplete SARs

The SAR form clearly states "ALWAYS COMPLETE ENTIRE REPORT." The SAR Activity Reviews emphasize that information in SAR filings should be as complete as possible. However, the regulatory and LEA officials told us the SAR forms were not always complete. For example, one LEA official provided 6-month statistics documenting 2,355 SARs involving \$178 million in losses with no violations indicated. Without the violations, the SAR usefulness to LEAs is minimized because there is no basis for evaluating the data.

FinCEN reported in the SAR Activity Review of October 2000 problems with listing regulators and advised filers to always identify the organization's primary Federal regulator. However, the regulatory and LEA officials continued to notice the SAR System included SARs with no regulators indicated. In fact, in one LEA database approximately 500 of 14,000 SARs downloaded from the SAR System did not indicate a regulator. As a result, when regulators queried the SAR System or received FinCEN downloads, they received understated data on SARs filed by the institutions they supervised. Additionally, the statistics and trends analytic

³ Unacceptable SARs include those with pages missing or illegible writing.

reports, issue papers, and publications could not accurately profile the statistics by regulator.

Also, some SAR narrative sections did not have a narrative, but instead had the statement “see attached.” However, attachments were not forwarded to FinCEN or IRS DCC. The SAR Activity Review of October 2000 addressed this issue stating the narrative section of the SAR should provide a detailed description of the known or suspected violation of law or suspicious activity, and supporting documentation should never be attached to a SAR form. Without having the supporting document available, any relevant information needed by the LEAs or regulators would not be entered into the SAR system. Without the narrative, it was difficult to determine what occurred or what further information was available on supporting documents held at the financial institution.

Inaccurate SARs

SARs did not always accurately indicate the location where the suspicious activity occurred. In some cases, the SAR System indicated the main office location or a central office location that forwarded the SARs, rather than the branch or office of where the reported violation occurred. This has been an on-going issue that FinCEN addressed as far back as FinCEN Advisory, Issue 8, February 1997. In addition, the SAR form instructs filers to indicate where the suspicious activity “occurred.” As a result, LEAs did not have all of the accurate information needed to perform analyses to find patterns and identify illegal activities by location.

The regulatory and LEA officials we interviewed also indicated that SAR filers did not always understand the SAR violation “computer intrusion.” Reports on computer intrusion should only describe a computer hacking incident involving a financial crime. However, some SAR filers included anything related to computers, such as hacking into the financial institution’s website or email. These filers incorrectly reported computer intrusion along with other violations involving a computer. As a result, financial institution

personnel provided misleading SAR information and crime computer intrusion instances were overstated.

“Other” and “Unknown/Blank” Categorized Violations

In addition to having no violation listed on the forms as discussed previously, SAR filers frequently filed under "other" instead of a specific violation. This choice was made even when the filer was reporting a known violation such as money laundering or check kiting. Even though the SAR form specifically disclosed the SAR was confidential and the Safe Harbor Law provided the filers protection from civil liability, filers chose "other" due to concerns over personal liability. The FinCEN Advisory of August 1996 thoroughly discussed the "Safe Harbor" provision of the BSA as it applies to reports of suspicious transactions. Filers also chose "other" when they did not have a clear understanding of the SAR violations listed on the SAR form. According to the SAR Activity Review dated October 2001, some violations such as identity theft and pretext calling properly belonged in "other."

The SAR Activity Reviews dated October 2000 and June 2001 reported "other" at 7.3 and 7.2 percent, respectively, of total SAR filings for the audit period covered, ranking it as the third most frequently reported violation out of the 19 violation categories listed on the SAR form.

The SAR Activity Reviews reported "unknown/blank" at 3.8 percent of total SAR filings, classifying it as the eighth most frequently filed SAR as of the June 2001 SAR Review. The "unknown/blank" categorization represented SARs with characters that did not match an established violation, SAR fields with unrelated symbols, or SAR fields void of data.

Together SARs filed under "other" or categorized as "unknown/blank" represented 11 percent of all SAR violations filed from April 1996 through December 2000. These SAR filings were

not readily identifiable and not accurately included in SAR trends and patterns.

Data Entry Errors

Finally, regulatory officials told us some errors and omissions occurred when the IRS DCC contractor created electronic databases from paper SARs. The regulatory and LEA officials found some SAR data in the SAR System contained inaccurate or incomplete data when compared to the original SARs completed by the financial institution personnel.

SARs Reviewed by OIG

During a recent audit of a failed bank, we found bank personnel had filed many SARs with incomplete or unclear data. The bank had filed approximately 220 SARs between April 1996 and July 2001. These SARs reflected a gross potential loss exposure of \$44 million, including \$33 million related to mortgage fraud, and \$7.3 million to auto loan fraud. We reviewed the 220 SARs in an attempt to gain information on possible suspicious activities involving the bank's affiliates or related entities. We could clearly identify only four SARs related to an affiliate since many of the 220 SARs were incomplete or unclear.

Initiatives to Improve SARs

The BSA Advisory Group Feedback subcommittee, which comprises representatives from the banking, law enforcement and regulatory communities, meets on a regular basis to discuss methods for improving feedback to financial institutions. Some LEA officials did not believe FinCEN had been consistently responsive in correcting the data problems discussed at these meetings. Also, one FinCEN official thought the meetings could be held more frequently.

The subcommittee was responsible for producing the periodic SAR Activity Review—Trends, Tips and Issues twice a year. These reviews included tips on SAR form preparation and filing, to assist in ensuring the accuracy and completeness of SAR filings. FinCEN also released SAR Bulletins that provided guidance to financial institutions that file SARs. These efforts may have begun to pay off some dividends, as officials from one LEA believed that although the reliability of the SAR data remained low, it had improved by about 50 percent since mid-1999.

FinCEN and IRS DCC Agree to Condition

During our extended August and September 2002 fieldwork with FinCEN and IRS DCC to solicit input on the discussion draft, officials from both organizations agreed there is an on-going problem with SARs having missing and incomplete data. SARs are frequently filed without the basic information, such as the narrative portion, identification of a suspect, or a characterization of the suspicious activity. SARs are still filed with only “see attached” in the narrative section. Additionally, the officials have received duplicate SARs and SARs with missing data in the SAR System even though the data was included in the original SAR form.

Multitude of Causes for Incomplete and Inaccurate SARs

FinCEN officials believe the SAR System contains missing and incomplete data because SAR filers make human errors and the CBRS, where the SAR System resides, allows the errors and omissions to go uncorrected. Additionally, previous outreach efforts have concentrated more on getting financial institutions just to file the SARs versus improving the accuracy of the data submitted and the importance of accurate data.

Duplicate SARs in the SAR System resulted from IRS DCC double posting of SARs and financial institutions filing the same SAR more than once. This occurs because there are no procedures or computer checks established for matching SARs to determine duplicate postings. FinCEN personnel stated there were 3,300 duplicates in the system last year that were caused by IRS DCC

posting or financial institutions filing SARs twice. FinCEN personnel identified these SARs by reviewing 10 fields, including the "correction" field, and the first 1,000 characters in the narrative.

Draft Proposal for SAR Improvements

During our extended fieldwork, the SAR point of contact in the Office of Compliance and Regulatory Enforcement at FinCEN Headquarters briefed us on his study of the problems with SARs and outlined his proposal for improvements. The Office of Compliance and Regulatory Enforcement works with SAR filers, LEAs, the Office of Information Technology at FinCEN, and the IRS DCC. The Office of Compliance and Regulatory Enforcement and the Office of Information Technology share SAR program and technical responsibilities at FinCEN, while IRS DCC updates and maintains the SAR System. The point of contact stated the proposal is in the draft stage and will need the coordinated approvals of FinCEN, IRS DCC and the remaining members of the SAR System Group.

The proposal includes expanding the definition for unacceptable SARs to include SARs without basic data, applying additional manual and system edits and data perfection routines to the SARs, corresponding with filers regarding invalid and missing data, and enhancing outreach efforts. FinCEN and IRS DCC officials believe the SARs provide LEAs with excellent investigative leads, yet receive less edits and resolution routines compared to other BSA reports.

It should be noted that since the proposal was still in draft and had not been presented to senior management, the point of contact did not provide us a copy for our review. Therefore, all our comments on the proposal are based solely on briefings provided by the point of contact and IRS DCC personnel who are working on the proposal.

Processing Paper SARs

The draft proposal recommends that IRS DCC increase the definitional criteria for unacceptable SARs. IRS DCC implemented a process in 1996 for providing an initial review of paper SARs and immediately returning to filers those SARs deemed unacceptable. Unacceptable SARs include those with pages missing or illegible writing. Based on this limited criteria, accuracy and completeness are not grounds for returning SARs. The SAR point of contact and IRS DCC officials believe the unacceptable criteria needs to be increased to cover additional types of omissions and inconsistencies.

Currently, once unacceptable SARs are separated out and returned to filers, the remaining SARs are subjected to manual edits. IRS DCC applies manual edits on only five SAR items, such as editing the dollar amount of the recovery to whole dollars. Other BSA reports, such as the Report of Foreign Bank and Financial Accounts, the Currency Transaction Report by Casinos, and the Report of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300), receive 37, 20 and 19 edits respectfully. Although the draft proposal recommends increasing the edit checks, IRS DCC and FinCEN officials commented on the trade-off with resources and cost have to be considered, as well as, significance of data when matched against the other BSA reports.

After manual editing occurs, the SARs are sent to the keying contractor to create, and electronically transmit via the internet back to IRS DCC, a database of the SARs. IRS DCC uploads the transmitted SAR database to the CBRS, where the various BSA reports reside. The system edits BSA reports to identify fields with invalid data, missing data in mandatory fields, and provides an error register.

A BSA Specialist performs on-line data perfection of the invalid fields by sitting down with the error register, calling up the form on the database, comparing it to the hard copy, and making corrections on-line. System edits to identify invalid fields include 14 error codes for SARs, as compared to 18, 43, and 7 respectively for the 3 previously mentioned BSA reports. In

addition to the system errors, the error register also identifies missing mandatory fields for other BSA reports. Specifically, the error register looks at 14, 38, and 29 fields respectively for the other BSA reports and none for SARs. Again, one must recognize the resource, cost, and data significant trade-offs.

SARs Filed by Magnetic Media

SARs filed directly by financial institutions on magnetic media are uploaded directly onto the CBRS, but no edits, error corrections or correspondence with filers occur. However, validity checks and mandatory field checks are applied to Currency Transaction Reports, another BSA report, that are filed by magnetic media and entered directly into the CBRS. Also, for Currency Transaction Reports, acknowledgement tapes are returned to the filers with document control numbers and error messages. The acknowledgement tapes provide a means to let filers make corrections. The draft proposal recommends that IRS DCC apply system edits to SARs filed by magnetic media. The biggest cost trade-off here relates to the cost of changing or upgrading computer programs.

Enhanced Outreach Efforts

Personnel emphasized the need to refocus the SAR Outreach Program. The presentations FinCEN, IRS DCC, and the regulators provide to financial industry groups need to refocus on SAR data quality, and not just on the compliance aspect. Outreach efforts need to emphasize the importance of SAR data and how the utility of the data is adversely affected by poor quality reports. The proposal includes recommending that IRS DCC provide regulatory agencies the capability of retrieving SAR error registers from the SAR system, to review with financial institutions that made the errors. This would provide regulators with tools to discuss repeated SAR problems with specific banks and trends within their institutions. This process is available for Currency Transaction Reports.

Internet Filing of SARs

The PACS is designed to allow participating financial institutions to quickly and securely file SARs over the internet. The electronic filing expedites the reporting process, making the information available to LEAs more quickly, and reduces financial institution filing costs. PACS allows financial institutions to electronically file discrete (single) or batched forms. FinCEN and IRS DCC officials told us discrete SARs filed over the PACS have some mandatory fields. However, batch SARs filed over PACS do not.

The American Banker reported on October 22, 2002 that U.S. Treasury officials expect as many as 1,500 of the country's largest banks to use PACS to file SARs. These large banks generally use batch filings, which means a majority of SARs filed by PACS will not be screened for missing mandatory fields prior to acceptance into the system. Also, once in the system, FinCEN and IRS DCC officials told us IRS DCC is applying the same minimal data integrity routines to SARs filed by PACS as it does to SARs filed in paper or magnetic format.

Planned Enhancements

The various planned enhancements brought to our attention by FinCEN and IRS DCC personnel confirmed our originally reported weaknesses in the discussion draft, brought to our attention additional types of inaccurate and or incomplete SAR data, and clearly demonstrated the need to improve on the accuracy and reliability of SAR data.

Recommendations

The Director of FinCEN should provide enhanced leadership of BSA by working with its partners in the financial and regulatory communities to ensure:

1. FinCEN, in coordination with IRS DCC and the five Federal regulatory agencies, review the SAR processing procedures to evaluate the need to:

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- a. Expand the criteria for unacceptable SARs to reduce the number of incomplete and inaccurate SARs upfront, including rejecting SARs with inadequate narratives;
 - b. Increase the number of manual edits applied to SARs to be in line with other BSA reports, taking into account the relevance of the information required by users;
 - c. Increase the number of system edits that identify invalid data or inconsistent information versus the cost associated with system changes;
 - d. Designate mandatory fields for SARs and, subsequently, system edits that identify missing data in the mandatory fields;
 - e. Establish a systematic procedure as to when to correspond with filers regarding missing, incomplete, or invalid SAR information;
 - f. Enhance outreach efforts to include providing regulatory agencies with the capability of retrieving SAR error registers to review with financial institutions; and
 - g. Assess the adequacy of existing internal controls to ensure that SAR data submitted is accurate and reliable.

We did not review in detail the various planned proposals to address many of the reported problems, particularly with respect to the cost benefits to FinCEN, LEAs, and SAR filers. However, we believe the various proposals as explained to us conceptually address many of the reported problems, and as such would merit due consideration by senior management when planning corrective actions.

Management Response and OIG Comments

FinCEN concurred and stated FinCEN has discussed proposed enhancements with the five Federal regulatory agencies. By June 2003, FinCEN will prepare an overall implementation plan that considers many of the suggestions OIG provided in this recommendation. We believe FinCEN's planned management actions address the recommendation, if properly implemented.

2. In the absence of expanding the definition of "Unacceptable" SARs subject to returning the SAR to the filer due to incomplete information (see recommendation 1.a.), expand the "Outreach" training to focus on explaining the importance of a clear and complete narrative and the procedures for maintaining attachments at the financial institution.

Management Response and OIG Comments

FinCEN concurred and is improving its industry outreach efforts to specifically focus on providing complete and accurate data, including the importance of a clear and complete narrative and the procedures for maintaining any needed attachments at the financial institution. The specific activities will be outlined in the overall implementation plan by June 2003. In addition, the next SAR Activity Review will highlight the necessity of complete and accurate data. We believe FinCEN's planned management actions address the recommendation, if properly implemented.

3. To better ensure that all violations are accurately listed, consideration should be given to include a statement on the SAR form, Part III, Suspicious Activity Information for filers to contact FinCEN for assistance in identifying the violation being reported.

Management Response and OIG Comments

FinCEN concurred with providing a point of contact for institutions needing assistance in identifying violations being reported. Rather than revising the SAR form, FinCEN will include in its outreach information, broad suggestions for identifying violations and refer financial institutions to their Federal regulators for more specific assistance. FinCEN's planned corrective actions will be completed by June 2003.

We believe FinCEN's planned actions are responsive to the intent of the recommendation. We also further suggest that during its planned outreach efforts that consideration also be given to referring financial institutions to FinCEN given the advantages and benefits of better ensuring consistent and uniform guidance. In so doing, FinCEN might be better able to systematically monitor the extent and nature of inquiries to readily identify any needed revisions to the SAR form and instructions.

4. To better ensure against duplicative SAR filings, develop internal controls that would match new SARs against SARs already input into the database.

Management Response and OIG Comments

FinCEN concurred and is now evaluating alternative approaches to deal with duplicate SARs posted to the SAR database. This will include determining the costs of enhanced internal controls to implement a cost effective solution. This corrective action will also be incorporated into the overall implementation plan with a targeted completion of June 2003. We believe FinCEN's planned management actions address the recommendation.

5. To address the erroneous information from submissions via the PACS, reassess system controls covering the accuracy and completeness of this new media. Consideration should be given to areas such as edits and mandatory fields for financial

institutions using commercial software for both individual and batch processing.

Management Response and OIG Comments

FinCEN concurred in concept, agreeing that adequate system controls and edits are necessary to assure complete SAR data. FinCEN stated the system error resolution procedures are the same for SARs filed on magnetic media and PACS, and improving data perfection routines at IRS DCC will result in more complete and accurate data. We agree that the cited actions address the intent of the recommendation. However, we would further suggest that the cited corrective actions be closely monitored in light of the difference between batch and discrete SAR filings as noted by FinCEN and IRS DCC officials.

OIG Comments to Other Management Responses

We believe the data reliability weaknesses warrant management consideration in designating the reported weaknesses as a material weakness under FMFIA. In its response to the draft report, FinCEN disagreed that the reported weaknesses constituted a material weakness, and that the Federal regulators, as co-owners of the SARs, had equal responsibility for the issues raised in the report, and that joint concurrence with the Federal regulators was required on SAR issues.

With respect to the material weakness designation, we would respectfully clarify the issue that under FMFIA, the Office of Management and Budget (OMB) Circular A-123, and Treasury Directive 40-04, it is the bureau's, not the OIG's, responsibility to report on management deficiencies identified in audit reports that have the potential of meeting the Department's material weakness criteria. The OIG was only bringing to FinCEN's attention conditions that we believed warranted consideration as to the material weakness designation for the following reasons:

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1. The reliability of SAR data is vital to accomplishing one of FinCEN's core missions with respect to the BSA and the attendant money laundering enforcement programs.
 2. As noted in the report, the same data reliability concern was previously reported by the OIG in 1999 and despite the corrective actions cited by FinCEN, regulatory and law enforcement agencies (SAR data users) continued to find SARs with incomplete and inaccurate data.
 3. The reported data reliability problems are associated with regulated financial institutions that have been filing SARs since April 1996, and FinCEN may likely face a large influx of SARs filed by new institutions, which are likely not as familiar as banks with the SAR filing requirements. More specifically, the USA PATRIOT Act has expanded the type of financial institutions subject to SAR filing to include other institutions such as security brokers/dealers, currency exchanges, credit card operators, insurance companies, finance companies, and casinos just to name a few. Again, we believe the importance of correcting the data reliability weaknesses has only been heightened given the expanded number of potential SAR reporting entities.
 4. The importance of complete and accurate SAR data is further underscored by the Department of Treasury's 2002 National Money Laundering strategy, which reflects two themes that have driven the Administration's approach to money laundering enforcement. One of those themes is the need to ensure that the information that the financial institutions are required to report is useful, and can be used effectively by the government.

In its December 11, 2002 response to the draft report, FinCEN also stated that the material weakness designation was not warranted given that the current SAR data error rate was well within acceptable limits. We were unable to assess the applicability of that claim with respect to the noted weaknesses in this report. It should be noted that at no time did FinCEN bring to our attention

documented information as to the nature and extent of any error rate assessments, the precise acceptable error rates used, or how many of our reported data weaknesses were specifically covered by these assessments. However, the cited assessments will be included in any future OIG follow-up audits to this report.

Finally, FINCEN's response to the draft report emphasized the shared responsibility with the Federal regulators for the reported issues and the need for joint concurrence on SAR matters. We agree, as noted in Recommendation 1, that as co-owners of the SARs that Federal regulators have a key and important role in the overall enforcement of the BSA. However, it should be noted that, as in our prior report in 1999, our reported findings and recommendations address only those functions, processes, and operations under the direct control of FinCEN and not the Federal Banking regulators. Furthermore, we believe these specific weaknesses with respect to SAR data reliability will need to be addressed to fully combat financial crimes, money laundering and now terrorist financing, and that the vital role of accurate and complete SAR data once filed by financial institutions cannot be deferred across SAR owners.

* * * * *

We would like to extend our appreciation to FinCEN for its cooperation and courtesies extended to our audit staff during the audit. If you have any questions, please contact John A. Richards, Supervisory Auditor, at (415) 977-8810 ext. 225. Major contributors to the report are listed in Appendix 3.

/S/
Benny W. Lee
Regional Inspector General for Audit

Appendix 1 Objectives, Scope and Methodology

The objective of the audit was to profile SARs to assess the nature and extent of fraudulent activities affecting institutions regulated by OCC and OTS. We have deferred this objective to a future period. During the course of our fieldwork, a related matter came to our attention that we believe warranted FinCEN's immediate action. Specifically, this matter relates to the reliability and accuracy of SARs and the SAR System.

The scope of the audit included the data in the SAR System database as of December 31, 2000, which comprised more than 554,000 violations from over 505,000 SARs filed since April 1, 1996. We also reviewed the SAR Activity Reviews of October 2000, June 2001 and October 2001, which provided suspicious activity trends and patterns based on the SAR System database.

To accomplish our objectives, we conducted interviews with FinCEN, IRS DCC, OCC and OTS officials, reviewed the policies and guidelines surrounding SAR filings and SAR processing procedures, and requested reports on SAR data. We also interviewed law enforcement officials at the Federal Bureau of Investigation, the United States Secret Service, and the Internal Revenue Service to determine whether these agencies used the SAR System to develop comprehensive analyses of trends and patterns in financial crime activities, and whether they were satisfied with SARs' usefulness in fighting crimes.

We requested from OCC and OTS 18 reports on SAR data (9 for each regulator) for institutions they regulated. We requested the reports on SAR data from FinCEN through the regulators at FinCEN's request. FinCEN was concerned with sharing Right to Financial Privacy data that FinCEN did not own.

We assessed the reliability of 10 of the 18 reports on SAR data by comparing for reasonableness the report totals and data received from FinCEN to the report totals and data published in the SAR Activity Reviews, for the period covered by the audit. The eight remaining reports were not assessed because of delays in receiving

Appendix 1 Objectives, Scope and Methodology

the reports from the regulators. Due to unreliability and late arrival issues with the reports, as well as the Right to Financial Privacy issue, we were unable to accomplish our initial objective to profile SAR data. The report does not, therefore, address any of the issues relating to this work.

We conducted fieldwork between March 2001 and March 2002 in accordance with generally accepted government auditing standards. We originally provided FinCEN a discussion draft of this report on August 1, 2002. At the time, FinCEN officials took issue with the audit finding, foremost suggesting that improvements have been made that were not being considered and that the report was based on hearsay from SAR users. Thus, FinCEN wanted to show evidence of improvements and actions taken. As a result, we agreed with FinCEN to extend the audit fieldwork to corroborate, consider and incorporate any additional information in support of their improvements and corrective actions. This included meetings with FinCEN and IRS DCC officials in August and September 2002.

During the August and September meetings, we reviewed documents showing how SARs were processed, e.g. paper and magnetic filings, data edits, and follow-up actions, at IRS DCC. This information was provided for all BSA reports to show comparisons on the amount of coverage among the different reports. Briefings were also presented to show efforts proposed to enhance the accuracy of SARs and efforts being considered to improve the "Outreach" programs.

Appendix 2 Management Response



DEPARTMENT OF THE TREASURY
FINANCIAL CRIMES ENFORCEMENT NETWORK

DEC 11 2002

MEMORANDUM FOR BENNY W. LEE
REGIONAL INSPECTOR GENERAL FOR AUDIT

FROM:

for James Sloan *James Sloan*
Director, Financial Crimes Enforcement Network

SUBJECT:

Management Response to Draft Audit Report – Financial
Crimes Enforcement Network's Suspicious Activity Reports

This memorandum is in response to the subject draft report dated November 5, 2002. The report notes that some Suspicious Activity Reports (SARs) have been posted to the database with inaccurate and missing data. The report also suggests that FinCEN consider reporting SAR data inaccuracy as a material weakness under procedures established by Treasury to comply with the Federal Manager's Financial Integrity Act. We do not agree with the report's implication that missing or inaccurate SAR data constitutes a material weakness. While some of the SARs on Detroit Computing Center's (DCC) database are missing data or contain inaccurate data, the data quality of SARs has been consistently improving since the program was implemented on April 1, 1996, and the current error rate is well within acceptable limits.

Furthermore, the report states that law enforcement finds the SARs are very useful in identifying various violations, which substantiates FinCEN's contention that the data issues alone do not constitute a material weakness. FinCEN does not believe that the report has demonstrated that the type of data that is missing from some SARs is critical to the usefulness of those reports to law enforcement or that the number of SARs with inaccurate or missing data is large enough to have any significant impact. Trend information, such as the number of SARs associated with each regulatory agency or the summary characterization of the activity, is secondary. The examples cited in the OIG report reflect that most of the missing information deals with trend information and therefore is not essential to the utility of the data.

Prior to the OIG review, FinCEN was aware of and taking steps to address the issue of the SAR data inaccuracies. As the report points out, FinCEN developed proposed enhancements to the data perfection process for SARs as well as plans to increase and focus industry outreach efforts on improving the accuracy and completeness of the forms. FinCEN shares responsibility for the SAR, with the five Federal regulators. The Federal regulators are also owners of the SARs with equal responsibility for the issues raised in the report, and we are bound by agreements with the regulators, which require their concurrence on SAR issues. FinCEN recommends that the draft report clearly state this joint responsibility. FinCEN recently met with the regulators to ensure their agreement with our proposed enhancements. We are confident that, when fully implemented, these improvements will result in SAR data that has maximum utility no matter how it is used.

Appendix 2 Management Response

***Response to Specific Audit Recommendations:**

Recommendation 1: FinCEN, in coordination with IRS DCC and the five Federal regulatory agencies, review the SAR processing procedures to evaluate the need to:

- a. Expand the criteria for unacceptable SARs to reduce the number of incomplete and inaccurate SARs upfront, including rejecting SARs with inadequate narratives;
- b. Increase the number of manual edits applied to SARs to be in line with other BSA reports, taking into account the relevance of the information required by users;
- c. Increase the number of system edits that identify invalid data or inconsistent information versus the cost associated with system changes;
- d. Designate mandatory fields for SARs and, subsequently, system edits that identify missing data in the mandatory fields;
- e. Establish a systematic procedure as to when to correspond with filers regarding missing, incomplete, or invalid SAR information;
- f. Enhance outreach efforts to include providing regulatory agencies with the capability of retrieving SAR error registers to review with financial institutions; and
- g. Assess the adequacy of existing internal controls to ensure that SAR data submitted is accurate and reliable.

Response: Concur. FinCEN has discussed proposed enhancements with our partners in the financial and regulatory communities and are awaiting their input. FinCEN, in conjunction with the five Federal regulatory agencies, will prepare an overall implementation plan that considers many of the suggestions provided above to improve the quality of the SAR reporting. [Target Completion: June 2003]

Recommendation 2: In the absence of expanding the definition of "Unacceptable" SARs subject to returning the SAR to the filer due to incomplete information (see recommendation 1.a.), expand the "Outreach" training to focus on explaining the importance of a clear and complete narrative and the procedures for maintaining attachments at the financial institution.

Response: Concur. As discussed above, FinCEN is increasing and improving its industry outreach efforts to specifically focus on providing complete and accurate data, including the importance of a clear and complete narrative and the procedures for maintaining attachments at the financial institution. Consequently, these efforts will continue whether or not the definition of unacceptable SARs is expanded. The specific activities will be outlined in the overall implementation plan, referred to above. In addition, the next SAR activity review will also highlight the necessity of complete and accurate data. [Target Completion: June 2003]

Appendix 2 Management Response

Recommendation 3: To better ensure that all violations are accurately listed, consideration should be given to include a statement on the SAR form, Part III, Suspicious Activity Information for filers to contact FinCEN for assistance in identifying the violation being reported.

Response: Concur in concept. FinCEN concurs in concept with the recommendation to provide a point of contact for financial institutions to contact in identifying the violation being reported. Since it is impractical to revise the SAR form at this time, FinCEN will include in its outreach information broad suggestions for identification of the violation and refer the financial institutions to their federal regulator for more specific assistance. [Target completion date: June 2003]

Recommendation 4: To better ensure against duplicative SAR filings, develop internal controls that would match new SARs against SARs already input into the database.

Response: Concur. FinCEN is currently evaluating alternative approaches to deal with the problem of duplicate SARs being posted to DCC's database. For example, our review of the 3,300 duplicate SARs cited in the report found that 18 filers were responsible for over two thirds of the duplicate SARs. Working with these institutions, FinCEN was able to identify and resolve systemic problems that had resulted in a large number of SARs being filed more than once. We are also determining the costs associated with internal controls that prevent duplicate SARs from being posted to the database. Our goal is to identify and implement the most cost-effective solution, which will be incorporated into our overall implementation plan to improve the quality of the SAR reporting. [Target completion date: June 2003]

Recommendation 5: To address the erroneous information from submissions via the Patriot Act Communications System (PACS), reassess system controls covering the accuracy and completeness of this new media. Consideration should be given to areas such as edits and mandatory fields for financial institutions using commercial software for both individual and batch processing.

Response: Concur in concept. FinCEN concurs that adequate system controls and edits are necessary to assure the completeness of the data. These controls have been built into the PACs system. For example, the single form filing option requires all critical data files to be completed. As for filer errors and omissions, as was explained to the OIG staff during their review, DCC's error resolution procedures are the same for SARs filed either on magnetic media or on PACS. Consequently, improving data perfection routines at DCC will result in more complete and accurate SARs no matter how they are filed. [Corrective Actions: Completed]

*Planned corrective actions must have the concurrence of SAR co-owners prior to implementation.

Appendix 3
Major Contributors to this Report

John A. Richards, Supervisory Auditor

Charlotte C. Bergh, Auditor-in-Charge

Gale Dwyer, Auditor

Appendix 4 Report Distribution

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