

Office of Inspector General

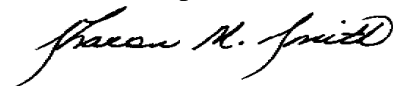


March 30, 2001
Audit Report No. 01-013

Examination Assessment of Bank Secrecy
Act Compliance



DATE: March 30, 2001

TO: Michael J. Zamorski, Acting Director
Division of Supervision


FROM: Sharon M. Smith
Assistant Inspector General

SUBJECT: *Examination Assessment of Bank Secrecy Act Compliance*
(Audit Report No. 01-013)

This report presents the results of the Office of Inspector General's (OIG) audit of the Division of Supervision's (DOS) assessment of financial institutions' compliance with the Bank Secrecy Act (BSA). Generally, we found that DOS did not adequately document its BSA examination work. Therefore, we could not always determine the extent to which DOS examiners reviewed regulated institutions' compliance with BSA. Additionally, we found that DOS can improve the planning process for the BSA examinations.

BACKGROUND

In 1970 the United States Congress passed the Bank Secrecy Act to aid law enforcement agencies in the investigation of suspected criminal activity ranging from income tax evasion to money laundering by organized crime. More recently, law enforcement agencies have found BSA reports and records maintained by financial institutions extremely valuable in investigating drug trafficking.

The BSA regulations require all financial institutions to maintain certain records and prepare reports on cash transactions by and through financial institutions in excess of \$10,000 into, out of, and within the United States. Specifically, a financial institution must file a Currency Transaction Report (CTR) with the Internal Revenue Service for each cash transaction over \$10,000 or multiple cash transactions by an individual in one business day aggregating over \$10,000. In addition, BSA requires financial institutions to file a Suspicious Activity Report (SAR) with FinCEN when suspected money-laundering activity or BSA violations occur.¹ Finally, the U.S. Department of the Treasury (Treasury) Office of Foreign Assets Control (OFAC) promulgated regulations that require banks to identify transactions with prohibited

¹ Treasury's Financial Crimes Enforcement Network (FinCEN) collects, analyzes, and shares information and provides technical assistance to support law enforcement investigative efforts against domestic and international financial crimes. Using BSA information reported by financial institutions, FinCEN serves as the nation's central clearinghouse for broad-based intelligence and information sharing on money laundering that helps illuminate the financial trail for investigators to follow as they track criminals and their assets. FinCEN also provides policy makers with strategic analyses of domestic and worldwide money-laundering developments, trends, and patterns.

entities and notify OFAC when such transactions are attempted or completed.² OFAC rules may require an institution to reject or freeze the funds involved in these transactions. Violations of BSA and OFAC recordkeeping and reporting requirements expose financial institutions to substantial penalties.

The FDIC has developed comprehensive examination procedures to determine whether financial institutions properly implemented BSA provisions and to independently identify instances of potential money laundering. The FDIC's BSA examination procedures, in the form of the BSA Examination Documentation (ED) Module, were jointly developed with the Federal Reserve and are structured in a three-tiered examination process: Core Analysis, Expanded Analysis, and Impact Analysis. The Core Analysis and Expanded Analysis tiers have a set of examination procedures and decision factor questions. The Impact Analysis has a set of questions that prompts the examiner to review the impact of deficiencies identified in the Core and Expanded Analysis on the institution's overall condition and to consider possible supervisory options. The decision factors are answered based on the conclusions reached for the procedures performed within the tier. The extent to which an examiner works through each tier of analysis depends on the conclusions (decision factor answers), risks, and deficiencies noted in the preceding tier. The responsibility for performing the FDIC's BSA examinations resides with DOS, and the BSA exam is performed as 1 of 10 ED Modules during the safety and soundness examinations.

DOS has implemented a risk-focused examination program designed to focus examination resources on those areas that pose the greatest risk to the insured institution. The DOS examiner performs pre-examination risk scoping activities using the Risk Scoping ED Module, a critical element of the safety and soundness exam as a whole. During the risk scoping and pre-examination process, the examiner develops an examination plan that is commensurate with the level of risk in each functional area, including BSA, of the financial institution. The risk scoping assessment should determine which examination tiers will be performed as well as the extent of the procedures within the tiers. The risk scoping assessment is documented in a Scope Memorandum.

Specifically, during DOS's safety and soundness examinations, the BSA examination procedures require DOS examiners to determine whether bank management:

- established adequate policies and procedures in accordance with the anti-money laundering laws and regulations;
- developed a system to identify large currency deposits, including numerous small deposits that, when aggregated, exceed the reporting threshold;
- identified, investigated, and reported suspicious transactions;
- assigned responsibility for ongoing compliance with the BSA and financial recordkeeping regulations to a qualified and knowledgeable person;
- established an adequate ongoing BSA training program for its employees; and
- performed internal reviews and independent audits to identify potential deficiencies in the BSA program.

² OFAC restricts transactions by U.S. persons or entities, located in the U.S. or abroad, with certain foreign countries, their nationals, or special designated nationals. OFAC regularly provides to banks, or banks may subscribe to certain databases or other information providers to receive, current listings of foreign countries and designated nationals that are prohibited from conducting business with any U.S. entity or individual.

DOS spent approximately 3 percent of its total examination time on the BSA ED Module during the period of March 31, 1999 through May 15, 2000. The percentage of time spent remained relatively consistent for examinations of both large institutions with assets in excess of \$1 billion and for institutions with assets of \$1 billion or less. However, in certain BSA exams, we found that the examiners spent additional time where risks were identified.

In the wake of a much-publicized Bank of New York money laundering scandal in 1999, the question of whether the BSA is fulfilling its mission gained renewed interest from the legislative and executive branches of the federal government. As recently as the fall of 1999, the Congress proposed legislation aimed at enhancing certain provisions of the BSA.

Additionally, the Departments of Treasury and Justice jointly issued a revised National Money Laundering Strategy in March 2000 assigning responsibility for implementing parts of the strategy to bank regulatory agencies, including the FDIC, to enhance efforts to prevent money laundering. The strategy specifically stated that regulatory agencies should continue to review existing examination procedures and, where necessary, revise, develop, and implement new examination procedures that will ensure that anti-money laundering supervision is risk focused. The regulatory agencies were tasked with placing increased emphasis on identifying those institutions or practices that are most susceptible to money laundering. An essential part of the strategy was the identification of High Intensity Money Laundering and Related Financial Crime Areas (HIFCAs) for 2000. The HIFCAs for 2000 are: New York/Northern New Jersey; the Los Angeles metropolitan area; San Juan, Puerto Rico; and the states that border Mexico (Texas, Arizona, New Mexico, and California).

Recent legislative concerns have included the effectiveness of safety and soundness examiners in detecting money-laundering activities through SARs and CTRs. In September 2000 the Office of the Comptroller of the Currency issued new guidelines for examiners, including the mandatory review of SARs and related bank activities. We plan to conduct a follow-up audit that will focus on the use of SARs and CTRs during FDIC's examination process. We will include a review of the examination procedures of other federal bank regulatory agencies in an attempt to identify best practices.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine the extent to which DOS examiners reviewed regulated institutions' compliance with the BSA during the course of the safety and soundness examinations of financial institutions.

To accomplish our audit objective, the OIG interviewed DOS headquarters and Dallas, San Francisco, and New York regional management personnel. We judgmentally selected and interviewed field examiners who either supervised or performed BSA examination work. We also reviewed the *DOS Manual of Examination Policies*, DOS Regional Directors Memoranda, FDIC Financial Institution Letters, DOS BSA training materials, and the Risk-Focusing and BSA ED Modules to obtain an understanding of the policies and procedures that determine the scope

and requirements for BSA examination work. Finally, we reviewed current news articles, proposed legislation, and other agency BSA audit reports and related documents to gain an understanding of third party concerns and viewpoints of the regulators' role and responsibilities in combating money laundering.

We reviewed 50 BSA examinations along with the related correspondence and administrative files. Initially, we judgmentally selected 30 examinations from the Dallas regional office based on institution size and geographic location. Based on our initial results, we judgmentally selected 20 additional BSA examinations performed at financial institutions in HIFCA geographic locations. These 20 examinations were specifically selected from institutions located in the states that border Mexico and the San Francisco and New York regional offices. We limited our review to the BSA ED Module's first tier Core Analysis decision factors and examination procedures to focus our review only on those BSA exam procedures performed at the majority of the financial institutions. We reviewed the DOS BSA exam workpapers, the general safety and soundness correspondence and administrative files, independent reviewer audit reports, and various FDIC and state examination reports.

From the sample of 50 BSA exams, we reviewed 45 of the pre-examination Scope Memorandum comments relating to the BSA ED Module.³ This review was essential for developing an understanding of the risk-scoping and pre-examination planning activities performed by examiners to risk-focus the BSA exam. We also selected 10 HIFCA BSA examinations in our sample of 50 to review other related ED Modules such as electronic wire transfers, electronic banking, and international banking. For these 10 BSA exams we assessed the extent the examination work under these other ED Modules impacted the BSA examination.

We performed fieldwork at the DOS headquarters in Washington D.C., as well as the Dallas, New York, and San Francisco regional offices and at 14 field offices within those regional offices. We reviewed examinations performed during the period of March 31, 1999 through May 15, 2000. We conducted our audit work from May 2000 through September 2000 in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

Our review found that DOS examiners did not adequately document their BSA work in the pre-examination Scope Memorandum and ED Module. As a result, we could not always determine the extent to which DOS examiners reviewed regulated institutions' compliance with the BSA during safety and soundness examinations. We believe the BSA examinations were not sufficiently documented in the workpapers because examiners did not receive consistent guidance from management regarding what constitutes adequate documentation to support their scoping decisions and conclusions reached for the decision factors. Although additional formal examiner training for the BSA exam is being provided in 2000/2001, the training material does not clarify and reinforce DOS examination documentation requirements.

³ Five exams did not have the general safety and soundness administrative files available for various reasons, i.e., state examiners retained files, files were checked out for use in a current ongoing examination, etc.

We also found that examiners could have improved their BSA exam planning by taking full advantage of the various BSA information systems available and by clarifying the OFAC planning procedure. Specifically, examiners did not consistently use the independent FinCEN examination support databases that contain information on CTRs and SARs during the examination planning process. We also found that the examiners generally did not review the OFAC listing to identify a financial institution's potential violations of OFAC regulations. We believe that more consistent use of the independent examination support databases will result in more effective identification of risks associated with BSA activities at each institution. In addition, we recognize examiners are not required to compare OFAC listings with accounts at institutions under examination. However, we believe the current BSA ED Module planning procedure relating to OFAC listings needs clarification to ensure examiners effectively monitor an institution's compliance with OFAC regulations.

BSA EXAM DOCUMENTATION CAN BE IMPROVED

DOS management can improve the BSA exam process by ensuring that examiners adequately document both the Scope Memorandum and the ED Module. DOS policy recognizes that pre-examination planning and the Scope Memorandum are critical elements in the risk-focused examination process and that the ED Modules are the basis for adequate examination documentation. However, we found that DOS examiners did not adequately document the preplanning Scope Memorandum to describe the extent to which BSA ED Module decision factors and procedures would be completed. We also found that the examiners did not consistently document the ED Module during the examination process in order to leave a written trail of their decisions and supporting logic.

We believe these conditions existed because examiners received inconsistent guidance regarding what constituted sufficient documentation to support their scoping decisions, exam procedures, and answers to the decision factors. Further, we believe a lack of formal BSA training since the three-tiered ED Module procedures were implemented in 1997 contributed to these inconsistencies. DOS's 2000/2001 BSA training initiative should provide examiners with an improved understanding of the BSA examination process. However, the training does not clarify and reinforce the DOS examination documentation requirements established to identify the extent BSA procedures are performed at each examination.

Scope Memorandum Did Not Adequately Document BSA Risk-Scoping Process

The BSA risk-scoping and pre-examination planning process was not adequately documented in the Scope Memoranda we reviewed. When a Scope Memorandum is prepared in accordance with DOS policy, it should provide justification for the examiner's decision to limit the BSA review. A Scope Memorandum is intended to increase the efficiency of the exam process by eliminating unnecessary decision factors and examination steps.

The BSA Core Analysis contains the standard series of examination procedures for examiners to consider, but not necessarily perform, at every examination. The examiner should understand the unique characteristics, complexity, and risk profile at each institution in deciding which procedures should be performed and which should be excluded. The Examiner-in-Charge (EIC) is responsible for developing a pre-examination plan commensurate with the level of risk in each ED Module, including the BSA Module. This pre-examination plan is developed to justify the scope of procedures performed during the exam. DOS policy states that examiners may omit procedures when risk-scoping indicates either low materiality or an insignificant level of risk as long as the EIC prepares a Scope Memorandum justifying the decision. According to DOS policy, the memorandum should explain the reasons for setting/establishing the scope of the examination for each ED Module.

Regional Directors Memorandum 99-011 (RD 99-011) dated March 23, 1999 entitled *Risk-Focused Examination Program – Documentation Requirements* provided examiners greater flexibility by no longer requiring that they answer all decision factors in the ED Modules. The BSA ED Module includes six Core Analysis decision factors that represent the examiner’s summary conclusions of the Core Analysis procedures performed. RD 99-011 states that the examiner does not have to answer those decision factors when the examiner decides an answer is not needed due to risk-scoping. The basis for this decision is to be documented in the Scope Memorandum. RD 99-011 also states that when a decision factor can be answered “yes” during the risk-scoping process, no further comments are necessary in the ED Module because the supporting comments are included in the Scope Memorandum. However, for the portions of the BSA ED Module where risks are deemed significant or poorly controlled, RD 99-011 requires the examiner to perform Core Analysis procedures and document conclusions. The DOS examination manual requires the examiner to answer “yes” or “no” for the related decision factors with high risk and provide supporting documentation for each answer. The documentation to support the decision factors is completion of those required Core Analysis procedures that are performed based on the risk-scoping decisions documented in the Scope Memorandum.

Our review of 45 Scope Memoranda indicated that for the majority of examinations the examiners did not adequately document the risk-scoping activities related to the BSA ED Module as required by RD 99-011. We typically found that the Dallas region examiners printed out the Risk-Scoping ED Module and used it as a checklist in the pre-planning process rather than providing answers to the risk-scoping exam procedures to support comments in the Scope Memorandum. We found that the New York and San Francisco region examiners did complete the Risk-Scoping ED Module, but did not always provide comments in the Scope Memorandum to document the risk-scoping activities of the BSA ED Module.

For 41 of the 45 (91 percent) Scope Memoranda we reviewed, examiners did not provide specific information commenting on risk-scoping the BSA examination. Some memoranda contained general comments, such as, “Core analysis procedures will be performed for all 10 primary modules,” “All applicable examination modules will be completed...risk focused procedures will be implemented where possible,” or “Bank Secrecy Act will be reviewed utilizing the Core Analysis Decision Factors.” In other memoranda we found more specific BSA comments addressing the scope of the BSA exam. However, these memoranda were also general in nature and clearly did not indicate the areas of risk where further analysis by the examiner was necessary. These memoranda stated that either normal BSA procedures would be performed, or the BSA exam would be risk-

focused with Core Analysis procedures performed, or the BSA exam would receive a full-scope review.

The remaining 4 of the 45 Scope Memoranda were adequately documented to show the scope of the BSA exam. These four exams were all performed by New York region examiners. It was evident in the four adequately documented memoranda that the examiners used the information provided by the regional BSA Subject Matter Expert to scope the BSA work.⁴ Overall, when examiners did not provide comments to specific procedures in the BSA ED Module, we seldom found related comments in the Scope Memoranda to justify why the procedures were not performed.

RD 99-011 considers the BSA Core Analysis procedures as a requirement that must be completed at every examination. However, the DOS policy also provides guidance to the examiners for risk-scoping the BSA Module. For example, when the institution's BSA policies have not changed from the previous examination, the DOS policy does not require the examiners to review the BSA policies. Because examiners generally did not document the pre-examination assessment of the BSA risk areas in the Scope Memoranda, we were not able to determine how the DOS examiners assessed the risks to limit the BSA examination procedures performed or determined which decision factors would be answered.

Although the risk-focused approach to examining financial institutions has been improving since its inception in October 1997, we found that examiners do not fully document the pre-planning process for the BSA examination. The examiner misunderstandings and uncertainties regarding documentation in the pre-planning process were first reported in our report entitled *Audit of Implementation of the DOS Risk-Focused Examination Process*, dated November 5, 1998. DOS responded to our audit findings by issuing Regional Directors Memorandum 98-100, dated December 16, 1998, which reinforced guidance on pre-planning and documentation of ED Modules. Following the issuance of this new guidance, we performed a second review of the pre-planning and documentation of ED Modules. In our report entitled *Follow-up Audit of Implementation of the DOS Risk-Focused Examination Process*, dated May 2000, we reported improvements in risk focusing, but we also noted inconsistent documentation of the modules. Although the follow-up audit report stated that the examiners had improved their risk-focusing approach in the safety and soundness examination overall, we found in our current detailed review of risk-focusing the BSA examination that examiners were not fully following DOS policy. Accordingly, we believe DOS needs to reinforce the risk-focusing process to the examiners performing BSA examinations.

DOS management told us that a new BSA examiner training initiative was implemented in the fall of 2000. We believe the examiners will benefit from this training initiative. However, the training curriculum does not stress the importance of documenting the pre-examination assessment of BSA risks in the Scope Memorandum as required by RD 99-011. The BSA examination documentation requirements need to be addressed and corrected for DOS management to better understand the BSA risks at each financial institution. By requiring better documentation during the preplanning process on which BSA exam procedures will be performed, DOS can ensure that its staffing resources are more effectively used for the entire safety and soundness exam.

⁴ These regional examiners are considered to have special knowledge in BSA matters and may be used as a resource by other examiners. Some DOS regional offices refer to these experts as Fraud Specialists or Special Activities Case Managers. Further, certain DOS field offices also have designated staff as BSA Subject Matter Experts.

BSA ED Modules Not Adequately Documented

After completion of the risk-scoping process, the examiners did not adequately document the procedures performed in the BSA ED Module. The *DOS Manual of Examination Policies* requires examiners to sufficiently document procedures performed and conclusions reached in their workpapers. However, because the examiners did not consistently document the work performed and the decisions reached during their BSA examinations of financial institutions, we were not able to determine the basis for the examiners' conclusions regarding an institution's BSA compliance. As previously noted, DOS examiners should rely on the Scope Memorandum to establish the decision factors and related procedures to be completed during the BSA examination. Once all necessary steps are determined during the risk-focused pre-examination process, the DOS examination manual states that the documentation requirement can be met through the use and completion of the ED Module. According to the manual, the examiner's workpapers should include a summary of the procedures performed at each examination. The use and completion of the ED Module procedures meet the workpaper requirement. The workpapers should also include a brief summary of the basis for conclusions reached. This workpaper summary requirement is satisfied by use of the ED Module decision factors. Based on our review of the 50 BSA exam files, we found no other form of workpaper documentation to support BSA work performed. In most of the BSA examinations we reviewed, Core Analysis procedures were needed to support the examiners' answers to the Core Analysis decision factors because the Scope Memorandum did not document the elimination of any decision factors or procedures.

We reviewed 50 BSA examination files covering 14 field offices in three regions (33 in Dallas, 8 in New York, and 9 in San Francisco). We found that each BSA file contained fairly consistent documents that were obtained from the financial institution. The file documentation usually included copies of the institution's anti-money laundering policies and procedures, reports of independent or internal audit review of these policies and procedures and testing of the related controls, employee training materials and rosters, and other miscellaneous BSA-related materials. These documents were incorporated in the files as the basis for answering the Core Analysis procedures that would support the decision factor conclusions.

Our review found that Scope Memoranda did not generally provide sufficient documentation to support eliminating BSA ED Module decision factors or procedures. Therefore, we reviewed the completion of the BSA ED Module and workpaper documentation to determine the exam procedures performed and decision factors answered for all 50 examinations in our sample. Although completion of the ED Module was intended to serve as adequate documentation for work performed, our review of the BSA workpapers found that in 22 percent of the examinations, the Core Analysis decision factor responses were not documented. Further, we found that 48 percent of the Core Analysis exam procedures were not documented. We considered the decision factor and/or procedure as not documented when the examiner did not provide any answer to the procedure, simply placed a check mark by the procedure, or wrote "N/A" with no additional comments.

An example of where documentation can be improved was in our review of the internal audit/independent review of BSA compliance. Each financial institution is required to have an annual independent BSA compliance review, and one of the examination decision factors asks: "Is the scope of the internal audit/independent review appropriate?" To evaluate this decision factor, we

reviewed the scope statement of the independent reviewer's report for 45⁵ of the 50 BSA files in our sample. We found that 13 reviews were performed by external parties and 32 were performed internally by financial institution personnel. The results were consistent for both types of reviews: that is, 20 scope statements (5 external and 15 internal reviews) in the independent reviewer reports did not adequately show review coverage of the BSA compliance issues noted in the Core Analysis procedures. Specifically, the BSA exam files relating to these 20 reports were not adequately documented to show what steps the examiner performed or how a decision was reached on the appropriateness of the independent reviewer's scope. Our interviews with examiners indicated that examiners typically limit their review to reading the independent reviewer's report. The examiners seldom review the independent reviewer's workpapers to determine the scope of their review. We consider these annual independent compliance reviews to be especially important when the FDIC shares examination responsibility with the states because some states consider the BSA exam to be a federal compliance issue and therefore do not perform the BSA review.

We believe these documentation deficiencies occurred because examiners received inconsistent guidance regarding the discretion they have in determining what constitutes sufficient documentation to support their decisions. Our interviews disclosed that many examiners believed that responses to decision factor questions could be limited to a "Yes" or "No" response, regardless of what was contained in the Scope Memorandum. However, RD 99-011 states that "Yes" or "No" responses to decision factors are only acceptable if supporting comments are contained in the Scope Memorandum. Further, many examiners said that they are instructed to always complete the Core Analysis. RD 99-011 states that Core Analysis decision factors and procedures may be omitted when the risk scoping indicates a lack of materiality or an insignificant level of risk. We believe examiners' lack of formal BSA training since implementation of the ED Modules in 1997 may have contributed to the inconsistencies as to what constituted adequate documentation. Although DOS management implemented a BSA training initiative for 2000/2001, the training material does not clarify and reinforce the BSA documentation requirements.

BSA CORE ANALYSIS PLANNING CAN BE IMPROVED

DOS management can improve the planning for the BSA ED Module by ensuring examiners take full advantage of the BSA information systems available and clarifying the OFAC planning procedure. Current DOS policy recognizes pre-examination planning as a critical element in the risk-focused examination process. However, we found examiners were not consistently using the independent FinCEN support databases that contain information on CTRs and SARs during the BSA examination planning process. We believe more consistent use of these independent databases will result in more effective identification of risks associated with BSA activities at each institution. We also found that the examiners generally did not adequately perform the BSA planning procedure that required the examiner to review the OFAC listing to identify a financial institution's potential violations of OFAC regulations. We believe the current BSA ED Module planning procedure relating to the OFAC listing needs clarification to ensure examiners effectively monitor an institution's compliance with OFAC regulations.

⁵ For the other five files, one BSA file was lost, one BSA file indicated the institution was cited by examiners for inadequate testing by the independent reviewer but the file did not have documentation to support that an independent review was performed, and three BSA files indicated no independent review was performed at the financial institution.

As discussed earlier, at the field offices we visited, we found that DOS examiners did not consistently perform the BSA Core Analysis planning procedures. The Dallas and San Francisco DOS regional examiners did not perform three of the eight BSA ED Module planning procedures. However, the New York DOS region examiners did perform all eight planning procedures. Two of the three planning procedures that Dallas and San Francisco did not perform related to the review of the SAR and CTR independent databases, and the third procedure related to review of the OFAC listing to identify which institutions had potential violations of OFAC regulations.

The Dallas and San Francisco regional examiners we interviewed generally told us that they had sufficient knowledge of the individual banks they have responsibility to examine and therefore did not need to perform the SAR, CTR, and OFAC planning procedures. The examiners explained that access to the CTR and SAR databases is limited to the regional BSA Subject Matter Experts, and the process for requesting and receiving the data is not efficient. The examiners also stated that they generally performed more efficient alternative exam procedures at the financial institutions by requesting and using copies of CTR and SAR listings prepared by the financial institutions. Further, the examiners told us that, generally, the OFAC planning procedure was limited to an inquiry to ensure the institution's management was aware of the OFAC listing. The examiners generally do not review the OFAC listing to determine whether potential OFAC violations have occurred as stated in the BSA module planning procedure.

We noted during our visit to the New York DOS regional office that management had designated a fraud specialist to track the examination start dates. Prior to the start date for each exam, the fraud specialist prepared a report of the FinCEN system SARs and CTRs to meet the BSA ED Module planning requirements. This report was sent to the EIC for use in pre-planning the BSA examination. The report provided a 3-year history of SARs and CTRs filed at the financial institution and indicated whether the institution had significant changes in the volume of SAR and CTR filings since the previous examination as well as whether any suspicious or alleged illegal activity had occurred. The EIC could then use the report to determine whether the scope of the BSA examination should be altered.

The fraud specialist in the New York regional office also prepared summary reports by institution and field office. The summary reports provided the Field Office Supervisors with 5-year histories of SAR and CTR filings and identified whether an institution was located in a High-Intensity Drug Trafficking Area. The New York regional fraud specialist also provided field offices with tracking reports on suspicious activities when the financial institutions had not filed a SAR.

The New York regional examiners we interviewed said their examination of OFAC was limited to determining whether the financial institution was aware of the OFAC listing and whether the institution used OFAC software to comply with the OFAC regulations. The New York examiners also said they seldom planned tests for identifying potential OFAC violations as indicated in the planning procedure.

We believe the New York region BSA planning procedure is an efficient risk-focused examination practice and a good off-site BSA monitoring tool for SAR and CTR information. As such, we believe DOS regional management can improve BSA examinations by providing Dallas and San

Francisco regional examiners SAR and CTR reports similar to those used by New York regional examiners.

DOS management should also consider whether field examiners are effectively performing the OFAC planning procedure to ensure that financial institutions comply with OFAC regulations. We recognize that DOS policy does not require examiners to compare the OFAC listing with accounts at institutions under examination. However, examiners should ensure that financial institutions have policies and procedures in place to monitor compliance with OFAC regulations. The BSA Core Analysis has two additional procedures that address the adequacy of the bank's policies and the independent review of OFAC compliance. However, based on interviews with the examiners and lack of documentation of the BSA exam procedures, we could not always determine whether the examiner ensured adequate controls were in place to monitor OFAC compliance. We believe OFAC planning could be improved by having DOS management clarify the intent of the OFAC planning procedure in the BSA ED Module. The procedure should explain the type of review of the OFAC listing the examiner is expected to perform in order to identify potential OFAC violations. We believe the examiners should document whether an institution's independent reviewer actually tested for OFAC compliance and assess whether the examiner should independently perform OFAC testing.

CONCLUSION AND RECOMMENDATIONS

Although the Treasury and Justice Departments lead the law enforcement effort to combat money laundering, the federal financial regulatory agencies, such as the FDIC, are responsible for the examination of financial institutions to ensure these institutions have created effective internal control systems to detect potential money laundering. Money laundering is on the rise and, therefore, has heightened the concern of the Congress regarding the effectiveness of BSA examinations. In response to this concern, DOS management can improve the overall BSA exam process. Improving the overall BSA exam process through consistent planning and documentation of the ED module will result in exams that are more effectively performed by the FDIC and are more responsive to concerns of external third parties. Better planning and documentation will also help new examiners learn the institutions' risks and examination process quicker, ensure effective controls are in place for the examination process, aid law enforcement agencies in their efforts to combat money laundering, better protect the FDIC's reputation, and maintain public confidence.

Although new BSA training is being provided to the examiners, we believe additional training or instructions will be necessary relating to planning and documenting the BSA examination process. As part of that training, DOS management needs to better communicate its expectations regarding the use of the BSA Scoping Memorandum and ED Module.

Accordingly, we recommend that the Acting Director, DOS:

- (1) Reinforce and ensure that the specific guidance for DOS examiners to follow when risk-focusing BSA examinations—including documentation requirements of scoping decisions, procedures to be performed, and conclusions reached during the pre-examination process is followed.

- (2) Reinforce and ensure that the DOS policy and instructions that describe adequate documentation of the BSA ED Module decision factors and procedures are followed.

These two recommendations could be accomplished through ongoing training and quality reviews of examiners' work.

We further recommend that the Acting Director, DOS:

- (3) Implement in other DOS regional offices the New York region's practice of assigning a regional examination specialist to provide CTR and SAR system reports to field examiners for the risk-focusing and pre-planning process of the BSA examination.
- (4) Evaluate the effectiveness and implementation of the BSA ED Module planning procedure relating to the examiner's review of the OFAC listing of prohibited entities in order to identify potential violations of OFAC regulations.

CORPORATION COMMENTS AND OIG EVALUATION

On March 23, 2001, the Acting Director, DOS, provided a written response to the draft report, agreeing with the intent of our recommendations. The Corporation's response provided us with the requisite elements of a management decision on all recommendations. The Acting Director's response is presented as Appendix 1 to this report. The Acting Director's response to recommendations 1 and 2 along with our analysis follows. We did not summarize the response to recommendations 3 and 4 because the actions planned are identical to those recommended.

Reinforce and ensure that the specific guidance for DOS examiners to follow when risk-focusing BSA examinations-including documentation requirements of scoping decisions, procedures to be performed, and conclusions reached during the pre-examination process, is followed (recommendation 1): The Acting Director stated that "Because the Department of the Treasury has delegated to us the responsibility for ensuring compliance with the BSA . . . we require the six core decision factors to be answered at every examination." The Acting Director also stated that "We have just completed revisions to the BSA Module for inclusion in the next release of ED updates . . . we will reemphasize our existing policies requiring all of the BSA core decision factors to be answered at each examination."

We recognize that the requirement for all of the BSA core decision factors to be answered essentially removes the requirement for BSA scoping decisions or any mention of BSA in the Scope Memorandum. We accept this alternative procedure as a valid alternative to the current guidance on risk-focused examination documentation requirements. Therefore, we consider the Acting Director's response to provide the necessary requisites for a management decision.

Reinforce and ensure that the DOS policy and instructions that describe adequate documentation of the BSA ED Module decision factors and procedures are followed (recommendation 2): The Acting Director stated that "We will reemphasize current guidance regarding the mandatory completion of the core decision factors and the optional use of core analysis procedures when we release revisions to the BSA module, no later than July 31, 2001."

To the extent that this new guidance will emphasize the current requirement to identify in the examiner workpapers which core procedures the examiner opted to perform and the basis of conclusions reached, i.e., answers to the core decision factors, the planned corrective action addresses our recommendations. This information is necessary to provide the written trail of decisions and supporting logic required. Therefore, we consider the Acting Director's response to provide the necessary requisites for a management decision.

We understand that DOS is reassessing examination scoping and documentation requirements in the course of its Process Redesign project. We will review DOS's revised BSA guidance before it is issued to ensure it addresses our concerns and is consistent with the Process Redesign results.




Federal Deposit Insurance Corporation

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Division of Supervision

Date: March 23, 2001

To: Sharon M. Smith
Assistant Inspector General

From: Michael J. Zamorski 
Acting Director

Subject: Draft Report Entitled *Examination Assessment of Bank Secrecy Act Compliance*

The Division of Supervision (DOS) appreciates the opportunity to respond to the subject Draft Report prepared by the FDIC's Office of Inspector General (OIG). Among other things, the Draft Report indicates that Congress has become increasingly concerned about Bank Secrecy Act (BSA) compliance. The Draft Report also indicates that the OIG believes that DOS did not adequately document our BSA work and that the planning process for BSA examinations can be improved.

We agree that recent high profile money laundering cases have highlighted the importance of a sound BSA program in financial institutions. We also recognize that opportunities exist to improve the effectiveness of our BSA examination program, and we will take appropriate steps to implement OIG's recommendations. We do believe that for the vast majority of institutions, BSA compliance is a low risk area. Our outstanding guidance for risk-focused examinations differentiates between high risk and low risk areas. Accordingly, we fully utilize risk-focused procedures in our BSA examinations, which procedures include streamlined documentation.

Also, as you know, we are currently reviewing our examination processes as part of our ongoing Process Redesign project. That project is nearly complete (March 31, 2001 completion deadline for submitting recommendations to me) and involves a thorough assessment of DOS's supervisory processes with a goal of identifying ways to improve and streamline them. The recommendations from this initiative may impact our policies and requirements in this area; changes will not be made without prior consultation and discussion with the OIG.

- (1) **Reinforce and ensure that the specific guidance for DOS examiners to follow when risk-focusing BSA examinations---including documentation requirements of scoping decisions, procedures to be performed, and conclusions reached during the pre-examination process, is followed.**

Our guidance on the use of the ED modules was disseminated in Regional Director Memorandum number 99-011, "Risk-Focused Examination Documentation Requirements," (RD 99-011). The ED modules offer flexibility to the Examiner-in-Charge to determine the extent of activities for "Pre-examination Planning." The Risk Scoping Module provides some broad overall guidance for these activities.

Under current guidance, all the Primary Modules (which include the BSA Module) are to be used on all examinations, and all the core decision factors are to be answered, unless the Scope Memorandum prescribes that the area can be limited and explains the reasons for the limited scope. Because the Department of the Treasury has delegated to us the responsibility for ensuring compliance with the BSA by our supervised banks, and because we are mandated to report to Treasury any noted violations or enforcement actions we take, we require the six core decision factors to be answered at every examination. Therefore, the scope of the BSA examination would generally not be mentioned in the Scope Memorandum.

We have just completed revisions to the BSA Module for inclusion in the next release of ED updates. In conjunction with the release of those modules, we will reemphasize our existing policies requiring all of the BSA core decision factors to be answered at each examination. We expect to issue this guidance no later than July 31, 2001 (we hope to issue this sooner, but timing is related to the release of the general ED updates).

- (2) **Reinforce and ensure that the DOS policy and instructions that describe adequate documentation of the BSA ED Module decision factors and procedures are followed.**

RD 99-011 requires that the six core decision factors are required to be answered at each examination. However, under this guidance, the core analysis procedures are not required to be answered at each examination. Core analysis procedures are various tasks that could be performed to arrive at answers to the core decision factors. Management intended that the core decision factors could be answered without completing the core analysis procedures, leaving completion of the core analysis procedures to the examiner's discretion. We will reemphasize current guidance regarding the mandatory completion of the core decision factors and the optional use of core analysis procedures when we release revisions to the BSA module, no later than July 31, 2001 (we hope to issue this sooner, but timing is related to the release of the general ED updates).

- (3) **Implement in other DOS regional offices the New York region's practice of assigning a regional examination specialist to provide CTR and SAR system reports to field examiners for the risk-focusing and pre-planning process of the BSA examination.**

We agree with this recommendation and will issue guidelines to the regional office specialists no later than July 31, 2001.

- (4) **Evaluate the effectiveness and implementation of the BSA ED Module planning procedure relating to the examiner's review of the OFAC listing of prohibited entities in order to identify potential violations of OFAC regulations.**

We concur with this recommendation. The real intent of the examination procedures is to ensure that banks are aware of the OFAC requirements and have taken steps to implement appropriate policies and procedures to ensure compliance and to try to identify parties subject to the OFAC regulations. In our next ED Module revision, which will be issued no later than July 31, 2001 we will have reworded the OFAC procedures to clarify the examiner's responsibilities.

MANAGEMENT RESPONSES TO RECOMMENDATIONS

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC's responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management's response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid.

Second, the OIG must determine that management's descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management's written response to our report.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Documentation That Will Confirm Final Action	Monetary Benefits	Management Decision: Yes or No
1	The Acting Director, DOS, will require that all BSA Core Decision Factors be answered at every examination. Therefore, the scope of the BSA examination will generally not be mentioned in the Scope Memorandum. DOS will issue guidance to reemphasize that all of the BSA core decision factors are to be answered at each examination.	No later than July 31, 2001	Directive or Memorandum	N/A	Yes
2	The Acting Director, DOS, will reemphasize current guidance regarding the mandatory completion of all core decision factors at each examination and optional use of core analysis procedures. To the extent that this guidance will emphasize the requirement to identify which core procedures the examiner opted to perform and the basis of conclusions reached, i.e., answers to the core decision factors, the planned corrective action addresses our recommendations.	No later than July 31, 2001	Directive or Memorandum	N/A	Yes
3	The Acting Director, DOS, agreed with the recommendation. DOS will issue guidelines to regional examination specialists.	No later than July 31, 2001	Directive or Memorandum issued to regional office specialist	N/A	Yes
4	The Acting Director, DOS, agreed with the recommendation. DOS will reword the OFAC procedures in its next BSA ED Module revision to clarify the examiner's responsibilities.	No later than July 31, 2001	Modified language in future BSA ED Module	N/A	Yes