



*Indian Tribal Noncompliance With  
the Bank Secrecy Act Is  
Effectively Identified and Addressed,  
but Improvements Can Be Made*

**August 29, 2008**

**Reference Number: 2008-10-140**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information  
2(e) = Law Enforcement Procedure(s)



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 29, 2008

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION  
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES  
DIVISION

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Indian Tribal Noncompliance With the Bank  
Secrecy Act Is Effectively Identified and Addressed, but Improvements  
Can Be Made (Audit # 200810027)

This report presents the results of our review of the Internal Revenue Service's (IRS) effectiveness in identifying and addressing Indian tribal governments' noncompliance with the Bank Secrecy Act (BSA).<sup>1</sup> Our overall objective was to determine whether the IRS effectively identified and addressed Indian tribal entities that are potentially not compliant with the BSA. This review was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2008 Annual Audit Plan related to the Major Management Challenge of tax compliance initiatives.

*Impact on the Taxpayer*

The BSA requires certain businesses to submit reports of large-dollar cash transactions for use by law enforcement agencies in identifying terrorist funding, money laundering, and other illegal activity. The IRS is effective at identifying and addressing BSA noncompliance in the \$25 billion per year Indian tribal gaming industry. However, improvements could further assure that tribal noncompliance can be addressed through enforcement action to deter future criminal activities and identify Indian tribes with the highest risk of noncompliance.

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<sup>1</sup> Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. Sections 103.11-103.77 (2007).



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Synopsis

The Indian Tribal Governments (ITG) office and the Small Business/Self-Employed Division Fraud/BSA function have been effective in identifying and addressing Indian tribal entities that are not compliant with the BSA. The IRS has identified 286 tribal entities—out of a population of more than 2,500—that are required to comply with the BSA and has focused its efforts on those with the highest risk of noncompliance. When indications of noncompliance are identified, the IRS takes action to correct these deficiencies by providing increased educational contacts to help tribes understand BSA requirements, pursuing unfiled information reports during educational contacts and examinations, and referring cases with willful noncompliance to the IRS Criminal Investigation Division to develop for prosecution. If the Criminal Investigation Division does not accept a case for further development, the IRS Fraud/BSA function can forward the case to the Financial Crimes Enforcement Network<sup>2</sup> for potential penalty assessment when appropriate.<sup>3</sup> Examinations of all 286 tribal entities required to comply with the BSA have not been performed. However, the IRS had identified noncompliance in 34 (97 percent) of the 35 examinations closed from September 30, 2005, through November 9, 2007, that we reviewed.<sup>4</sup>

Improvements could further assure that tribal noncompliance can be detected and acted upon. For example, the ITG office and Fraud/BSA function could not account for all Notifications of Possible IRS Check to Verify Maintenance of Required Records and Filing Reports (Letter 1052), which are used to advise tribal entities of their BSA compliance responsibilities. Without documented evidence that tribes were notified of their responsibilities, the IRS cannot take enforcement actions such as penalty assessments against tribes that have not complied with the BSA.

During the audit, we presented the results of our tests for the accounting of Letters 1052 to IRS management, who recognized the need to better account for the Letters. In a revised Memorandum of Understanding dated March 6, 2008, the ITG office accepted responsibility for accounting for Letters 1052 after they have been issued to tribal entities. In addition, an ITG office official informed us that the Letters would be kept in a central location so that they could be easily located.

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<sup>2</sup> The Financial Crimes Enforcement Network is an organization within the Department of the Treasury that has overall authority for enforcement of the BSA.

<sup>3</sup> When considering penalty assessment, the Financial Crimes Enforcement Network considers factors such as whether violations resulted from negligent or willful action, what the violations were and the number that occurred, or the length of time the violations persisted.

<sup>4</sup> The data extract provided to us by the Fraud/BSA function showed 46 records of examination cases were closed during the period. Four cases could not be located, and we did not review seven additional cases because they had been surveyed and not examined.



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The Fraud/BSA function primarily selects entities for examination from a list provided by the ITG office that is prioritized based on a risk analysis. However, feedback to ITG office management on the effectiveness of the risk analysis is infrequently provided and only addresses individual cases. Further feedback was limited because the database used to record the population of tribal entities required to comply with the BSA and data on BSA examinations contained incomplete and inaccurate information. In addition, there is no structured feedback process requiring the Fraud/BSA function to advise the ITG office as to why entities were selected for examination or to provide the actual results of the examinations. Sharing this information could help the ITG office improve the risk assessment process to focus on issues with greater impact.

During the audit, we presented our conclusion that there was no structured feedback process requiring the Fraud/BSA function to provide the ITG office the results of examinations. In a revised Memorandum of Understanding dated March 6, 2008, the Fraud/BSA function agreed to provide the results of examinations to the ITG office.

### Recommendations

We recommended that the Director, Fraud/BSA, ensure that the Fraud/BSA function database is complete and accurate by performing periodic reconciliations with the ITG office database and by completing all applicable fields in the Fraud/BSA function database when data are available. We also recommended that the Director, Fraud/BSA, provide feedback to the ITG office about why Indian tribal entities were selected for examination and instances when a case is closed without an examination.

### Response

IRS management agreed with our recommendations and provided planned actions to address them. These actions include 1) reconciling the Fraud/BSA function database with the ITG office database and ensuring that all applicable fields in the Fraud/BSA function database are completed when information is available, and 2) providing information to the ITG office as to why entities are selected for examination or instances when referrals are closed without an examination. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-3837.



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*Abbreviations*

BSA	Bank Secrecy Act
FinCEN	Financial Crimes Enforcement Network
IRS	Internal Revenue Service
ITG	Indian Tribal Governments



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## *Background*

Title 31 of the Bank Secrecy Act<sup>1</sup> (BSA) requires certain businesses to keep records and provide reports to the Federal Government about large-dollar and suspicious financial transactions. These reports are greatly used by domestic and international law enforcement agencies and serve as a tool for identifying and intercepting terrorist funding and uncovering other criminal activity, such as money laundering. For example, the Financial Crimes Enforcement Network (FinCEN), an organization within the Department of the Treasury that has overall authority for enforcement of the BSA, recently reported that BSA documents were used to trace millions of dollars of organized crime-controlled sports-betting proceeds through casinos. According to police, the ring handled several million dollars a month and its operators paid “tributes” to organized crime figures.

Within the Internal Revenue Service (IRS), the Small Business/Self-Employed Division Fraud/BSA function has overall responsibility for the BSA Program. In addition, the Tax Exempt and Government Entities Division Indian Tribal Governments (ITG) office assumed responsibility for administering some parts of the BSA program for Indian tribes in April 2002 by signing a Memorandum of Understanding with the Fraud/BSA function.

Currently, 225 tribes operate 442 casinos. According to the National Indian Gaming Association, estimated revenues from these operations have climbed at double-digit rates and increased from \$17 billion to almost \$25 billion in the last 2 years.<sup>2</sup> Tribal gaming is the fastest growing segment of the gaming industry. IRS examinations have regularly encountered weak internal control practices on the part of nontaxable entities, including Indian tribal casinos. These weaknesses can result in tribal casinos being used as accommodating parties to enable money laundering to occur<sup>3</sup> because tribal entities, as sovereign governments, are not required to file income tax returns to report income.

***Law enforcement agencies use reports of large-dollar and suspicious transactions for identifying and intercepting terrorist funding and other criminal activity through casinos and banks, including the \$25 billion Indian tribal gaming industry.***

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<sup>1</sup> Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. Sections 103.11-103.77 (2007).

<sup>2</sup> We did not have access to and therefore could not verify the information from the National Indian Gaming Association.

<sup>3</sup> Money laundering can occur in casinos by exchanging cash for “chips” and converting the chips back into money.



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While this report discusses some of the results of BSA enforcement activities, our audit scope did not include evaluating activities completed by the 1) Fraud/BSA function to obtain missing large-dollar or suspicious transaction reports as the result of an examination, 2) IRS Criminal Investigation Division to pursue criminal sanctions, or 3) FinCEN to pursue the assessment of penalties. In addition, this audit was conducted while changes were being made to the BSA program. Any changes that have occurred since we concluded our analyses in April 2008 are not reflected in this report. Consequently, this report might not reflect the most current status of the IRS BSA program.

This review was performed at the Tax Exempt and Government Entities Division ITG Headquarters Office and the Small Business/Self-Employed Division Fraud/BSA function in Washington, D.C.; the ITG field office in Buffalo, New York; and the Enterprise Computing Center<sup>4</sup> in Detroit, Michigan, during the period December 2007 through April 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>4</sup> IRS Computing Centers support tax processing and information management through a data processing and telecommunications infrastructure.





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## *Results of Review*

### ***Noncompliance Is Identified and Addressed, but Improvements Could Further Assure That Potential Criminal Activities Are Detected and Acted Upon***

The ITG office and the Small Business/Self-Employed Division Fraud/BSA function have been effective in identifying and addressing Indian tribal entities that are not compliant with the BSA. The IRS has identified tribes required to comply with the BSA and focused its efforts on those with the highest risk of noncompliance. When indications of noncompliance are identified, the IRS takes action to correct these deficiencies by providing increased educational contacts to help tribes understand BSA requirements, pursuing unfiled information reports during educational contacts and examinations, and referring cases with willful noncompliance to the IRS Criminal Investigation Division to develop for prosecution. If the Criminal Investigation Division does not accept a case for further development, the Fraud/BSA function can forward the case to the FinCEN for potential penalty assessment when appropriate.<sup>5</sup>

However, improvements could further assure that tribal noncompliance can be addressed through enforcement action to deter future criminal activities and identify Indian tribes with the highest risk of noncompliance.

#### **Noncompliance with the BSA is identified and addressed**

The Memorandum of Understanding between the ITG office and Fraud/BSA function includes procedures for identifying and addressing potential noncompliance with the BSA and is intended to maximize effectiveness and efficiency by assigning responsibility to each office according to its area of expertise. The procedures outlined in the Memorandum of Understanding are consistent with internal guidelines in the Internal Revenue Manual, and we did not identify any omissions that would have a material effect on the BSA program. More importantly, the procedures in the Memorandum of Understanding are effective in identifying and addressing noncompliance with the BSA.

#### **Identifying noncompliance**

The ITG office and Fraud/BSA function effectively identify noncompliance by performing an annual analysis to identify high-risk entities and to select entities for examination based on the

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<sup>5</sup> When considering penalty assessment, the FinCEN considers factors such as whether violations resulted from negligent or willful action, what the violations were and the number that occurred, or the length of time the violations persisted.



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risk analysis. Examinations of books and records for a limited number of tribal entities have identified a high percentage of actual noncompliance.

Through outreach efforts and Internet research for revenue indicators such as the number of tables or games at casinos, the IRS has identified 286 tribal entities—out of a population of more than 2,500—that are required to comply with the BSA. The ITG office uses ratios and a point system—which includes input from the Federal Bureau of Investigation and ITG office field specialists who are familiar with tribal businesses—to determine which of the 286 tribal entities have the highest risk of being noncompliant with the BSA. For example, a specialist might have specific knowledge of internal control weaknesses within the tribal entity’s operations or might have received a referral from a tribal employee. When completed, the final prioritized list of tribal entities with potential noncompliance is forwarded to the Fraud/BSA function for examination consideration.

The Fraud/BSA function generally selected tribal entities for examination based on the results of the ITG office risk analysis and identified noncompliance from most entities selected. Examinations of all 286 tribal entities required to comply with the BSA have not been performed. However, the IRS identified noncompliance in 34 (97 percent) of the 35 examinations closed from September 30, 2005, through November 9, 2007, that we reviewed.<sup>6</sup>

- **Reporting violations** – Reporting violations were identified in 26 (74 percent) of the 35 examinations because entities failed to report large-dollar or suspicious transactions to the IRS. For example, a reporting violation occurs when an individual exchanges more than \$10,000 in cash for chips in a casino and the exchange is not reported to the IRS on a Currency Transaction Report by Casinos (FinCEN Form 103). Another example of a reporting violation is a casino’s failure to file a Suspicious Activity Report by Casinos and Card Clubs (FinCEN Form 102) for any suspicious activity or transaction of less than \$10,000. Information on these Forms is used by law enforcement agencies to help identify individuals who might be involved in laundering large amounts of money related to criminal activities.
- **Recordkeeping violations** – Recordkeeping violations were identified in 20 (57 percent) of the 35 examinations because casinos did not document and retain identifying information on individuals making certain transactions in a casino (e.g., casinos failed to maintain or document the names and addresses of individuals who might have a credit account with the casino). These records are used by law enforcement agencies to identify specific individuals who might be involved in illegal activities.

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<sup>6</sup> The data extract provided to us by the Fraud/BSA function showed that 46 examination cases were closed during the period. Four cases could not be located, and we did not review seven additional cases because they were surveyed and not examined. Some examinations identified multiple violations. Therefore, the total number of violations will be greater than 35.



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- **Program violations** – Program violations were identified in 19 (54 percent) of the 35 examinations because casinos did not include certain internal control procedures in their BSA programs. For example, casinos' BSA programs did not include or document independent testing of internal controls to identify reportable transactions and employee training that emphasized identification of large-dollar and suspicious cash transactions.

**Addressing noncompliance**

The IRS has effectively addressed noncompliance by 1) conducting BSA compliance checks for entities that are not examined but are at risk of being noncompliant, 2) creating procedures to obtain missing documentation during examinations, and 3) referring cases with willful noncompliance to the IRS Criminal Investigation Division to develop for prosecution. If the Criminal Investigation Division does not accept a case for further development, the Fraud/BSA function can forward the case to the FinCEN for potential penalty assessment when appropriate.

- Between January 2007 and February 2008, the ITG office completed 49 BSA compliance checks to review BSA procedures for tribal entities at risk of noncompliance but not examined by the Fraud/BSA function. Unlike an examination or audit, a BSA compliance check is a voluntary process (for the tribe) wherein an ITG office field specialist interviews key personnel in the tribe and asks questions about the tribe to determine whether all recordkeeping and information-reporting requirements are being met. The ITG office field specialist documents an assessment of the compliance risk and any recommendations for future activity needed for that tribal entity. Corrective actions were taken and/or recommendations were made to correct internal weaknesses in 42 (86 percent) of the 49 BSA compliance checks. For example, the ITG office specialists assisted entities in completing and filing delinquent information reports, advised them regarding improving detection of reportable suspicious activities, and made recommendations for employee training required under the BSA.
- The Fraud/BSA function has developed procedures requiring examiners to request that tribes submit or prepare any unfiled information reports that are identified when they are conducting examinations. We observed and reviewed evidence in examination case files that examiners follow these procedures when appropriate.
- The Fraud/BSA function also addressed willful noncompliance by referring cases to the FinCEN for potential penalty assessment when appropriate. We determined that 3 (9 percent) of the 35 closed examinations identified willful noncompliance, and the cases were referred to the FinCEN.

1.2(e)



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1.2(e)

**Improved accounting for BSA notification will help assure that enforcement action can be taken**

The ITG office and Fraud/BSA function could not account for all Notifications of Possible IRS Check to Verify Maintenance of Required Records and Filing Reports (Letter 1052),<sup>7</sup> which are used to advise tribal entities of their BSA compliance requirements. The Memorandum of Understanding requires the ITG office to forward copies of Letters 1052 to the Fraud/BSA function after the Letters have been issued to tribal entities. The Fraud/BSA function is responsible for accounting for the Letters. If tribes are not notified, they might not be aware of their BSA reporting requirements, which could lead to reduced compliance. Without documented evidence that tribes were notified of their responsibilities, the IRS cannot take enforcement actions such as penalty assessments against tribes that have not complied with the BSA, which could also result in revenue lost to the Federal Government.

We determined that the IRS could account for only 65 (71 percent) of the 92 Letters 1052 we requested for review. However, ITG office and Fraud/BSA function management stated that they are confident that all Letters 1052 were issued. They further explained that they believed that the Letters could not be easily located because the responsibilities for issuing and retaining Letters 1052 were once decentralized.

In August 2005, the ITG office accepted responsibility for issuing Letters 1052 from the Fraud/BSA function. ITG office management stated that prior to approval of the Memorandum of Understanding, ITG office specialists made personal visits to each casino in their areas and issued Letters 1052. However, copies of the Letters were not always retained or could not be located. In addition, Fraud/BSA function management stated that their copies of Letters 1052 were filed in examination case files in the field offices where the tribal entities were located. Filing of Letters 1052 was centralized in a new office within the Fraud/BSA function in November 2006, but not all Letters were accounted for.

Management Actions: During the audit, we presented the results of our tests for the accounting of Letters 1052 to IRS management, who recognized the need to better account for the Letters. In a revised Memorandum of Understanding dated March 6, 2008, the ITG office accepted responsibility for accounting for Letters 1052 after they have been issued to tribal entities. In addition, an ITG office official informed us that the Letters would be kept in a central location so that they could be easily located. Because the IRS has taken corrective actions, we are making no recommendations regarding Letters 1052 at this time.

<sup>7</sup> Letters 1052 must include a copy of the current regulations (31 C.F.R., Part 103).



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**Improved feedback could focus risk assessments on issues with greater impact**

As stated previously, the Fraud/BSA function primarily selects entities for examination from a list provided by the ITG office that is prioritized based on a risk analysis. However, feedback to ITG office management on the effectiveness of the risk analysis is infrequently provided and only addresses individual cases. Further feedback was limited because the database used to record the population of tribal entities required to comply with the BSA and data on BSA examinations contained incomplete and inaccurate information. In addition, there is no structured feedback process requiring the Fraud/BSA function to advise the ITG office as to why entities were selected for examination or to provide the actual results of the examinations. Sharing this information could help the ITG office improve the risk assessment process to focus on issues with greater impact.

The Fraud/BSA function maintains a database (the BSA database) comprised of entities engaged in businesses dealing with large amounts of cash, such as casinos, currency exchanges, check cashers, and dealers of gold. This database is used to record the population of tribal entities required to comply with the BSA. In addition, certain fields within the database include information such as the reasons for and the results of examinations.

We reviewed an extract of the population of 376 tribal entities from the BSA database and determined that the data were incomplete and inaccurate.<sup>8</sup>

- 142 (38 percent) of 376 records in the BSA database did not include information identifying each tribal entity (i.e., Employer Identification Number<sup>9</sup>).
- 14 (6 percent) of the remaining 234 records with Employer Identification Numbers in the BSA database were inaccurate and did not have corresponding records in the ITG office database. [REDACTED] This part of the BSA database should include only Indian tribal information.

Without complete and correct data, the Fraud/BSA function does not have an accurate population of entities subject to the BSA requirements. Fraud/BSA function management stated that the BSA database would never fully agree with the ITG database. The BSA database might have entries for two casinos that use one Employer Identification Number. The ITG database would probably contain only one entry for the one Employer Identification Number.

In addition, Fraud/BSA function management cannot easily identify why entities were selected for examination. During our review of data for examinations completed during Fiscal

<sup>8</sup> See Appendix IV.

<sup>9</sup> A unique nine-digit number used to identify a taxpayer's business account.



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Years 2005 through 2007,<sup>10</sup> we could identify why the entity was selected for examination for only 5 (4 percent) of 120 entities.<sup>11</sup> Fraud/BSA function management advised that the reasons for selecting entities for examination are currently documented only in the examination case files. In addition, Fraud/BSA function management advised us that they inherited the BSA database from another office and do not input data in all fields.

Therefore, the Fraud/BSA function cannot systematically inform the ITG office of the results of examinations and why particularly productive cases were chosen for examination. Without this feedback, the ITG office might be unable to improve its risk analysis to better focus on issues with greater impact. For example, it might be useful for the ITG office to know why seven examinations were surveyed (not examined) so that this information could be considered during the next risk analysis or compliance checks could be performed if needed.

**Management Actions:** During the audit, we presented our conclusion that there was no structured feedback process requiring the Fraud/BSA function to provide the ITG office with the results of examinations. In a revised Memorandum of Understanding dated March 6, 2008, the Fraud/BSA function agreed to provide the results of examinations to the ITG office. Because the IRS has taken corrective actions, we are making no recommendations regarding this issue.

After our audit fieldwork had concluded, Fraud/BSA function management advised us that the BSA database is being replaced in the first quarter of Fiscal Year 2009, and the new database will not include “reason for” and “results of examination” database fields. Fraud/BSA function management also advised us that new database fields cannot be added until a later release of the new system, possibly in Fiscal Year 2010 or later.

## ***Recommendations***

**Recommendation 1:** The Director, Fraud/BSA, should ensure that the BSA database is complete and accurate by:

- a) Performing periodic reconciliations of the Fraud/BSA function and the ITG office databases.
- b) Completing all applicable fields in the BSA database when data are available.

**Management's Response:** IRS management agreed with the recommendation. By December 15, 2008, the BSA Policy and Operations manager will provide confirmation to the Director, Fraud/BSA, that a reconciliation of the Fraud/BSA function and the

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<sup>10</sup> We requested an extract of data for all examinations opened and closed during Fiscal Years 2005 through 2007. We could not verify that all examination data for that time period were received because data were not always accurate or complete. In addition, there is no secondary source of BSA examination inventory information with which to validate the BSA extract provided.

<sup>11</sup> See Appendix IV.



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ITG office databases has been completed. The reconciliation will include checks to ensure that all applicable fields in the BSA database are completed when information is available. This reconciliation, in accordance with article 7 of the new Memorandum of Understanding, will be required on a semiannual basis, and its results will be shared with the ITG office.

**Recommendation 2:** The Director, Fraud/BSA, should provide feedback to the ITG office about:

- a) Why Indian tribal entities were selected for examination.
- b) Instances when a case is closed without an examination.

**Management's Response:** IRS management agreed with the recommendation. The Fraud/BSA function will provide the ITG office with classification sheets for each case selected for examination. The classification sheets reflect why an entity is selected for examination. The Fraud/BSA function will provide the sheets to the ITG office upon completion of the examination or when the decision is made to close the referral without an examination.



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to determine whether the IRS effectively identified and addressed Indian tribal entities that are potentially not compliant with the BSA.<sup>1</sup> To accomplish this objective, we:

- I. Compared the Memorandum of Understanding between the ITG office and the Fraud/BSA function to guidance outlined in the Internal Revenue Manual to determine whether there were any omissions that would have a material effect on the BSA program for tribal entities.
- II. Determined whether the ITG office informed tribal governments of their compliance responsibilities and performed risk analyses to identify tribal entities needing additional contact, as outlined in the Memorandum of Understanding. We determined whether the ITG office:
  - A. Performed risk analyses to identify tribal entities for potential noncompliance with the BSA and Internal Revenue Code Section 6050(I).<sup>2</sup>
  - B. Referred tribal entities to the Fraud/BSA function for potential examination.
  - C. Performed BSA and Internal Revenue Code Section 6050(I) compliance checks on tribal entities not selected for examination by the Fraud/BSA function.
- III. Determined whether the Fraud/BSA function fulfilled its responsibilities outlined in the Memorandum of Understanding. We determined whether the Fraud/BSA function:
  - A. Maintained a Fraud/BSA function database (the BSA database), received from the ITG office, of tribal entities required to comply with the BSA and Internal Revenue Code Section 6050(I). To accomplish this, we requested and reviewed an extract of the population of 376 tribal entities from the BSA database. The IRS performed examinations on 120 (32 percent) of the 376 tribal entities during Fiscal Years 2005 through 2007. Data validity tests were performed to determine whether the data were accurate (e.g., dates were not included in numeric fields) and complete (e.g., data

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<sup>1</sup> Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. Sections 103.11-103.77 (2007).

<sup>2</sup> Internal Revenue Code Section 6050(I) requires anyone involved in a trade or business, except financial institutions, to report currency received for goods or services in excess of \$10,000 on a Report of Cash Payments Over \$10,000 Received in a Trade or Business (Form 8300).





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- were not missing from fields). We also compared data fields to examination case files and compared records in the BSA database to records in the ITG database.
- B. Maintained copies of Notifications of Possible IRS Check to Verify Maintenance of Required Records and Filing Reports (Letter 1052). To accomplish this, we reviewed the 65 Letters 1052 received out of the 92 Letters 1052 we had requested. The 92 Letters 1052 represent all Letters associated with examinations or compliance checks conducted on tribal entities during the period September 30, 2005, through November 9, 2007.
  - C. Performed BSA and Internal Revenue Code Section 6050(I) examinations of tribal entities identified by the ITG office as being at risk of noncompliance. To accomplish this, we reviewed 35 of the 46 examinations closed during the period September 30, 2005, through November 9, 2007. The data extract provided to us by the Fraud/BSA function showed 46 records of examination cases were closed during the period. Four cases could not be located, and we did not review seven additional cases because they had been surveyed and not examined.
  - D. Forwarded the results of BSA and Internal Revenue Code Section 6050(I) examinations to the ITG office.
  - E. Referred tribal entities that might not have complied with the BSA and Internal Revenue Code Section 6050(I) to the FinCEN for potential penalty assessments.
- IV. Determined whether actions taken by the ITG office and Fraud/BSA function were effective in identifying and addressing tribal entities with the highest risk of noncompliance with the BSA. We determined whether:
- A. Fraud/BSA function examination results for tribal entities showed that the ITG office risk analysis criteria were good indicators of noncompliance.
  - B. The ITG office used feedback from the Fraud/BSA function to refine its criteria for identifying potentially noncompliant tribal entities.
  - C. The Fraud/BSA function examined the highest priority entities based on the list provided by the ITG office.
  - D. The Fraud/BSA function created taxpayer burden by reviewing lower priority cases that did not identify noncompliance.

### **Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the



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following internal controls were relevant to our objective: the ITG office and Fraud/BSA function policies, procedures, and practices for identifying and addressing potential noncompliance with the BSA. We evaluated these controls by interviewing management, reviewing applicable information, and reviewing BSA examination cases referred to the Fraud/BSA function by the ITG office.



*Indian Tribal Noncompliance With the Bank Secrecy Act Is  
Effectively Identified and Addressed,  
but Improvements Can Be Made*

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**Appendix II**

*Major Contributors to This Report*

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)  
Troy D. Paterson, Director  
Gerald T. Hawkins, Audit Manager  
Julia Moore, Lead Auditor  
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**Appendix III**

*Report Distribution List*

Commissioner C  
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Chief, Criminal Investigation SE:CI  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T  
Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division SE:S:F/BSA  
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE  
Director, Indian Tribal Governments, Tax Exempt and Government Entities Division  
SE:T:GE:ITG  
Chief Counsel CC  
National Taxpayer Advocate TA  
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Director, Office of Program Evaluation and Risk Analysis RAS:O  
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    SE:T:CL  
    Director, Communications and Liaison, Small Business/Self-Employed Division  
    SE:S:CLD:PSP:GTL



***Indian Tribal Noncompliance With the Bank Secrecy Act Is Effectively Identified and Addressed, but Improvements Can Be Made***

**Appendix IV**

***Outcome Measure***

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

**Type and Value of Outcome Measure:**

- Reliability of Information – Actual; 270 taxpayer accounts affected (see page 3).

**Methodology Used to Measure the Reported Benefit:**

We compared an extract of the population of tribal entities on the Fraud/BSA function database (the BSA database) to tribal entities on the ITG office database that are required to comply with the BSA.<sup>1</sup> We identified the following inaccurate and incomplete information:

- 142 (38 percent) of 376 records in the BSA database did not include information identifying each tribal entity (i.e., Employer Identification Number<sup>2</sup>).
- 14 (6 percent) of the remaining 234 records with Employer Identification Numbers in the BSA database were inaccurate and did not have corresponding records in the ITG office database. [REDACTED]
- 115 (96 percent) of 120 records for examinations completed during Fiscal Years 2005 through 2007 did not include why the entity was selected for examination.<sup>3</sup>

Without complete and correct data, the Fraud/BSA function does not have an accurate population of entities falling under the BSA requirements. In addition, knowing why entities were selected for examination by the Small Business/Self-Employed Division Fraud/BSA function might help the ITG office improve its risk analysis process.

<sup>1</sup> Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. Sections 103.11-103.77 (2007).

<sup>2</sup> A unique nine-digit number used to identify a entity's business account. [REDACTED]



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**Appendix V**

*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

AUG 13 2008

COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

August 11, 2008

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner  
Acting Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Indian Tribal Noncompliance With the Bank Secrecy Act is Effectively Identified and Addressed, but Improvements Can Be Made (TIGTA Audit No. 200810027)

Thank you for the opportunity to comment on the Treasury Inspector General for Tax Administration's report entitled, "Indian Tribal Noncompliance With the Bank Secrecy Act is Effectively Identified and Addressed, but Improvements Can Be Made". We agree with the recommendations made in the report and appreciate your recognition of our program's successes during the past two years.

Ensuring Indian tribal government compliance with Bank Secrecy Act (BSA) reporting requirements is a significant management challenge. The effectiveness of the Memorandum of Understanding (MOU) between the SB/SE BSA function and the Tax Exempt and Government Entities, Indian Tribal Government (ITG) office is central to those efforts. As your report acknowledges, a revised MOU dated March 6, 2008, clearly outlines responsibility for centralizing and accounting for issued Letters 1052, Notifications of Possible IRS Check to Verify Maintenance of Required Records and Filing Reports, as well as the SB/SE BSA function providing structured feedback to ITG regarding examination results.

An enhanced BSA database is pending launch in FY 2009. This enhanced database will contribute significantly to effectively ensuring increased information sharing between the operating divisions, inventory integrity through reconciliation efforts, and the consistency of data input allowing accurate trend analysis and enhanced records accountability.

In the meantime, we have corrected the inaccurate information in the database and established a structured feedback process for the SB/SE BSA function to share information with ITG on the reason an entity was selected for examination.

Attached is a detailed response outlining our corrective actions.



*Indian Tribal Noncompliance With the Bank Secrecy Act Is  
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If you have any questions, please contact me or Beth Elfrey, Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division at (202) 622-4699.

Attachment



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Attachment

**Recommendation 1:**

The Director, Fraud/BSA function should ensure that the BSA database is complete and accurate by:

- a) Performing periodic reconciliations of the Fraud/BSA function and the ITG office databases, and
- b) Completing all applicable fields in the BSA database when data are available

**Corrective Action:**

We agree with this recommendation. By December 15, 2008, the BSA Policy and Operations manager will provide confirmation to the Director, Fraud/BSA that a reconciliation of Fraud/BSA function and the ITG office databases has been completed. The reconciliation will include checks to ensure all applicable fields in the BSA database are completed when information is available. This reconciliation, in accordance with article 7 of the new MOU, will be required on a semi-annual basis, and its results will be shared with ITG.

**Implementation Date:**

December 15, 2008

**Responsible Official:**

The Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division

**Corrective Action Monitoring Plan:**

The Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division will ensure the corrective actions are taken by the implementation date or provide justification to reschedule the implementation date.

**Recommendation 2:**

The Director, Fraud/BSA function should provide feedback to the ITG office about:

- a) Why Indian tribal entities were selected for examination, and
- b) Instances when a case is closed without an examination

**Corrective Action:**

We agree with this recommendation. BSA will provide ITG with classification sheets for each case selected for examination. The classification sheets reflect the reason an entity is selected for examination. BSA will provide the sheets to ITG upon completion of the examination or when the decision to close the referral without an examination is made.

**Implementation Date:**

December 15, 2008

**Responsible Official:**

The Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division





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*Indian Tribal Noncompliance With the Bank Secrecy Act Is Effectively Identified and Addressed, but Improvements Can Be Made*

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**Corrective Action Monitoring Plan:**

The Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division will ensure the corrective actions are taken by the implementation date or provide justification to reschedule the implementation date.