

**WRITTEN STATEMENT OF
KEVIN BROWN
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION
INTERNAL REVENUE SERVICE
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
April 26, 2005**

Good morning, Mr. Chairman and distinguished Members of the Committee. I appreciate the opportunity to be here today to discuss the Internal Revenue Service's (IRS) efforts involving the Bank Secrecy Act (BSA) and to update you on the progress we have made since last September.

IRS Enforcement

Under the leadership of Commissioner Everson, we have strengthened the focus on enforcement at the IRS, while maintaining appropriate service to taxpayers. We have four enforcement priorities, which are to:

- Discourage and deter non-compliance, with emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap;
- Assure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law;
- Detect and deter domestic and offshore-based tax and financial criminal activity; and,
- Discourage and deter non-compliance within tax-exempt and government entities and misuse of such entities by third parties for tax avoidance.

Detecting and investigating money laundering activity is an important part of tax compliance for the IRS. In addition, the failure to file Forms 8300 and criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, often have a direct link to both tax evasion and money laundering. In some cases, because the schemes are sophisticated and because we may not be able to obtain evidence from some foreign countries, it is almost impossible to conduct traditional tax investigations. In these circumstances, money-laundering violations frequently are the only possible means to detect tax evaders.

Money laundering not only is used by domestic and international criminal enterprises to conceal the illegal, untaxed proceeds of narcotics trafficking, arms

trafficking, extortion, public corruption, terrorist financing, and other criminal activities; it is also an essential element of many tax evasion schemes. With the globalization of the world economy and financial systems, many tax evaders exploit domestic and international funds transfer methods to hide untaxed income. These schemes often involve the same methods to hide money from illegal sources and to hide unreported income. Both activities generally use nominees, currency, wire transfers, multiple bank accounts, and international “tax havens” to avoid detection.

Money laundering is the financial side of virtually all crime for profit. To enjoy the fruits of their crime, criminals must find a way to insert the illicit proceeds of that activity into the stream of legitimate commerce in order to provide the resources necessary for criminal organizations to conduct their ongoing affairs.

As part of its core tax administration mission, the IRS addresses both the civil and criminal aspects of money laundering. On the civil side, the Department of the Treasury has delegated to the IRS responsibility for ensuring compliance with the BSA for all non-banking financial institutions not otherwise subject to examination by another federal functional regulator, including Money Service Businesses (MSBs), casinos and certain credit unions. Under this delegation, the IRS is responsible for three elements of compliance – (i) the identification of MSBs, (ii) educational outreach to all these types of organizations, and (iii) the examination of those entities suspected of noncompliance.

IRS’ Criminal Investigation (CI) Division is responsible for the criminal enforcement of BSA violations and money laundering statutes related to tax crimes. CI uses the BSA and money laundering statutes to detect, investigate, and prosecute criminal conduct related to tax administration, such as abusive schemes, offshore tax evasion, and corporate fraud. CI also investigates the non-filing of Forms 8300 and criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, which frequently have a direct link to both tax evasion and money laundering.

BSA Program in IRS’ Small Business/Self-Employed (SB/SE) Division

In October 2004, SB/SE officially established a new organization, the Office of Fraud/BSA, which reports directly to the Commissioner of SB/SE. The director, an IRS executive, has end-to-end accountability for compliance with BSA including policy formation, operations, and BSA data management. The director’s operational responsibility includes line authority over all field activities, as well as the data management.

The Office of Fraud/BSA consists of four territories, with approximately 300 field examiners located in 33 field offices nationwide. In addition to this field operation, which is managed by 31 Group Managers, technical BSA staffing also includes eight Headquarters analysts located throughout the country. Our hiring

plans call for us to have between 320 and 325 field examiners on board by the end of Fiscal Year 2005. In addition, we plan to hire an additional 60 BSA examiners in Fiscal Year 2006.

As new examiners are brought on board, they receive specialized BSA training, including the identification of non-compliant MSBs, detection of structuring, and identification of transactions going to OFAC (Office of Foreign Asset Control) blocked countries. We also provide continuing professional education training classes for our BSA examiners in topics such as: (i) Audit Techniques for Anti-Money Laundering (AML) Compliance Examinations; (ii) Civil Penalties/Referrals to FinCEN; (iii) Disclosure; (iv) Currency Banking and Retrieval System (CBRS) Analysis; and, (v) Foreign Bank and Financial Account Reports (FBAR). To further support the development and identification of criminal activities (fraud) during BSA examinations, we also provided fraud training for our BSA examiners and Title 31 training to our Fraud Technical Advisors (FTAs). As a result of this cross-training, our FTAs and BSA examiners can work together more effectively and ensure that the cases we refer to our Criminal Investigation Division are thoroughly developed.

All of our BSA examiners and their managers devote 100 percent of their time to examinations of BSA-related cases. This contrasts with years past, when the BSA examiners were required to spend a substantial portion of their time on unrelated work, such as traditional income tax audits. Additional support personnel (28 employees) provide assistance to the examiners, including workload identification. Working in close collaboration with Treasury's Financial Crimes Enforcement Network (FinCEN), the IRS also conducts community outreach to ensure that MSBs are aware of their requirements under the BSA.

Bank Secrecy Act Data

The IRS currently has responsibility for processing and warehousing all BSA documents into CBRS at the IRS Detroit Computing Center. However, FinCEN will assume this role in the future upon completion and implementation of a new system, BSA Direct, which will replace CBRS. BSA documents include FBARs, Currency Transaction Reports (CTRs)¹, Forms 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business), CMIRs² and Suspicious Activity Reports (SARs)³. Managing the BSA data involves three separate but related functions that include: (i) collecting and inputting BSA data from reporting institutions; (ii) housing and controlling access to the BSA data after it is entered into the central database; and (iii) supporting the IRS and other law enforcement query systems to mine BSA data in support of law enforcement investigations. Currently, CBRS has approximately 144 million BSA documents on file. All documents entered into the CBRS (approximately 15 million annually) are made available, at FinCEN's direction, to other law enforcement agencies (Federal,

¹ CTRs include FinCEN Form 104 and FinCEN Form 103 (filed by casinos).

² Report of International Transportation of Currency or Monetary Instruments.

³ SARs are filed by financial institutions to report suspicious activity.

state, local and international) and regulatory agencies, in addition to the IRS. It bears noting that the IRS is one of the largest users of CBRS data.

We are aware that the U.S. Government Accountability Office (GAO) recently discovered security weaknesses at the Detroit Computing Center. We are mindful of those problems, and, in a recent letter to GAO, Acting Deputy Secretary Havens outlined the steps that we are taking to resolve those problems.

Usefulness of Bank Secrecy Act Data

The combined currency information in CBRS is extremely important for tax administration and law enforcement. The information provides a paper trail or roadmap for investigations of financial crimes and illegal activities, including tax evasion, embezzlement, and money laundering. The detailed information in these currency reports routinely is used by IRS CI special agents and Assistant U.S. Attorneys to successfully pursue investigations and prosecutions.

In civil matters, the IRS uses the CBRS database to identify cases for potential examination. For example, in many of our offshore trust schemes a search of CTRs can produce a wealth of information. IRS field examiners also access BSA documents to assist in on-going examinations. The CBRS database is used to assist in case building prior to beginning an examination.

The IRS CI Division has increased its emphasis on BSA responsibilities significantly, with particular focus on improving the effectiveness and efficiency of Suspicious Activity Report (SAR) Review Teams. CI now hosts 64 SAR Review Teams located throughout its 33 Criminal Investigation field offices. This expansion allows each team to focus specifically on SARs filed in its geographic area. Over 300 law enforcement agencies participate in some manner in the review of SARs, and IRS has at least 100 special agents and 36 investigative analysts assigned, either full or part-time, to these SAR Review Teams. CI routinely reviews between 12,000 and 15,000 SARs per month and uses data mining tools to assist teams in efficiently analyzing the ever increasing number of SARs being filed. Training on the use of these tools is ongoing. In June, CI will host a national meeting to train teams on a recordkeeping program and policy changes designed to improve the efficiency of SAR Review Teams.

IRS Coordination with FinCEN

In carrying out our responsibilities under the Bank Secrecy Act, we are engaged in a close partnership with FinCEN. Most recently, we have worked with FinCEN's newly established Office of Compliance to finalize an information sharing agreement that provides for the routine exchange of BSA compliance information, including information concerning financial institutions identified as

having significant BSA compliance deficiencies or violations. These exchanges, spelled out in a Memorandum of Understanding (MOU), are intended to help FinCEN in fulfilling its role as administrator of the BSA and to assist the IRS in conducting examinations of certain financial institutions to assess BSA compliance. The IRS and FinCEN expect this MOU will improve and enhance the level of interagency cooperation and enable both organizations to maximize their resources as they identify, deter, and interdict terrorist financing and money laundering. I am happy to report that IRS and FinCEN signed the MOU yesterday, with plans for immediate implementation.

IRS Headquarters senior analysts from both SB/SE and CI participate in several working groups involving Treasury and other agencies. As members of the Informal Value Transfer System Working Group, we are working with representatives of FinCEN, the Federal Bureau of Investigation (FBI), Immigration and Customs Enforcement (ICE), and the Drug Enforcement Administration (DEA) in an effort to identify unregistered MSBs. The working group was assembled to develop procedures relative to investigative intelligence gathering and outreach efforts to MSBs across the country.

IRS also is a member of the Money Laundering Threat Assessment working group, as is FinCEN. The focus of this group is to identify money laundering threats throughout the United States through investigations conducted by all law enforcement agencies.

The IRS assigns senior analysts to act as liaisons to FinCEN in both civil and criminal matters. Key areas of coordination include:

- Conducting joint monthly meetings to discuss BSA issues, trends, and examination results;
- Establishing examination priorities;
- Using data-driven analysis to assist in the risk-based identification of cases as well as to identify geographic locations of potential noncompliance;
- Improving the quality of referrals for enforcement;
- Having FinCEN participate in IRS BSA training classes and managers' meetings;
- Incorporating feedback from FinCEN on IRS outreach materials; and,
- Establishing production schedules at DCC for new forms and form revisions.

Since Fiscal Year 2003, funding from FinCEN has allowed the IRS to add 82 additional full-time employees (FTEs) to its BSA program.

Recent Accomplishments

Since I appeared before this Committee in September 2004, we have made considerable progress at the IRS in enhancing the operation of our BSA program:

§ **MSB Audits** – Our goal for MSB examinations is to close more than 3,500 cases during Fiscal Year 2005, or about 1.8 percent of the estimated 200,000 MSBs. With 3,200 examinations in progress or closed as of March 31, 2005, we fully expect to meet this target. The principal issues we are finding with MSBs include:

- § Lack of sufficient recordkeeping;
- § Lack of an AML compliance program or one that is not tailored to the entity's risk;
- § Failure to identify and investigate suspicious activity, or to identify structuring; and,
- § Nonfiling of CTRs.

As advocated by FinCEN, we also are conducting examinations of some larger MSBs at the entity's corporate headquarters level. Five of these examinations are underway, with plans to begin additional examinations later in 2005. Through this centralized approach we are able to work with the businesses to identify their agents with the highest risk of noncompliance and then use our examination resources accordingly. The result is more carefully focused examinations for the MSBs and improved use of our resources. In particular, these centralized examinations give us the potential to impact the compliance behavior of a much larger number of MSBs. For example, there are 29,000 MSBs related to the five corporate entities now under examination.

The IRS also is employing for the first time, an examination technique known as a "saturation audit." Specifically, we are conducting simultaneous examinations of all MSBs located within particular ZIP Codes in two cities, which were selected in coordination with other law enforcement agencies. In addition to examining the MSBs for BSA compliance, this saturation approach allows our BSA examiners to identify individuals with unusual patterns of financial activity which fall below the reporting threshold. Upon completion of these two pilot examinations, we will analyze the results and determine whether to initiate similar examinations in additional cities.

§ **Increased Coordination with the States** – Since the last hearing in September 2004, we have obtained the concurrence of the Conference of State Bank Supervisors (CSBS) on our model Fed/State MOU. This past month, IRS and FinCEN conducted joint presentations to CSBS districts to promote the MOU, which provides both the IRS and the participating state the opportunity to leverage resources for examinations, outreach, and training. CSBS also is assisting us as we "market" this MOU to the states. I am pleased to tell you that just last week New York State signed the MOU – the first state to do so. We expect that additional states will sign the MOU in the near future.

- § **Centralized Case Selection** – We are moving the responsibility for identifying BSA workload and building these cases from the general IRS Examination program to the Fraud/BSA organization. This newly created operation will incorporate leads from the field and CI, as well as CBRS analysis, and is on track to be fully operational by October 1, 2005. We expect that this approach will ensure consistency in risk-based case selection and result in improved case selection and results.
- § **Improved Workload Identification** – We are exploring two new methods for identifying BSA workload. The first uses a risk-based scoring system based on criteria such as BSA workload priorities, prior compliance history, and BSA reports filed. It is intended to give our classifiers additional information to pinpoint which cases in the potential universe are most in need of examination. The criteria used to select a particular case for examination are included in the case file so that the Group Manager and the examiner know why the case was selected. Our classifiers in the Western Territory for BSA are using this methodology currently to select all of its BSA cases and will be evaluating the results. If this scoring system proves successful for classifying cases, we plan to implement it nationwide in October 2005, when we have our centralized workload selection unit in place.

In the second related effort, we are researching the feasibility of using CBRS data to create an automated national workload identification and selection system for Title 31 cases. The first phase of the project – documenting current workload selection practices and translating these into rule-based selection factors – is complete. The second phase, which entails combining the selection factors into formulas that will be run against the CBRS, is just getting under way. In the third phase, we will be testing the effectiveness of the selection formulas in identifying appropriate BSA workload, and making any necessary adjustments. If this technique is successful in identifying the universe of potential cases, we will begin employing the new methodology early in 2006 – most likely in tandem with the classification method described above.

- § **Reengineering** – To increase the effectiveness and efficiency of our BSA examiners, we are reengineering the examination process. We have developed standardized workpapers for BSA examinations that delineate clearly the audit steps the examiner must complete to ensure that the recordkeeping and reporting requirements of the entity under examination are being met. The workpapers also provide guidance on evaluating the entity's AML compliance program to determine if it is commensurate with the risk that the entity could be used as a vehicle for money laundering or terrorist financing.

Other aspects of the BSA reengineering include managerial review meetings with the examiner after the initial interview with the entity, and a requirement to set a mutual commitment date for the completion of the examination which will be shared with the entity and the manager.

We anticipate that we will begin training our employees in June 2005 on the use of standardized workpapers to document their cases, as well as the other requirements of the reengineered examination process. All of the standardized documents will be available on the examiners' computers.

- § ***Better Education and Outreach*** - The national strategy for education and outreach related to anti-money laundering (AML) was designed in conjunction with FinCEN, SB/SE, and CI to increase compliance of MSBs and casinos with the BSA and is carried out by SB/SE's Taxpayer Education and Communication (TEC) Division. Our BSA outreach specialists are located in the six top HIFCA (High Risk Money Laundering and Related Financial Crimes Areas) – Miami, New York, Chicago, Houston, San Francisco, and Los Angeles. They work frequently with MSB trade associations to reach large numbers of stakeholders. Since October 2004, the TEC BSA specialists have contacted 158 new entities in an effort to establish relationships for AML/BSA outreach. They also have participated in 80 AML outreach events where they interacted with more than 8,000 individuals. In March 2005, Tax Talk Today featured a presentation for practitioners, payroll professionals and financial planners on BSA. The viewership of this live, Internet program co-sponsored by IRS has grown to almost 55,000 registered sites.

Streamlined Quality Review – IRS also is in the process of implementing a centralized closed case review process which is intended to identify compliance trends and training needs for particular programs, including BSA.

Conclusion

As I stated earlier in this testimony, the fight against money laundering and terrorist financing are top priorities for the Internal Revenue Service. We are prepared to increase our commitment to the BSA Program, and we will continue to coordinate our efforts closely with FinCEN.

Mr. Chairman, I thank you for this opportunity to appear before this distinguished Committee and I will be happy to answer any questions you and the other Members of the Committee may have.