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**FOREIGN ASSETS CONTROL:  
OFAC's Ability To Monitor Financial  
Institution Compliance Is Limited  
Due To Legislative Impairments**

**OIG-02-082**

**April 26, 2002**



**Office of Inspector General**

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**The Department of the Treasury**

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## Abbreviations

CFR	Code of Federal Regulations
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FMD	Financial Management Division
FMFIA	Federal Manager's Financial Integrity Act

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FRS	Federal Reserve System
FY	Fiscal Year
GAO	General Accounting Office
IEEPA	International Emergency Economic Powers Act
N/A	Not Applicable
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OFAC	Office of Foreign Assets Control
OTS	Office of Thrift Supervision
RFPA	Right to Financial Privacy Act
SDN	Specially Designated National
SDNT	Specially Designated Narcotics Trafficker
Treasury Department	Department of the Treasury
TWEA	Trading With the Enemy Act
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism
U.S.	United States
U.S.C	United States Code

April 26, 2002

R. Richard Newcomb  
Director  
Office of Foreign Assets Control

This report presents the results of the Office of Inspector General's (OIG) audit to determine whether the Office of Foreign Assets Control's (OFAC) implementation of its Foreign Sanctions Program provides reasonable assurance that United States (U.S.) foreign policy and national security requirements are met. Specifically, our coverage included how OFAC administers and facilitates both the implementation and enforcement of foreign sanctions. Also, we evaluated the role of the financial institution regulators in assisting OFAC to accomplish its Foreign Sanctions Program objectives.

OFAC administers a series of laws that impose economic sanctions against hostile targets to further U.S. foreign policy and national security objectives. Economic sanctions are powerful foreign policy tools. However, their success requires the active participation and support of every financial institution. In view of the September 11<sup>th</sup> terrorist activities which took place in the United States and the current threat of such activities, it is increasingly crucial that the implementation, administration, and enforcement of foreign sanctions is adequate to ensure that prohibited financial transactions are identified and blocked or rejected.

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We conducted our audit from June 2000 to August 2001 at the Headquarters offices of OFAC, Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), Federal Reserve System (FRS) and Federal Deposit Insurance Corporation (FDIC) in Washington, D.C. Also, we reviewed compliance examinations at Riggs Bank in Washington, D.C. In addition, we surveyed 138 financial institutions to assess their processes for compliance with foreign sanction requirements and received responses from 102 institutions. A more detailed description of our objectives, scope and methodology is provided as Appendix 1.

## **Results in Brief**

OFAC has devoted considerable effort to compliance outreach in the financial community to enhance, through education, the awareness of foreign sanction requirements. These efforts have improved financial institutions' ability to detect, correct, and prevent violations of foreign sanctions.

However, OFAC is limited in its ability to monitor financial institution compliance with foreign sanction requirements due to legislative impairments. First, OFAC primarily relies on the authority established under the Trading With the Enemy Act (TWEA) and the International Emergency Economic Powers Act (IEEPA). Neither TWEA nor IEEPA provide OFAC with the authority to randomly monitor financial institution compliance with foreign sanction requirements. Unless OFAC is made aware that a prohibited transaction was allowed, i.e., indication that a violation has occurred, or there is a blockable interest, OFAC cannot monitor or examine the transactions of a financial institution for compliance with foreign sanction requirements. Also, the Right to Financial Privacy Act (RFPA), with some exceptions, does not allow financial institution regulators to share the financial records of the institutions they supervise

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with OFAC because OFAC is not a bank supervisory agency.<sup>1</sup> As a result, OFAC must rely on the financial institution regulators' examination process to monitor financial institution compliance with foreign sanctions. This process may not provide adequate assurance that financial institutions are complying with the requirements of the various foreign sanctions. We found that as a result of the risk-based approach which is applied in conducting compliance examinations, transaction testing is rarely performed. Transaction testing, i.e., testing individual financial transactions for compliance with foreign sanctions is critical to determine whether a prohibited transaction has been allowed.

Also, because OFAC is not a bank supervisory agency it cannot dictate the extent of the compliance program which is implemented at the financial institution. As a result, the extent of foreign sanction compliance efforts at financial institutions varies. For instance, our survey showed that some financial institutions deem it necessary to employ automated detection software and designate a compliance officer specifically for OFAC issues while others do not.

In addition, we found that OFAC generally followed its guidance for processing blocked and rejected financial transactions, annual blocked asset reports, license applications, and civil penalties. However, we identified instances where procedures were not established, databases were not updated, and guidance was not followed. Consequently, OFAC has limited

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<sup>1</sup> RFPAs originally provided for financial records to be transferred to another agency or department when there was reason to believe that the records are relevant to a legitimate law enforcement investigation within the jurisdiction of the receiving agency. This has been expanded by Title III of Public Law 107-56, USA PATRIOT Act to include intelligence or counterintelligence activity, investigation or analysis related to international terrorism. Also, the USA PATRIOT Act requires the Treasury Secretary to issue regulations to encourage cooperation among financial institutions, their regulators, and law enforcement authorities to share information regarding persons and organizations who may be engaged in terrorism or money laundering.

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assurance that statistical reports captured complete, reliable, and timely information.

We recommended that the Department of the Treasury (Treasury Department) inform Congress that OFAC lacks sufficient legislative authority to ensure financial institution compliance with foreign sanctions. Also, we recommended that the Treasury Department inform Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by assuring that bank regulators share information that comes to their attention with OFAC. This could be accomplished by amending the RFPA to include OFAC in its definition of a "bank regulator" for the purpose of sharing information with OFAC. In addition, we recommended that OFAC (1) establish processing procedures for financial transactions reported, (2) develop a standardized form which can be used by financial institutions when reporting blocked and/or rejected financial transactions, (3) review its Blocked/Rejected Transactions database to identify duplicates and make necessary adjustments to remove the duplicate transactions, (4) research the feasibility of developing procedures to reconcile the Annual Blocked Property Report to the Blocked/Rejected Transactions database, (5) ensure that the Licensing database is updated to reflect current information, and (6) adhere to its penalty guidance when notifying the Financial Management Division (FMD) to establish an accounts receivable.

OFAC management took exception to our finding that due to legislative constraints, OFAC's ability to monitor financial institution compliance with foreign sanctions is hampered, thus requiring OFAC to rely on the financial institution regulators' examination process to monitor financial institution compliance with foreign sanctions to provide increased assurance that prohibited transactions are not allowed. However, OFAC management agrees that current legislative authority could be improved with regard to federal bank regulators sharing information with OFAC and that increased oversight and detailed account reviews by regulators could be beneficial.



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Despite stated disagreement with our finding, OFAC's response did not provide any new information that would refute the facts or conclusions presented in this report. We, therefore, believe the finding and its accompanying recommendations are still valid. OFAC management did not respond to our recommendation regarding establishing processing procedures for financial transactions reported. Regarding our recommendation to develop a standardized form, OFAC management stated that they established a voluntary form for blocked and rejected items and posted it on its website. OFAC's response to our recommendation to review its Blocked/Rejected Transactions database to identify duplicates and adjust the database did not address the recommendation. Regarding our recommendation to research the feasibility of developing procedures to reconcile the Annual Blocked Property Report to the Blocked/Rejected Transactions database, OFAC stated that they will assess whether staff resources should be redirected to reconcile the Annual Blocked Property Report. In response to our recommendation to ensure that the Licensing database is updated to reflect current information, OFAC stated that they are migrating to an Oracle based platform which will facilitate accurate licensing data tracking and generation of statistics. Regarding our recommendation that OFAC adhere to its penalty guidance when notifying FMD to establish an accounts receivable, OFAC stated that they have developed an initial account set-up form that will be used to request that FMD pursue avenues to exercise other debt collection tools. We maintain that OFAC should adhere to its Penalty Guidance and provide adequate debtor information to facilitate account collection.

Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* provides a resolution process for recommendations where there are non-concurrences which includes elevating the recommendations to the Deputy Secretary for resolution. Also, this Directive requires that you provide actions taken and planned, and target dates for any incomplete

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action before we can consider your response a management decision. Accordingly, where your response did not fully or clearly address the recommendation and delineate what corrective action had been taken, or did not provide target dates for incomplete action, we are requesting that this information be provided to our office within 15 days. Based on your comments, we made changes to the report where appropriate. The complete response is included as Appendix 5.

## **Background**

OFAC administers economic and trade sanctions against hostile targets to further U.S. foreign policy and national security objectives. These sanction programs are normally imposed pursuant to a declaration of national emergency by the President under specific statutory authority, but may also be imposed directly by the Congress. OFAC receives guidance from the National Security Council, and the U.S. Department of State.

Historically, sanctions have been imposed mainly against countries such as Cuba, North Korea, Libya, Iraq, Iran, and Sudan. Today, sanctions can be used against dangerous groups and individuals, such as international narcotics traffickers, terrorists, and foreign terrorist organizations. At the time of our review, OFAC administered 21 economic sanctions programs involving blocked targets, trade embargoes, or other restrictions. See Appendix 2 for a list of OFAC sanctions programs.

Economic sanctions are powerful foreign policy tools. However, their success requires the active participation and support of every financial institution. Sanctions may take the form of (1) prohibited trade, (2) blocked assets, (3) prohibited commercial, investment, and financial transactions, or (4) a combination of these measures.

OFAC can impose both civil and/or criminal penalties for non-compliance with the established sanctions. Civil penalties range from \$11,000 to \$1,000,000 per infraction, while criminal

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violations can result in corporate and personal fines up to \$10 million and 30 years in jail. Also, financial institutions are required to block or reject financial transactions which are prohibited by foreign sanctions. During Fiscal Year (FY) 2000, OFAC imposed \$3.2 million in civil penalties. Also, financial institutions reported that 2,110 financial transactions totaling \$125 million were blocked and 4,565 financial transactions totaling \$458 million were rejected.

Awareness of the substantial penalties, as well as the associated negative publicity resulting from the financial institution's violation of U.S. sanctions, is a factor in motivating financial institutions to devote resources to implementing quality OFAC compliance programs.

OFAC is not a financial institution regulator. Accordingly, it does not have regulatory oversight of financial institution compliance with foreign sanction requirements.<sup>2</sup> The financial institution regulators play a critical role by ensuring financial institutions' compliance with OFAC sanctions. The financial institution regulators are the OCC, OTS, FRS, FDIC, and the National Credit Union Administration (NCUA).

OFAC also has the authority to license, or authorize, transactions that would otherwise be prohibited under the sanctions programs. OFAC's Licensing Division reviews license applications on a case-by-case basis and issues or denies specific licenses based on U.S. foreign policy. Transactions consistent with normal banking practice are frequently permitted by general license. OFAC issues general licenses, which are regulatory provisions authorizing certain transactions, without the filing of an application.

Financial institutions are required to monitor their financial transactions to ensure that Specially Designated Nationals (SDN),

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<sup>2</sup> For purposes of this report financial institutions are defined as "depository institutions." These financial institutions located in the U.S., its overseas branches, and overseas subsidiaries must comply with OFAC regulations.

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terrorists, Blocked Persons and Specially Designated Narcotics Traffickers (SDNT) do not benefit from U.S. financial systems. When a transaction is blocked or rejected by a financial institution, the institution is required to file a report with OFAC within 10 business days from the date that the property was blocked or rejected. A comprehensive report on all blocked property held as of June 30 of the current year is required to be filed annually with OFAC by September 30. These reports are mandatory and apply to all U.S. financial institutions. The financial institution maintains control over all funds that have been blocked or frozen. The funds are placed into a separate interest bearing account while the title to blocked property remains with the designated country or national. OFAC does not take possession of any funds that are blocked or frozen.

## **Findings and Recommendations**

### **Finding 1      OFAC Has Devoted Considerable Effort To Compliance Outreach For The Financial Community**

OFAC has devoted considerable effort to compliance outreach for the financial community. OFAC has made reference materials available free of charge through its Web site, fax-on-demand service, and compliance hotline. OFAC program information can also be obtained through a variety of other sources such as the *Federal Register*, bulletin boards, seminars, and articles. Services provided by OFAC to assist the financial community in their compliance efforts include the following:

- OFAC's program brochures, as well as SDN information, can be downloaded over the Treasury Department's World Wide Web server. OFAC's Home Page is <http://www.treas.gov/ofac>. OFAC documents kept up-to-date on the system include program and general brochures, SDN listings, including changes to the listings, licensing guidelines, and *Federal Register* notices. The reference materials also include publications

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geared toward the specific concerns of financial institutions and summaries of each sanction program. All of OFAC's public information documents are updated whenever there is a change to an existing program, or when a new program is announced.

- OFAC operates a free automated fax-on-demand service, which can be accessed 24 hours a day, 7 days a week, by dialing (202) 622-0077 from any touchtone phone and following voice prompts. The index lists all of the documents OFAC makes available by fax, and indicates the date each document was last updated.
- OFAC provides assistance through a toll-free compliance hotline at (800) 540-OFAC (6322) on weekdays from 7:30 a.m. to 7:00 p.m. eastern time. Calls to the hotline are confidential. OFAC also has a Miami branch office and a bilingual hotline specializing in information on the Cuban embargo. The bilingual hotline number is (305) 810-5140.
- OFAC has provided formal notice of changes to its SDN listing through publication in the *Federal Register*. SDNs are frequently added on an unscheduled basis due to foreign policy or national security objectives, which are influenced by world events, and ongoing investigations. These unscheduled changes necessitate vigilance in maintaining a current SDN listing because what was permitted yesterday may be prohibited or restricted today, and vice versa.
- OFAC has periodically posted information to various banking and government electronic bulletin boards, which can be downloaded by institutions. When time is of the essence to effect blockings or when critical to sanctions enforcement, OFAC utilizes the Fedwire Bulletin electronic message system as an emergency means of notification to on-line and off-line institutions serviced by the FRS before such information can be published in the *Federal Register*. Such bulletins are faxed to the Federal Reserve Banks to be electronically echoed to all

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Fedwire-connected institutions within each district. Also, OFAC provides a simultaneous fax copy of these Fedwire Bulletins to OCC and OTS Headquarters in Washington, D.C.

- OFAC has provided training and educational seminars on sanctions compliance requirements to specific groups. For example, OFAC has provided various compliance workshops for Federal and state bank examiners through the Federal Financial Institutions Examination Council (FFIEC). On September 19, 2000, OFAC gave a special sanction workshop at the FDIC's regional headquarters in Chicago for Midwestern Federal and state bank examiners at a conference in cooperation with OCC.
- OFAC has been featured in articles and advertisements in journals, magazines, and various publications. According to the Chief of the Compliance Division, all of the Federal financial institution regulators disseminate sanction information for OFAC. The November/December 1998 issue of American Bankers Association Bank Compliance magazine contained a ten-page color spread on OFAC compliance for community financial institutions under the heading of "Caught Unaware: Don't Let It Happen to You." OCC published an article in its newsletter featuring OFAC entitled "It's a Matter of FAC: Banks Doing Business with Sanctioned Nations Can Receive Stiff Penalties."

OFAC attempts to maximize compliance with sanctions programs by enhancing awareness through education of the financial community. According to OFAC, the success of sanctions programs depends largely on the awareness and education of the public and financial industry. The strategic objective is to provide enough information to enable key personnel to recognize, stop, or interdict suspected transactions for further review before the transactions are processed.

It is our belief that the actions mentioned above have enhanced familiarity with requirements for compliance with OFAC

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regulations, enhanced OFAC's credibility and reputation within the financial industry, and increased information sharing between OFAC, financial institution regulators, and financial institutions. In this regard, through education and awareness, it is our opinion that financial institutions' ability to detect, correct, and prevent violations of OFAC laws and regulations has been enhanced.

## **Finding 2**

### **OFAC's Ability To Monitor Financial Institution Compliance Is Hampered Due To Legislative Constraints**

OFAC administers and enforces economic and trade sanctions based on Presidential declaration of "national emergency." OFAC primarily relies on the authority established under the Trading With the Enemy Act (TWEA), 50 U.S.C. App. §§ 1-44, and the International Emergency Economic Powers Act (IEEPA), 50 U.S.C. §§ 1701-06, to prohibit commercial or financial transactions involving sanctioned countries, entities, or individuals. However, OFAC is limited in its ability to monitor financial institution compliance with foreign sanction requirements due to certain legislative constraints. As a result, OFAC must rely on the financial institution regulators' compliance examination process to monitor financial institution compliance with foreign sanctions. This process may not provide adequate assurance that financial institutions are complying with the requirements of the various foreign sanctions.

At the time of our review, OFAC administered 21 economic sanctions programs. These programs include sanctions directed against Angola (UNITA), Burma, Cuba, Iran, Iraq, North Korea, Sierra Leone, Sudan, foreign terrorists, and foreign narcotics traffickers (See Appendix 2 for a complete list of OFAC programs). OFAC relies principally on the broad authority established by TWEA and IEEPA to prohibit financial transactions involving specific countries, entities, or individuals. Also, OFAC's authority to administer and enforce economic sanctions is established under the following additional legislation:

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- Iraqi Sanctions Act, P.L. 101-513, 104 Stat. 2047-55
  - United Nations Participation Act, 22 U.S.C. §287c
  - International Security and Development Cooperation Act, 22 U.S.C. 2349 aa-9
  - Cuban Democracy Act, 22 U.S.C. §6001-10
  - Cuban Liberty and Democratic Solidarity Act, 22 U.S.C. 6021-91
  - Antiterrorism and Effective Death Penalty Act, 8 U.S.C. 219, 18 U.S.C. 2332d and 18 U.S.C. 2339b
  - Foreign Narcotics Kingpin Designation Act, P.L. 106-120, Title VIII, 113 Stat §1606, 1626-1636 to be codified at 21 U.S.C. §1901-1908

This varied legislation does not provide OFAC with the authority to proactively monitor financial institution compliance with foreign sanctions. We were informed by OFAC officials that OFAC is not a bank regulator and thereby cannot randomly monitor financial institutions to ensure foreign sanction compliance. OFAC officials stated that unless they are made aware that a prohibited transaction was allowed, i.e., indication that a violation has occurred, or there is a blockable interest,<sup>3</sup> OFAC cannot monitor or examine the transactions of a financial institution for compliance with foreign sanction requirements. TWEA limits OFAC's authority to investigate financial institution transactions to circumstances involving property in which a foreign country or a national thereof has an interest. Specifically TWEA provides OFAC the authority to:

*"...investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest."*

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<sup>3</sup> Blockable interest is property interest which is subject to the jurisdiction of the United States resulting from foreign sanctions. Property interest includes money, checks, bank deposits, stocks and other tangible property.



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Similarly, IEEPA also limits OFAC's authority to investigate financial institution transactions to circumstances involving property in which a foreign country or a national thereof has an interest.

In situations where there is indication that a violation has occurred or there is a blockable interest, Title 31 CFR 500.602 authorizes OFAC to collect and investigate any information which is relative, either directly or indirectly, to the sanctioned country or national thereof. This process is known as an Administrative Demand for Information.

As a result, OFAC must rely on the compliance and/or safety and soundness examinations of the financial institution regulators to monitor foreign sanction compliance. However, we were informed by OFAC officials that the financial institution regulators do not, on a systematic basis, provide OFAC with the results of their compliance examinations.

FRS officials stated that certain legislation prohibits the financial institution regulators from sharing the results of their compliance/safety and soundness examinations<sup>4</sup> with OFAC.

FRS officials stated that the RFA, (12 U.S.C. 3412-3413), provides for the disclosure of financial records to the supervisory agency pursuant to its supervisory and regulatory functions with respect to financial institutions. The Act also allows the transfer of financial records between the five member supervisory agencies of the FFIEC (FRS, OCC, OTS, FDIC, NCUA). However, OFAC is not a bank supervisory agency and is therefore not allowed access to financial records under the Act. These disclosure restrictions do not apply to OFAC when there is reason to believe the financial records may be relevant for criminal investigative purposes relating to money laundering and other financial crimes. This

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<sup>4</sup> Both the FRS and the FDIC review OFAC compliance under their safety and soundness examinations.

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exception has been expanded by Title III of P.L. 107-56, USA PATRIOT Act, which became law on October 26, 2001. Specifically, section 358 (f) of the Act expands the RFPA exception to include intelligence or counterintelligence activity, investigation or analysis related to international terrorism. Also, the USA PATRIOT Act, section 314 requires the Treasury Secretary to issue regulations to encourage cooperation among financial institutions, their regulators, and law enforcement authorities to share information regarding persons and organizations who may be engaged in terrorism or money laundering.

**OFAC Must Rely on the Financial Institution Regulators' Examination Process to Monitor Foreign Sanction Compliance**

Although legislation prohibits the financial institution regulators from transferring financial records, i.e., examination results to OFAC, we were informed that the regulators will notify OFAC if the examination process surfaces foreign sanction compliance deficiencies. The financial institution regulators use a "risk-based" approach to establish both the scope and frequency of their foreign sanction compliance examination process. For example, OCC uses a risk assessment process which is based on both the quality of risk management and the associated quantity of risk. These procedures are used to assess the adequacy of the bank's compliance management system in detecting, correcting, and preventing violations of OFAC laws and regulations. If the risk assessment determines that OFAC compliance represents a low risk area, the scope of the examination will be reduced.

We found that as a result of the risk-based approach which is applied in conducting compliance examinations, transaction testing is rarely performed by the financial institution regulators. Transaction testing, i.e., testing individual financial transactions for compliance with foreign sanctions, is only performed when the risk assessment determines that the risk associated with foreign sanction compliance is high. The financial institution regulators

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stated that the risk associated with foreign sanction compliance is generally low. Transaction testing is critical, however, to determine whether a prohibited transaction has been allowed.

Our review of compliance examinations at OCC and OTS revealed that a minimal amount of transaction testing was performed for the compliance examinations we reviewed. At OCC, we reviewed 15 compliance examinations to assess the procedures used by OCC examiners in determining foreign sanction compliance. Of the 15 compliance examinations reviewed, 2 did not address OFAC processes and controls. The remaining 13 compliance examinations only included 2 examinations where transaction testing was performed.

Similarly, at OTS we reviewed 4 compliance examinations to assess the procedures used by OTS examiners in determining foreign sanction compliance. These examinations did not include transaction testing.

Further analysis revealed that even when the internal bank examination process identified foreign sanction compliance deficiencies, OCC and OTS bank examiners did not perform transaction testing. For example, of the 11 OCC compliance examinations where transaction testing was not performed, internal reviews for OFAC compliance at 4 of these banks identified OFAC deficiencies. Also, of the 4 OTS compliance examinations where transaction testing was not performed, internal reviews for OFAC compliance at one of these banks identified OFAC deficiencies.<sup>5</sup> As a result, OFAC must rely on a monitoring process to ensure that financial institutions comply with foreign sanctions that does not provide for an effective method to achieve this objective.

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<sup>5</sup> Financial Institution regulators are not required to perform transaction testing. The regulators assess the foreign sanction compliance program of the individual financial institution and a business decision is made whether to perform transaction testing based on the associated risk.

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Also, because OFAC is not a bank supervisory agency, it cannot dictate the extent of the compliance program which is implemented at the financial institution. For instance, although not required, some financial institutions deem it necessary to employ software designed to interdict prohibited transactions and designate a compliance officer specifically for OFAC issues while others do not.

Specifically, of the 102 financial institutions that responded to our survey:

- 26 institutions, or 26 percent of the survey institutions<sup>6</sup> reported that they did not use interdict software to detect prohibited transactions, including 17 large institutions (assets exceeding \$1 billion). 10 large and medium institutions reported that they used a manual interdiction process.
- 16 institutions, or 16 percent of the survey institutions reported that they have not specifically designated a compliance officer to handle sanction issues. 13 of these respondents were large institutions.
- 8 financial institutions reported that their compliance programs did not include written procedures and guidelines for examining financial transactions for prohibited countries, entities, and individuals.

In addition, our survey revealed that 27 of the 102 banks that responded to our survey identified 74 prohibited transactions during calendar year 2000. Twenty of these banks used interdict software to identify the prohibited transactions, while seven banks used the “know your customer” process and interdict software to identify the prohibited transactions. See Appendix 3 for complete survey results.

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<sup>6</sup> As discussed in Appendix 1, we did not receive a sufficient number of responses to our survey to statistically project these results to the universe of financial institutions subject to OFAC foreign sanction requirements.

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To enhance OFAC's ability to ensure that financial institutions are employing adequate processes and procedures to identify prohibited transactions we believe that the Treasury Department should inform Congress that OFAC lacks sufficient legislative authority to ensure financial institution compliance with foreign sanctions. Also, the Treasury Department should inform Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by assuring that bank regulators share information that comes to their attention with OFAC. This could be accomplished by amending the Right to Financial Privacy Act to include OFAC in its definition of a "bank regulator" for the purpose of sharing information with OFAC.

### **Recommendations**

1. The Treasury Department should inform Congress that OFAC lacks sufficient authority to ensure financial institution compliance with foreign sanctions.

### **Management Comment**

OFAC management agrees that current legislative authority could be improved with regard to federal bank regulators sharing information with OFAC. However, OFAC management does not agree that it must rely on the financial institution regulators' examination process to monitor financial transactions and thus provide assurance that prohibited financial transactions as a result of foreign sanctions are not allowed. OFAC management stated that its success in ensuring compliance by the financial community has been a result of its aggressive public awareness campaign regarding the prohibitions in the regulations and the fines associated with them, as well as, the negative publicity that would result from the financial institution's violation of foreign sanctions. OFAC management asserted that despite the statutory limitations cited in the OIG report, OFAC and the banking community have

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created a “web” of compliance from which target transactions are unlikely to escape. OFAC stated that nearly every transaction that takes place hits more than one financial institution and if a prohibited financial transaction escapes one bank, another will likely catch it.

Also, OFAC management responded that the OIG report states that financial institutions are required to monitor their transactions using sophisticated interdict software to ensure that SDNs, SDNTs, terrorists, and Blocked Persons do not benefit from the United States financial systems. Along with this, OFAC management stated that the report implies that a bank is non-compliant if it does not utilize sophisticated screening software to achieve the above objective.

OFAC management agrees that increased oversight and detailed account reviews by regulators could be beneficial. However, OFAC management does not agree that transaction testing is the only effective method of determining whether a prohibited transaction has been allowed. OFAC management added that the OIG report implies that the financial institution regulators are somehow remiss in their duties if they do not perform transaction testing.

#### OIG Comment

The OIG agrees with OFAC management that current legislative authority could be improved with regard to federal bank regulators sharing information with OFAC. However, we believe that due to legislative constraints, as stipulated in our report, OFAC’s ability to monitor financial institution compliance with foreign sanctions is hampered. As a result, OFAC must rely on the financial institution regulators’ examination process to monitor financial institution compliance with foreign sanction requirements to provide increased assurance that prohibited transactions are not allowed. We acknowledge the numerous and extensive

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efforts of OFAC' public awareness campaign regarding foreign sanction compliance and the associated fines. Along with this, we also acknowledge that as a result, the financial institution community has implemented certain voluntary control mechanisms to detect and prevent prohibited financial transactions.

The OIG is fully aware that financial institutions are not required to monitor their transactions using sophisticated interdict software to ensure that prohibited countries, entities, and individuals do not benefit from the United States financial systems and we do not state that financial institutions are required to use interdict software in the report. The decision to use interdict software is purely a voluntary decision of bank management to provide internal assurance to the bank that it does not allow prohibited financial transactions to occur. However, we believe that money center banks and other large financial institutions that have high volumes of financial transactions which includes international business should use some form of electronic screening. In these scenarios, electronic screening is a viable method to provide assurance that prohibited financial transactions are not allowed. Also, it is not our intention to imply that a bank is non-compliant if it chooses not to utilize sophisticated screening software to achieve the above objective.

The OIG believes that transaction testing, whether conducted by OFAC, the financial institution regulators, or voluntarily by the financial institution, is critical to ensure that prohibited financial transactions are, in fact, not allowed. Also, it is not our intention to imply that the financial institution regulators are somehow remiss in their duties if they do not perform transaction testing. The financial institution regulators use a risk-based approach to establish both the scope and frequency of their foreign sanction examination process. The financial institution regulators, in the overall scheme of

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ensuring the safety and soundness of the financial institution, assess the risk associated with each line of business and determines the associated priority. Regarding foreign sanctions, the financial institution regulators assess the foreign sanction compliance program of the individual financial institution and a business decision is made whether to perform transaction testing. We are not questioning the business decision of the financial institution regulator. We are demonstrating that the control mechanism, i.e., transaction testing via the examination process, which OFAC is forced to rely on due to legislative impairments often does not exist.

2. The Treasury Department should inform Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by assuring that bank regulators share information that comes to their attention with OFAC. This could be accomplished by amending the Right to Financial Privacy Act to include OFAC in its definition of a "bank regulator" for the purpose of sharing information with OFAC.

Management Comment

OFAC management concurred with this recommendation.

**Finding 3      Internal Control Processes Need To Be Strengthened**

OFAC personnel generally followed guidance for processing blocked and rejected financial transactions, annual blocked asset reports, license applications, and civil penalties. However, we identified instances where procedures were not established, various databases were not updated, and guidance was not followed. Consequently, OFAC has limited assurance that statistical reports captured complete, reliable, and timely information.



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The Federal Managers' Financial Integrity Act (FMFIA) of 1982 requires renewed focus on the need to strengthen internal accounting and administrative controls in order to prevent fraud, waste, and mismanagement in Federal programs and operations. Internal control techniques include, but are not limited to, specific policies, procedures, and plans of the organization. Management should adopt methods and procedures to ensure its goals are met.

The FMFIA required that the General Accounting Office (GAO) issue standards for internal controls in the federal government. The *Standards for Internal Controls in the Federal Government*, reissued November 1999, published by GAO specifies that internal control systems are to provide reasonable assurance that the following objectives will be achieved:

- effectiveness and efficiency of operations,
- reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use, and
- compliance with applicable laws and regulations.

Internal control systems, transactions, and other significant events are to be clearly documented, and the documentation is to be readily available for examination.

### **Blocked and Rejected Financial Transactions**

Our review disclosed that OFAC had not established processing procedures for blocked and rejected financial transactions reported by financial institutions. OFAC relies on the knowledge and experience of its Compliance staff to ensure that financial transactions are properly processed. Consequently, duplicates exist in reporting the number of and dollar value for blocked and rejected financial transactions.

Not all OFAC sanctions programs require financial institutions to block property. A funds transfer may be stopped because

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the underlying transaction is prohibited under a sanctions program, but the funds may not involve a blockable interest. In these cases, the transfer is simply "rejected," or returned, instead of being blocked. Whenever a financial institution blocks or rejects a prohibited transaction, that institution must report its action to OFAC within 10 business days, describing the action taken in a simple cover letter that includes a copy of the payment order or other relevant documentation.

We obtained the number of blocked and rejected financial transactions reported to OFAC during FY 2000 and FY 1999. OFAC recorded a grand total of 4,375 blocked financial transactions totaling \$162 million and 9,762 rejected financial transactions totaling \$831 million for both fiscal years. We selected a judgmental sample of 49 blocked financial transactions totaling \$16 million and 50 rejected financial transaction totaling \$216 million to review. Our selection was based on dollar amounts and multiple occurrences. The majority of the transactions selected were over \$10,000. We also selected transactions to ensure that we covered different programs and countries. Appendix 4 shows a breakdown of the universe and sample selection for each fiscal year.

Our review disclosed concerns regarding accuracy of the blocked and rejected information contained in the database. Specifically, we noted six rejected transactions and one blocked transaction included in our sample that were recorded twice. While we understand that a transaction can be rejected more than once per day, we were given documentation to substantiate only one transaction. The duplicate rejected transactions totaled \$2.4 million, and the duplicate blocked transaction amount was \$500. According to OFAC personnel, the transactions were inadvertently entered into the system twice. The transactions were probably initially entered based on receipt of a faxed copy and then re-entered when the original documentation was received through the mail. Currently, to avoid duplicate entries OFAC personnel would have to query the system before each entry is made.

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Regarding financial institution reporting, OFAC does not have a standardized form for financial institutions to use when reporting blocked and/or rejected financial transactions. A form specifically designed to capture information regarding blocked and rejected financial transactions would foster accuracy, as well as consistency in the reporting process.

To assist us in verifying certain blocked and rejected transactions, OFAC was required to request source documentation from 28 financial institutions to attest to blocked and rejected financial transactions recorded in the database. OFAC personnel indicated that the documentation may have been part of a judicial proceeding and therefore unavailable or simply mis-filed. OFAC normally does not have a need to go back and look at the transaction once it is entered into the system. OFAC personnel explained that instead of attempting to locate the documentation it was easier to have the financial institutions to fax another copy of the blocked or rejected report to OFAC.

It is our belief that processing procedures are needed to effectively control financial transactions reported to OFAC. The procedures would ensure that financial transactions are (1) properly recorded; (2) complete and accurate to permit the preparation of reliable statistical reports for internal and external use; (3) clearly documented; and (4) readily available for review. OFAC should also review the database to identify duplicates and make necessary adjustments to remove duplicate transactions.

### **Annual Reports of Blocked Property**

Any financial institution holding property blocked or funds retained under OFAC Regulations is required to submit an Annual Report of Blocked Property to OFAC. OFAC reports to Congress on an annual basis regarding assets in the United States belonging to terrorist countries or international terrorist organizations. At the time of our review, more than \$4 billion in assets of the designated state sponsors of terrorism were

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located within the United States jurisdiction. Of that amount, over \$3.5 billion were blocked as a result of economic sanctions imposed against terrorist countries.

Section 304 of Public Law 102-138, as amended by Public Law 103-236 (22 U.S.C. 2656g), requires the Secretary of the Treasury, in consultation with the Attorney General and appropriate investigative agencies, to provide annual reports to the Congress concerning the nature and extent of assets held in the United States by terrorist countries and organizations engaged in international terrorism. OFAC submits the Terrorist Assets Report to the Committees on Foreign Relations and Finance in the Senate and to the Committees on International Relations and Ways and Means in the House of Representatives.

OFAC personnel do not reconcile the annual reports received from the financial institutions to the Blocked/Rejected Transactions database to determine if financial institutions reported all blocked accounts. Financial institutions submit the annual reports in many different formats and in many instances OFAC has no way to identify a specific transaction. According to OFAC personnel, the financial institutions usually report the accounts in aggregate on the Annual Blocked Property Report, thus the various accounts could contain several transactions. Accordingly, OFAC personnel indicated that they could not reconcile the annual report to the Blocked/Rejected Transactions database. OFAC does not verify the annual reports and assumes that the reports are complete and accurate. In addition, the accounts included in the annual report reflect interest earned, and the database only identifies the original blocked amount. In this regard, we could not trace the annual reports to source documentation and determine if OFAC had complete and accurate information.

We believe that OFAC should research the feasibility of developing procedures to reconcile the Annual Blocked Property

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Report which is received from the financial institutions to the initial blocked accounts in the database to, at a minimum, ensure that all blocked accounts are reported.

### **License Applications**

OFAC personnel were unable to determine the number of licenses that were issued by accessing its Licensing database. The database was not updated as licenses were issued, modified, or denied. Consequently, OFAC has very little assurance that the statistical information on the number, purpose, and status of licenses is complete and accurate.

OFAC has the authority to license, or authorize transactions that would otherwise be prohibited under the sanctions programs. OFAC's Licensing Division reviews license applications on a case-by-case basis and issues or denies specific licenses based on U.S. foreign policy. Transactions consistent with normal banking practice are frequently permitted by general license. OFAC issues general licenses, which are regulatory provisions authorizing certain transactions without the filing of an application.

According to OFAC records, it received 15,102 applications for licenses during FY 2000 and issued 16,111 licenses during FY 1999. However, these numbers are estimates by OFAC because the database contains inaccurate information. According to OFAC officials, all Licensing agents do not update the Licensing database to accurately denote whether a license was issued, amended, or denied. In addition, the screen that describes the purpose of the license was rarely updated. OFAC personnel could manually search the files to determine the actual number of licenses that were issued, but it would be a time consuming task.

We selected a sample of 29 licensing cases to review. The basis of the selection was licensing cases over \$50,000 and involving significant business enterprises. Our review disclosed

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that two licensing cases that were reflected in the licensing database as issued licenses were not issued licenses. The first case, License Number IQ-1225, was cancelled and became IQ-1226. The system showed IQ-1225 as an issued license. The second case, License Number LI-1746, was not a license, instead a "fax release" was issued. A "fax release" authorizes the financial institution to return the funds to the remitter. When the remittance conforms to the requirements and is in the amount of \$1,000 or less, the return of funds may be authorized by a facsimile form of communication approved and signed by appropriate OFAC officials. A unique reference number is assigned instead of a license number.

To properly account for licensing statistics, OFAC needs to ensure that the licensing database is systematically updated as new information becomes available. Accordingly, OFAC would have reasonable assurance that the statistical information on the number, purpose, and status of licenses is complete and accurate.

### **Civil Penalties**

Since the last OIG audit,<sup>7</sup> OFAC has made improvements in its management of civil penalty receipts. OFAC established penalty guidance to include procedures to notify FMD to set up an accounts receivable for civil penalty cases. However, our review disclosed that OFAC used a notification memorandum which did not include due dates or payors addresses to notify FMD to set up account receivables. This memorandum covered several payors and included the payors' name, amounts, account number/case numbers, and type, but no due dates or payors' addresses were provided. In addition, OFAC could not locate documentation to verify that an accounts receivable was established for two financial institutions. However, OFAC did have evidence that payment was received in both cases.

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<sup>7</sup> Audit Report On The Office Of Foreign Assets Control, OIG-93-027, February 12, 1993.

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Over the past several years, OFAC has imposed millions of dollars in civil penalties involving U.S. financial institutions. The penalties can be severe. The majority of the fines resulted from failure to block or reject prohibited funds transfers when there was a reference to a target country, blocked person, or SDN. When this happens, OFAC sends an administrative demand for information to the institution requesting an explanation of how and why the transaction was processed. Depending upon the response, OFAC may issue a cautionary letter, a warning letter, or a "Prepenalty Notice" citing the violation and stating the amount of a proposed penalty. The institution has 30 days to respond to the Prepenalty Notice.

It is critical that institutions respond because failure to do so may result in default judgments that levy maximum fines. It is at the prepenalty stage that an institution should make its case as to why a penalty should not be imposed; or if imposed, why it should be a lesser amount than proposed. Financial institutions often present mitigating factors such as the sophistication of its compliance program or voluntary notification of the violation. OFAC will mitigate penalties considering such factors as self-disclosure, i.e., voluntary notification, the use and sophistication of interdict software, and other compliance initiatives.

We selected a total of 15 civil penalty cases totaling \$719,435 to review. We reviewed 10 civil penalty cases for FY 2000 and 5 cases for FY 1999 totaling \$130,685 and \$588,750, respectively. OFAC used a notification memorandum to inform FMD to set up accounts receivable in 10 of the 15 cases reviewed. This memorandum covered several payors. Although the memorandum included the payors' names, amounts, account number/case numbers, and type, no due dates or payors' addresses were provided. Of the remaining 5 cases reviewed, 3 included payor addresses and due dates and in 2 cases OFAC could not locate documentation to verify that an accounts receivable was established. Generally, without due dates and payors' addresses the efficiency of the accounts receivable process is reduced.

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However, in the cases we reviewed payments were received by FMD.

OFAC has been working very close with FMD on the accounts receivable issue. FMD and OFAC agreed that some information being provided by OFAC was not necessary to set up accounts receivable. FMD will not accept the payment if an accounts receivable has not been set up. The payors have been remitting funds immediately once a settlement has been reached and OFAC has been providing adequate information to facilitate the process.

FMD is responsible for establishing the accounts receivable, recording all collections, following up on unpaid accounts, and referring cases to the Financial Management Service for collection, when necessary. According to a FMD official, FMD is paralyzed in terms of following up on delinquent payments until it receives pertinent information such as the payor's address, social security number or tax identification, and due date.

In addition, OFAC could not locate documentation to verify that an accounts receivable was established for two financial institutions (Reference Numbers 97-C-2286 and 97-C-2287). However, both OFAC and FMD did have evidence that payment was received in both cases.

It is our belief that OFAC needs to adhere to its penalty guidance which requires inclusion of the payor name, case number, due date, and address when notifying FMD to establish the accounts receivable. This process will alleviate processing delays in collection of penalty amounts.

These procedures should also ensure that support documentation for civil penalty cases are clearly documented and are readily available for examination.



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## **Recommendations**

1. To effectively control financial transaction statistics, OFAC should establish processing procedures for financial transactions reported. These procedures would ensure that all financial transactions are properly recorded and accounted for; are clearly documented; and are readily available for examination.

### **OIG Comment**

OFAC management did not respond to this recommendation. Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* requires that you provide actions taken and planned, and target dates for any incomplete action.

2. In conjunction with the financial institution community, OFAC should develop a standardized form which can be used by financial institutions when reporting blocked and/or rejected financial transactions.

### **Management Comment**

OFAC management stated establishment of a standardized form to be used by the financial institutions to report blocked and/or rejected financial transactions does not take into consideration the myriad of different sources for blocking and reject reports, their need to see the original payment instructions, along with the preference of the financial institution community to maintain the current reporting process. However, OFAC stated that they have established a voluntary form for blocked and rejected items and posted it on its website and is assessing the viability of providing an electronic filing option for financial institutions to report block and rejected financial transactions.

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### OIG Comments

The OIG believes that the actions taken and planned by OFAC address the intent of the recommendation.

3. OFAC should review its Blocked/Rejected transaction database to identify duplicates and make necessary adjustments to remove the duplicate transactions.

### Management Comment

OFAC management stated that the Compliance Programs Division has instituted procedures that emphasize the importance of entering data regarding blocked and rejected items into R-base. However, given limited resources, and the need to respond to emergencies such as the financial war on terrorism, data entry has not been among OFAC's highest priorities.

### OIG Comment

OFAC's response does not address the OIG recommendation. Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* requires that you provide actions taken and planned, and target dates for any incomplete action.

4. OFAC should research the feasibility of developing procedures to reconcile the Annual Blocked Property Report which is received from the financial institutions to the accounts originally blocked in the Blocked/Rejected Transactions database to, at a minimum, ensure that all blocked accounts are reported.

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#### Management Comment

OFAC management stated that they will assess whether staff resources should be redirected to reconcile the Annual Blocked Property Report which is received from the financial institutions to the accounts originally blocked in the Blocked/Rejected Transactions database. OFAC management stated that the bank is in a far better position to reconcile these figures. If OFAC has reason to believe that the figures provided on its annual report are inaccurate, it has the authority to request reconciliation or perform an audit of the blocked accounts. Devoting limited staff resources to routinely reconcile the specific transaction information with the aggregate blocked assets information when such reconciliations are seldom necessary and can be accomplished with sufficient specificity on a case-by-case basis as required may not be a viable alternative.

#### OIG Comment

The OIG believes that the actions taken and planned by OFAC address the intent of the recommendation. However, Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* requires that you provide target dates for any incomplete action.

5. To properly control licensing determinations and statistics, OFAC should ensure that the Licensing database is systematically updated as new information becomes available.

#### Management Comment

OFAC management stated that they are currently in the process of migrating from the current R-Base program which is essentially a correspondence tracking system rather than a database system specifically designed to produce, on an

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automated basis, licensing statistics, to Oracle. When this migration is complete OFAC's Information Technology personnel will work with the Licensing personnel to implement the necessary statistical data gathering. OFAC management added that extensive training would be provided to all Licensing personnel to assure accurate data tracking and generation of statistics.

#### OIG Comment

The OIG believes that the actions taken and planned by OFAC address the intent of the recommendation. However, Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* requires that you provide target dates for any incomplete action.

6. OFAC should adhere to its penalty guidance which requires inclusion of the payor name, case number, due date, and address when notifying FMD to establish the accounts receivable. These procedures should also ensure that support documentation for civil penalty cases are clearly documented and are readily available for examination.

#### Management Comment

OFAC management stated that the findings misstate the roles of OFAC and FMD in the debt collection process. OFAC stated that it has revised the system in place for collecting penalty debt. Formerly, collections were sent to OFAC and subsequently delivered to FMD for deposit. After June 2001, FMD began to receive all collections. Also, OFAC stated that it has undertaken certain improvements in its record-keeping procedures. OFAC no longer establishes accounts receivable electronically with FMD due to the inefficiencies of that electronic system and FMD's general lack of cooperation with OFAC. Also, OFAC stated that it has developed an initial account set-up form that will be

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used by OFAC to request that FMD pursue avenues to exercise other debt collection tools.

OIG Comment

The process described in our report accurately reflects the process used by OFAC to establish an accounts receivable for collection of civil penalties due, as well as, FMD's role in the debt collection process, at the time of our audit activity. OFAC's Penalty Guidance states, " The issuance of a penalty notice creates a debt due the U.S. Government and triggers the provisions of the Debt Collection Act. OFAC advises the Financial Management Division upon the issuance of a penalty notice via the form letter set forth in Appendix B hereof. FMD will then take follow-up action to collect the penalty assessed if not paid within the period of time prescribed in the penalty notice." The initial account set-up form referred to in OFAC's response titled "Request that FMD-Accounting Pursue Avenues to Exercise Other Debt Collection Tools" appears to address scenarios where additional collection methods are requested to collect defaulted debt rather than to set up an initial accounts receivable. However, if this memorandum is used to set up the initial accounts receivable, we maintain that OFAC should adhere to its Penalty Guidance and provide adequate debtor information to facilitate account collection. Accordingly, the OIG does not believe that this response clearly addresses the recommendation. Treasury Directive (TD) 40-01, *Responsibilities of and to the Inspector General* requires that you provide actions taken and planned, and target dates for any incomplete action.

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We would like to extend our appreciation to OFAC for the cooperation and courtesies extended to our staff during the review. If you have any questions, please contact me at (202) 927-5591. Major contributors to this report are listed in Appendix 6.

A handwritten signature in black ink, reading "Alexander Best Jr." with a stylized flourish at the end.

Alexander Best, Jr.

National Director, Enforcement Program Audits

The objective of this audit was to determine whether OFAC's implementation of its Foreign Sanctions Program provides reasonable assurance that U.S. foreign policy and national security requirements are met. Specifically, our coverage included how OFAC administers, facilitates, and monitors the implementation and enforcement of sanctions. Also, we evaluated the role of the financial institution regulators, such as OCC and OTS, in assisting OFAC to accomplish its Foreign Sanctions Program objectives.

We conducted our audit at OFAC, OCC, and OTS Headquarters in Washington, D.C., from June 2000 through August 2001. We met with OFAC officials responsible for foreign sanction compliance, blocked assets, rejected financial transactions, licensing, and civil penalty programs. We also met with OCC, OTS, FRS, and FDIC officials responsible for monitoring financial institutions.

We visited Riggs Bank in Washington, DC to review recent compliance examinations conducted by OCC. In addition, we sent questionnaires to a statistically selected number of financial institutions to obtain details about their compliance program. We used attribute sampling to determine our sample size of 138 from a universe of 10,197 commercial and savings banks. This sample size was based on a confidence level of 90 percent with an expected error rate of 5.4 percent. The audit universe consisted of all FDIC Insured Depositories and Uninsured National Banks and Trust Companies. The universe did not include credit unions and a small number of state chartered and insured banks and savings associations. To ensure that the sample was representative of the universe of commercial and savings banks we stratified the universe into three stratum based on asset size; (1) small institutions – assets up to \$250 million; (2) medium institutions – assets between \$250 and \$1 billion; and (3) large institutions – assets exceeding \$1 billion. Based on this stratum design we used ratio random sampling without replacement to select the sample financial institutions. We received 102 responses from the 138 financial institutions surveyed. This survey response did not satisfy our sample size requirement. As a result, we could not

project the survey results to the universe of commercial and savings banks. Survey results discussed in the report represent the compliance characteristics of the 102 financial institutions that responded to our survey.

We reviewed OFAC financial and program data for FYs 1999 and 2000. The financial and program data included civil penalties paid and assessed, licensing determinations, annual blocked assets, blocked financial transactions, and rejected financial transactions. Other time periods were covered as deemed necessary to address the audit objective.

We conducted our audit in accordance with generally accepted government auditing standards.



Appendix 2  
Economic Sanctions Programs Administered By OFAC

PROGRAM & DATE OF INCEPTION	<u>BLOCKING TARGETS</u>	<u>TRADE OR OTHER RESTRICTIONS</u>
Angola (UNITA) 31 CFR 590 1993	<ul style="list-style-type: none"> <li>* UNITA.</li> <li>* Designated senior officials of UNITA and designated adult members of their immediate families.</li> </ul>	<ul style="list-style-type: none"> <li>- No sale or supply of aircraft, aircraft components, arms and related materiel, petroleum or petroleum products, equipment used in mining, motorized vehicles, watercraft, or parts for motorized vehicles or watercraft to the territory of Angola other than through designated points of entry.</li> <li>- No sale or supply of mining services or ground or waterborne transportation services to persons in designated areas of Angola.</li> <li>- No imports of diamonds exported from Angola unless controlled through Certificate of Origin regime of Angolan Govt. of Unity and National Reconciliation.</li> </ul>
Burma (Myanmar) 31 CFR 537 1997	<ul style="list-style-type: none"> <li>* No blocking provisions.</li> </ul>	<ul style="list-style-type: none"> <li>- New investment prohibited.</li> <li>- Most trade in goods, services and technology is exempt.</li> </ul>
Cuba 31 CFR 515 1963	<ul style="list-style-type: none"> <li>* Cuban nationals, wherever located.</li> <li>* Persons and entities located in Cuba.</li> <li>* Government of Cuba.</li> <li>* Specially Designated Nationals of Cuba.</li> </ul>	<ul style="list-style-type: none"> <li>- No exports of goods or services to Cuba, except food and agricultural commodities licensed by Department of Commerce.</li> <li>- No imports of goods or services from Cuba.</li> <li>- No dealing in Cuban origin goods.</li> <li>- No brokering of Cuban trade contracts.</li> <li>- Informational materials exempted from export and import prohibitions.</li> <li>- Food donations to non-governmental organizations exempted from export prohibitions.</li> <li>- Gift parcels exempted from export prohibitions; for-profit organizations licensed by Dept. of Commerce may consolidate and ship multiple gift parcels.</li> <li>- Humanitarian exports licensed by Department of Commerce.</li> </ul>

Appendix 2  
Economic Sanctions Programs Administered By OFAC

PROGRAM & DATE OF INCEPTION	<u>BLOCKING TARGETS</u>	<u>TRADE OR OTHER RESTRICTIONS</u>
Federal Republic of Yugoslavia (Serbia and Montenegro) [FRY(S&M) I] 31 CFR 585 1992	* Assets blocked prior to December 27, 1995, or in the case of Bosnian Serbs, prior to May 10, 1996, remain blocked.	- No restrictions but see FRY(S and M) II.
Federal Republic of Yugoslavia (Serbia and Montenegro) [FRY(S&M) II] 31 CFR 586 1998	* Assets blocked prior to January 19, 2001 remain blocked. * Persons indicted by the International Criminal Tribunal for the Former Republic of Yugoslavia, including Slobodan Milosevic, and their close associates and supporters ("blocked persons").	- Only transactions with blocked persons are prohibited.
Foreign Narcotics Kingpins 31 CFR 598 1999	* Foreign Narcotics Kingpins designated by President, and other narcotics traffickers derivatively designated pursuant thereto.	- No dealings in blocked property, including exports and imports.
Foreign Terrorist Organizations 31 CFR 597 1997	* Foreign Terrorist Organizations designated by Secretary of State.	- No dealings in blocked property, including exports and imports.

Appendix 2  
Economic Sanctions Programs Administered By OFAC

PROGRAM & DATE OF INCEPTION	<u>BLOCKING TARGETS</u>	<u>TRADE OR OTHER RESTRICTIONS</u>
Iran I 31 CFR 535 1979	* Assets of the Government of Iran blocked during the 1979-1981 hostage crisis now administered pursuant to the Algiers Accords.	- No restrictions but see Iran II.
Iran II 31 CFR 560 1987/1995	* No blocking provisions.	- No exports or reexports of goods, services, or technology to Iran, except agricultural commodities, medicine and medical equipment licensed by OFAC. - No imports of goods or services from Iran except carpets and food stuffs. - No facilitation of Iran-related transactions by third country firms. - Informational materials exempted from export and import prohibitions.
Iraq 31 CFR 575 1990	* Government of Iraq. * Specially Designated Nationals of Iraq.	- No exports of goods or services to Iraq or imports of goods or services from Iraq. - No dealing in Iraqi origin goods. - No brokering of Iraqi trade contracts. - Humanitarian exports licensed by OFAC are exempted.
Libya 31 CFR 550 1986	* Government of Libya. * Specially Designated Nationals of Libya.	- No exports of goods, services or technology to Libya, except agricultural commodities, medicine and medical equipment licensed by OFAC. - No imports of goods or services from Libya. - No brokering of Libyan trade contracts. - Informational materials exempted from import and export prohibitions. - Donated humanitarian goods exempted from export prohibitions.
Narcotics (Colombia) 31 CFR 536 1995	* Specially Designated Narcotics Traffickers centered in Colombia.	- No dealings in blocked property, including exports and imports.

Appendix 2  
Economic Sanctions Programs Administered By OFAC

PROGRAM & DATE OF INCEPTION	<u>BLOCKING TARGETS</u>	<u>TRADE OR OTHER RESTRICTIONS</u>
North Korea 31 CFR 500 1950	* Assets blocked prior to June 17, 2000, remain blocked.	- Imports require prior notification to and approval of OFAC.
Russian Uranium 31 CFR 540 2000	* Assets blocked relating to the implementation of the agreement between the United States and Russia on the disposition of highly enriched uranium in order to protect such assets from attachment or garnishment by third parties.	- No restrictions.
Sierra Leone (regulations pending) 2001	* No blocking provisions	- No import of rough diamonds except as controlled by Certificate of Origin regime of Government of Sierra Leone.
Sudan 31 CFR 538 1997	* Government of Sudan. * Specially Designated Nationals of Sudan.	- No exports of goods, services or technology to Sudan, except agricultural commodities, medicine and medical equipment licensed by OFAC. - No imports of goods or services from Sudan. - No brokering of Sudanese trade contracts. - Informational materials exempted from import and export prohibitions. - Donated humanitarian goods exempted from export prohibitions.
Taliban (Afghanistan) 31 CFR 545 1999	* The Taliban * Specially Designated Persons	- No imports or exports of goods or services to or from the Taliban or to or from areas controlled by the Taliban, except as authorized by OFAC. - Informational materials exempted from import and export prohibitions.

Appendix 2  
Economic Sanctions Programs Administered By OFAC

PROGRAM & DATE OF INCEPTION	<u>BLOCKING TARGETS</u>	<u>TRADE OR OTHER RESTRICTIONS</u>
Terrorism List Governments 31 CFR 596 1996	* No blocking provisions	- No trade restrictions. - Transfers prohibited from a Terrorism List Government constituting a donation to a U.S. person, or with respect to which the U.S. person knows or has reason to know that the transfer poses a risk of furthering terrorist acts in the United States.
Terrorists who threaten the Middle East Peace process 31 CFR 595 1995	* Specially Designated Terrorists	- No dealings in blocked property, including exports and imports.
Transaction Control Regulations 31 CFR 505 1953	* No blocking provisions	- Prohibit U.S. persons and foreign subsidiaries from dealing in transactions relating to shipment of certain goods to the former Communist Bloc, Cambodia, China, North Korea, and Vietnam of goods of the kind controlled for export from the United States under the Arms Export Control Act and the Atomic Energy Act.
Weapons of Mass Destruction 31 CFR 539 1994	* No blocking provisions.	- No imports of goods, technology or services produced or provided by foreign persons designated by the Secretary of State as persons who promote proliferation of weapons of mass destruction.



## Appendix 3

### Survey Questionnaire Results

6. Is the list of prohibited countries, entities, and individuals updated?
- |                              |                             |                              |         |       |        |
|------------------------------|-----------------------------|------------------------------|---------|-------|--------|
| <input type="checkbox"/> YES | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 99% | No 0% | N/A 1% |
|------------------------------|-----------------------------|------------------------------|---------|-------|--------|
- If yes, how often and what is the source of this information?
- |  |     |
|--|-----|
| <input type="checkbox"/> Daily                   | 11% |
| <input type="checkbox"/> Weekly                  | 8%  |
| <input type="checkbox"/> Monthly                 | 8%  |
| <input type="checkbox"/> Quarterly               | 9%  |
| <input type="checkbox"/> Other (Please Describe) | 58% |
| <input type="checkbox"/> Source _____            |     |
7. Approximately, what percentage of your financial transactions and activities involve international customers?
- |  |     |
|--|-----|
| <input type="checkbox"/> 0-25 Percent            | 94% |
| <input type="checkbox"/> 26-50 Percent           | 1%  |
| <input type="checkbox"/> Greater than 50 Percent | 2%  |
| <input type="checkbox"/> N/A                     | 3%  |
8. Does your financial institution disseminate a current listing of prohibited countries, entities, and individuals to your foreign offices? If no, briefly explain.
- |                              |                             |                              |         |       |         |
|------------------------------|-----------------------------|------------------------------|---------|-------|---------|
| <input type="checkbox"/> YES | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 20% | No 6% | N/A 74% |
|------------------------------|-----------------------------|------------------------------|---------|-------|---------|
9. When did your regulator conduct the last compliance examination at your financial institution to assess compliance with foreign sanction requirements?
- |  |     |
|--|-----|
| <input type="checkbox"/> 0-18 Months         | 75% |
| <input type="checkbox"/> 19-36 Months        | 19% |
| <input type="checkbox"/> 37-54 Months        | 1%  |
| <input type="checkbox"/> 55 Months or longer | 1%  |
| <input type="checkbox"/> N/A                 | 4%  |
10. Does your financial institution provide training to both management and operations employees to familiarize them with foreign sanction requirements? If yes, briefly describe.
- |                              |                             |                              |           |            |        |
|------------------------------|-----------------------------|------------------------------|-----------|------------|--------|
| <input type="checkbox"/> YES | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 88%   | No 10%     | N/A 2% |
|                              |                             |                              | Small 3%  | Small 20%  |        |
|                              |                             |                              | Medium 8% | Medium 20% |        |
|                              |                             |                              | Large 89% | Large 60%  |        |
11. What types of financial transactions and activities are examined for compliance with foreign sanction requirements? Check all that apply.
- |   |     |
|---|-----|
| <input type="checkbox"/> Wire Transfers       | 95% |
| <input type="checkbox"/> Credit Card Payments | 11% |
| <input type="checkbox"/> New Accounts         | 92% |
| <input type="checkbox"/> Extensions of Credit | 60% |
| <input type="checkbox"/> Other (Please List)  | 43% |
| <input type="checkbox"/> N/A                  | 2%  |

Appendix 3  
Survey Questionnaire Results

12. Does your financial institution use "interdict" software<sup>2</sup> to identify transactions with prohibited countries, entities, and individuals? If no, briefly describe the process used.
- |                              |                             |                              |         |           |        |            |        |
|------------------------------|-----------------------------|------------------------------|---------|-----------|--------|------------|--------|
| <input type="checkbox"/> YES | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 72% | Small 0%  | No 26% | Small 19%  | N/A 2% |
|                              |                             |                              |         | Medium 5% |        | Medium 15% |        |
|                              |                             |                              |         | Large 95% |        | Large 66%  |        |
13. Does your financial institution use a "know your customer" approach to establishing new accounts, extensions of credit, etc? If yes, briefly describe the process used.
- |                              |                             |                              |         |
|------------------------------|-----------------------------|------------------------------|---------|
| <input type="checkbox"/> YES | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 99% |
|                              |                             |                              | No 1%   |
|                              |                             |                              | N/A 0%  |
14. Did your financial institution identify any non-compliant transactions during calendar year 2000? If yes, how many and what method was used to identify the non-compliance? Check all that apply.
- |  |                             |                              |         |        |        |
|--|-----------------------------|------------------------------|---------|--------|--------|
| <input type="checkbox"/> YES                             | <input type="checkbox"/> NO | <input type="checkbox"/> N/A | Yes 26% | No 73% | N/A 1% |
| <input type="checkbox"/> Number <u>74</u>                |                             |                              |         |        |        |
| <input type="checkbox"/> Know your customer process      | 30%                         |                              |         |        |        |
| <input type="checkbox"/> Manual interdict process        | 19%                         |                              |         |        |        |
| <input type="checkbox"/> Interdict software              | 74%                         |                              |         |        |        |
| <input type="checkbox"/> Internal compliance examination | 19%                         |                              |         |        |        |
| <input type="checkbox"/> External compliance examination | 4%                          |                              |         |        |        |
15. Is your financial institution aware of the following methods of assistance provided by OFAC to facilitate compliance with foreign sanction requirements? Check all that apply.
- |  |     |
|--|-----|
| <input type="checkbox"/> OFAC Compliance Hotline -Toll Free at 1 800-540-OFAC (6322)                           | 90% |
| <input type="checkbox"/> OFAC Starter Kit  | 27% |
| <input type="checkbox"/> OFAC Fax-on-Demand Service – 202 622-0077   | 63% |
| <input type="checkbox"/> OFAC Web Site – <a href="http://www.ustreas.gov/ofac">http://www.ustreas.gov/ofac</a> | 94% |
16. Has your financial institution used any of the methods of OFAC assistance listed below? If yes, please indicate your level of satisfaction for each method used based on the following criteria.
- 1 = Very Satisfied  
2 = Somewhat Satisfied  
3 = Satisfied  
4 = Somewhat Dissatisfied  
5 = Very Dissatisfied
- \_\_\_\_ OFAC Compliance Hotline -Toll Free at 1 800-540-OFAC (6322)  
\_\_\_\_ OFAC Starter Kit  
\_\_\_\_ OFAC Fax-on-Demand Service – 202 622-0077  
\_\_\_\_ OFAC Web Site – <http://www.ustreas.gov/ofac>

<sup>2</sup> Interdict software is designed to assist banks to comply with OFAC foreign sanctions by electronically scanning funds transfer requests to ensure that they do not involve prohibited countries, entities, and individuals.



**QUESTIONS 6 & 16 RESPONSES CON'T**

6. **Sources:** OFAC website, ChexSystems, Equifax, Watchdog, Thompson Financial Fundtech, FDIC, President's Executive Orders, www.bankinfo.com, Interdict software, Fedwire, America's Software Corp., National Check Protection Service, Darien OFAC checker, Bridger Systems, FDIC Financial Institution letters, FDIC bulletins, Profit Protection Inc., www.ofacompliance.com, email notification

	<div> <div>←</div> <div>Level of Satisfaction</div> <div>→</div> </div>				
16.	1	2	3	4	5
<b>Compliance Hotline</b> (71 Responses)	51%	25%	17%	7%	0%
<b>Starter Kit</b> (12 Responses)	50%	17%	25%	0%	8%
<b>Fax on Demand</b> (36 Responses)	36%	36%	25%	3%	0%
<b>Website</b> (89 Responses)	56%	21%	20%	3%	0%

Appendix 3  
Survey Questionnaire Results

17. Do you have any suggestions for OFAC and/or your regulator which would enhance your financial institution's ability to ensure that foreign sanction requirements are met?

CONTROL NUMBER	COMMENTS
25	OFAC should develop or acquire and deploy on its web site, a facility for directly checking names and address against the OFAC lists. Or, the ability for sending inquiries directly via the web site with an email response.
72	It would be helpful if you could provide more identifying information when available on the SDN listing. This would cut down on the research time for "false hits" and the volume of phone calls to the OFAC Compliance Hotline.
103	See 72
547	The regulators should provide the SDN list electronically to financial institutions so as to facilitate the review of new and existing accountholders. Smaller institutions especially those without foreign offices or foreign accounts find the cost of quality interdict software prohibitive when compared to the potential for a confirmed "hit".
599	I recently started as the Compliance Officer. I have used the OFAC hotline and the OFAC website. Both have been helpful to me when a hit has come up on the software that the Bank utilizes. I would like to request an OFAC Starter Kit and information on the Fax on Demand service.
971	Provide consistency in the level of reports provided. As stated within this questionnaire, use of the interdict software results in an excess of "false-positives" and is therefore, not useful as a tool for ensuring compliance with foreign sanction requirements.
1026	Provide OFAC listing of prohibited persons in machine-readable format to permit us to run frequent/continuous compliance checks and inquiries without the expense of purchasing licensing proprietary software.
1043	There are, it seems, other lists of undesirable individuals which our vendors (ex. NCPS and ChexSystems) use to determine if a transaction includes an OFAC hit. These additional lists sometimes include SDN's not listed on OFAC's SDN list and are entitled "blocked officials". It would be helpful if these additional lists, or any other list that includes such sanctioned individuals, were included and regularly updated on OFAC's web site.
1191	We have inquired in the past about training material other than the brochures and the website. A training package comprised of an outline covering background, highlights of the Industry Summaries (the definitions are very helpful), basic explanations of sanctions and restrictions, a quick reference guide, frequently asked questions, red flags, an OFAC quiz, and penalties for non-compliance (with examples) would be beneficial. (A training video to supplement the written material would be even better!) The Industry Summary for banks mentions banks joining together for seminars. Does OFAC provide material, speakers, or guidance for these types of seminars? Does OFAC sponsor seminars? Perhaps seminar information could be posted on the OFAC website. As our bank continues to grow, the possibility of encountering a restricted entity increases. Any assistance provided by OFAC to enhance education and intervention is appreciated.
1273	Provide email alerts
1350	OFAC could continue to provide as much detail as possible on the list of prohibited individuals, such as the individual's date of birth. This type of information makes it easier to identify "false positives".
1882	Provide guidance and sample training information that is specific to the lending area of the bank, that includes examples of loans that have been originated or attempted to be originated by individuals or entities on the OFAC list. Provide examples of various acceptable methods for monitoring the OFAC list.
2531	Publish updates to the OFAC list on a scheduled frequency rather than at any time.

Appendix 3  
Survey Questionnaire Results

2550	We know that false hits are generated from the ChexSystems software and other software when their programs are matched against your OFAC database. When we call the Hotline to check them out, we hear complaints about the number of such false hits. We have no other way to check these names, so our suggestion is to screen your database and remove entries that generate the large number of false hits, on the assumption that the entry lacks sufficient detail to be meaningful. As an illustration, if your database had an entry containing only the following information: "John Smith, American citizen," you would get so many hits that you would be better off to remove the entry.
2621	At the current time, OFAC does not have a reporting form. Reports are made by letter. It may be useful for reporting financial institutions, as well as OFAC, to implement a reporting form for consistency and accuracy in reporting.
3050	Determining risk associated with OFAC transactions and where resources should be allocated by a financial institution is difficult. More detailed guidelines as to what is defined as high, medium and low risk transactions/accounts would be beneficial. The OFAC Hotline is frequently called when issues arise as to the true identity of an individual/business when a potential OFAC match is noted. Frequently, no guidance/assistance is provided that enables us to make an informed decision on the customer's identity. More detailed guidelines as to what procedures a financial instituting should perform on a potential OFAC match to verify identity would be beneficial, e.g., at a minimum what steps should be performed for an individual and what steps should be performed on a business/organization.
3526	Post a "Q&A" of commonly asked OFAC questions on your home page.
4373	Plain language descriptions on the specific prohibitions for each blocked country.
4474	Add a feature to website that permits real time scans of SDN list. See <a href="http://www.ofacompliance.com">www.ofacompliance.com</a> for example.
4577	Improve method of delivery of list on website. We import as text, into Excel, and try to match using the "find" function in Excel. This is beyond branch staff time and computer skills. If website was a database, with a search function, we could expect branch staff to check themselves.
5101	Provide free software to look for foreign nationals.
5937	Provide more detail on listed individuals and countries. Give specific instructions for "due diligence" requirements. Based on information OFAC provides, what is considered a match and account placed as a block.
6081	See 3526
6906	See 3526
8558	Continue with the OFAC website. It is a great resource.
8861	All credit reporting agencies should be required to tie the OFAC SDN list to their database. Therefore, when credit reports are pulled for loans or any other purpose, the credit report should indicate where the individual or entity is a possible match on the SDN list. This would aid in documenting compliance or non-compliance with OFAC. The institution would then be responsible for conducting further research to verify the accuracy of the credit report to ensure compliance with OFAC requirements.
9182	See 3526
9446	See 3526
9599	OFAC should develop more effective search and export functions on its web site
9647	We recommend that more detailed information appear on the OFAC list regarding suspects including date of birth and the last known country or address at which the suspect resided.
9770	The documents that discuss each sanction are very informative but could be of greater practical value if examples were used. Actual transactions and the reasons that they were or were not allowed to be processed. Longer hours for OFAC office to meet the needs of those on the West Coast. There are issues with getting in touch with OFAC after 1pm Pacific time. Availability of OFAC personnel until 3:30pm Pacific Time would be very helpful.
9800	Our primary source of information is the OFAC website. It would be helpful if there was information published that was directly related to bank compliance. For example, if there was a "frequently asked questions" section or a "best practices" section that could provide basic compliance helpful hints or answers. Also, if there were any information on SDN individuals' current activity, that would be helpful to share when conducting training for staff.

Appendix 4  
Universe And Sample Of Blocked And Rejected Financial Transactions

	FY 2000	
	No. of <u>Transactions</u>	<u>Amount</u>
Blocked Financial Transactions Recorded by OFAC (Universe)	2,110	\$125,048,516.90
Sample of Blocked Financial Transactions (Sample)	24	\$8,715,006.07
Percentage [(Sample) / (Universe)]		7%
Rejected Financial Transactions Recorded by OFAC (Universe)	4,565	\$458,172,640.97
Sample of Rejected Financial Transactions (Sample)	25	\$107,424,938.24
Percentage [(Sample) / (Universe)]		23%
Total Blocked and Rejected Financial Transactions	6,675	\$583,221,157.87
Sample Total Blocked and Rejected Financial Transactions	49	\$116,139,944.31
		20%
	FY 1999	
	No. of <u>Transactions</u>	<u>Amount</u>
Blocked Financial Transactions Recorded by OFAC (Universe)	2,265	\$37,050,292.62
Sample of Blocked Financial Transactions (Sample)	25	\$7,300,722.88
Percentage [(Sample) / (Universe)]		20%
Rejected Financial Transactions Recorded by OFAC (Universe)	5,197	\$372,840,175.00
Sample of Rejected Financial Transactions (Sample)	25	\$108,442,066.19
Percentage [(Sample) / (Universe)]		29%
Total Blocked and Rejected Financial Transactions	7,462	\$409,890,467.62
Sample Total Blocked and Rejected Financial Transactions	50	\$115,742,789.07
		28%
Grand Total Blocked Financial Transactions	4,375	\$162,098,809.52
Sample Grand Total Blocked Financial Transactions	49	\$16,015,728.95
		10%
Grand Total Rejected Financial Transactions	9,762	\$831,012,815.97
Sample Grand Total Rejected Financial Transactions	50	\$215,867,004.43
		26%



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

MAR 22 2002

FAC No GEN-199035

MEMORANDUM FOR MARLA A. FREEDMAN  
ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: R. RICHARD NEWCOMB *R. Newcomb*  
DIRECTOR  
OFFICE OF FOREIGN ASSETS CONTROL

SUBJECT: OFAC Comments on the IG Audit of OFAC Records

Pursuant to our recent discussions, I am hereby submitting OFAC's response to your draft audit report of the IG audit of compliance with the Office of Foreign Assets Control's (OFAC) Foreign Sanctions Programs. Your report focused on the different areas of licensing, compliance, blocked assets, and civil penalties. My response is therefore divided into three categories, the blocked assets comments being incorporated into the response describing compliance.

**LICENSING ISSUES**

Please note that OFAC has always had to rely on manual methods to obtain accurate statistical information. This is so because the current R-Base program used by OFAC is essentially a correspondence tracking system rather than one specifically designed or capable of producing, on an automated basis, licensing statistics.

OFAC is currently in the process of migrating to "Oracle". When this migration is complete, OFAC's IT personnel will work with the Licensing personnel to implement the necessary statistical data gathering. We expect this to be implemented in the near future at which time extensive training will be provided to all licensing personnel to assure accurate data tracking and the automated generation of statistics.

**COMPLIANCE ISSUES**

The level of compliance by the financial community as a whole is very high, especially on the part of money-center banks, which are most directly affected by OFAC's regulations. This high level of compliance is a direct result of OFAC's efforts with regard to its information dissemination campaign and its enforcement actions, as well as the banks' desire to avoid negative publicity associated with having been found in violation of OFAC regulations. The report generally ignores a "web" of compliance that has developed in the financial community in direct response to OFAC's enforcement actions and it places an inordinate emphasis on the role of the federal bank supervisory agencies in OFAC compliance. It has been OFAC's experience

that statutory constraints cited in the report have had limited impact on the level of compliance by the financial community or on OFAC's ability to enforce its regulations.

#### **I. OFAC's Authority and Effective Enforcement**

In its report, the IG states that "OFAC lacks sufficient legislative authority to ensure financial institution compliance with foreign sanctions." On the contrary, OFAC's authorities are extremely broad and enable it to reasonably ensure compliance by all U.S. financial institutions.

Prevalent throughout the Inspector General's audit of "OFAC's Foreign Sanctions Program" is the assumption that OFAC needs to "rely on the financial institution regulators compliance examination process to ensure financial institution compliance with foreign sanctions." We do not agree with this statement. While the report correctly states that OFAC is not a "bank supervisory agency" as defined by the Right to Financial Privacy Act, the IG uses that fact to assert that OFAC needs to rely on the financial institution regulators to ensure that institutions comply with its regulations. OFAC does not and never has been in a position of needing to rely on the financial institution regulators' examination process to ensure compliance with its sanctions programs.

OFAC's success in ensuring compliance by the financial community has been a result of its aggressive public awareness campaign regarding the prohibitions in the Regulations and the fines associated with violating them, as well as negative publicity that would result from the financial institution's violation of U.S. sanctions. OFAC's record of dealing directly with the banks without the intervention of bank examiners speaks for itself. Last year, there were in excess of 53,000 calls to OFAC's Compliance Programs Division over its toll-free telephone "Hotline." Post 9/11/01 calls now average well over 300 a day. Last year, those calls resulted in 8,211 transactions being either blocked or rejected, with \$123 million frozen and \$377 million returned to remitters as being contrary to U.S. sanctions. Following up on those transactions, without any involvement by the bank regulators, led to over 150 cases referred for Civil Penalty action and 100 cases referred to OFAC Enforcement for criminal investigation. OFAC Compliance, on its own and without the need for the involvement of outside examiners, sent out close to 2,000 "administrative demands for information" to financial institutions and issued over 800 "Warning letters" as a complement to its Civil Penalty and Enforcement activities. These results were neither addressed nor acknowledged by the IG report.

Those statistics, as well as the IG's own findings that 92% of the banks in its survey had an active compliance program in place, shows that "Sanctions compliance" has worked and is working even without regulator involvement. It should also be noted that this survey took place prior to 9/11/01. We believe that this level has gone up since that time. Closer cooperation by bank regulators in conducting transaction reviews and sharing findings with OFAC would obviously further enhance sanctions compliance effectiveness, but OFAC does not and has never "relied" on the bank regulators to assure sanctions compliance.

The report does not consider the "compliance web" that exists in the banking system to catch violative transactions. OFAC has spent 15 years establishing its relationship with the international banking community and believes that this has led to an impressive level of

compliance, especially by the larger money-center banks which are OFAC's primary customers and are the most impacted by OFAC's regulations. The fact that all of the major money center banks have made the business decision to develop and implement the use of interdict software is testimony to the high level of compliance enjoyed by OFAC. Despite the statutory limitations cited in the IG's report, the fact is that OFAC and the banking community have created a "web" of compliance from which target transactions are unlikely to escape. Nearly every transaction that takes place hits more than one financial institution. If a violative transaction escapes one bank, another will likely catch it.

The report also states that financial institutions are required to monitor their financial transactions using interdiction software to ensure that Specially Designated Nationals, terrorists, Blocked Persons and Specially Designated Narcotics Traffickers do not benefit from the U.S. financial systems. There is, in fact, nothing in the law that requires a bank to have any particular compliance program in place, much less a sophisticated electronic system. The law simply states that U.S. persons cannot process transactions in violation of the regulations. It does not mandate how a bank or a company accomplishes this objective. OFAC has no authority to fine a bank for not having a compliance program in place. It can only fine a bank if it processes a prohibited transaction.

The report implies that a bank is non-compliant if it does not have sophisticated screening software. The IG states that "some financial institutions deem it necessary to employ automated detection software and designate a compliance officer specifically for OFAC issues while others do not." Such a postulate fails to take into consideration that there is no one compliance program suitable for every financial institution. The customer base and products and services offered by a small credit union are very different than those offered by a global money-center bank with hundreds of foreign branches. In some cases a manual program is just as effective (or even more so) than an automated system. If a bank elects not to use interdiction software, it is not necessarily a reflection on the adequacy of its compliance program. The IG's attempt to classify banks as "small", "medium" and "large" does not completely address this issue. A financial institution can be "large" in terms of assets, but still have very little of the international business which is most likely to be affected by OFAC regulations. There are many "large" banks that specialize in domestic residential mortgages, for example. While such institutions may be "large" in terms of assets, nearly all of their customers are U.S. citizens living and working in the United States. They rarely process an international transaction. Such institutions need a much different type of compliance program than an institution of similar size specializing in international correspondent banking and trade finance.

The IG states that "transaction testing is the only effective method of determining whether a prohibited transaction has been allowed." OFAC does not agree with this statement. The IG explains that the bank regulators rarely perform transaction testing because they use a risk-based approach to determine whether or not it is necessary in a particular financial institution. The implication is that the regulators are somehow remiss in their duties if they do not perform transaction testing in each compliance exam. The risk of a bank encountering an OFAC issue varies by institution. If a regulator determines that the risk of a particular bank processing a transaction that violates OFAC regulations is so low that transaction testing is not necessary, that is a legitimate judgement call on the part of the regulator.

While OFAC agrees that increased oversight and detailed account reviews by regulators could be beneficial, we do not agree that they are the only effective method to ensure compliance. Much apparently has been made of a situation in which the OCC failed to detect the fact that a particular offshore account was not being monitored by a large U.S. financial institution. The “compliance failure” was uncovered in a review by internal auditors at the bank. In the current regime, that is precisely what was supposed to have happened. The fact that the institution's auditors uncovered the exception to the bank's procedures proves rather than disproves the efficacy of OFAC's compliance efforts.

We agree that current legislative authority could be improved with regard to federal bank regulators sharing information with OFAC. The Right to Financial Privacy Act prohibits federal bank regulators from sharing audit information with anyone other than another bank regulatory agency, as defined by the Act. Federal regulators do not notify OFAC if their examination process surfaces sanction compliance deficiencies. They have historically taken the position that they cannot share information regarding audit exceptions involving OFAC issues with OFAC because OFAC is not a “bank regulator.” Interestingly, OFAC has had very good relationships with State bank supervisory agencies that has involved their sharing information about potential violations that are discovered during the course of their routine examinations, so they apparently do not find themselves saddled with the same constraints. Although OFAC would appreciate having that additional information from the federal regulators, OFAC does not feel that the lack of audit information has significantly affected its ability to monitor or ensure sanctions compliance by the financial community.

Recommendation No. 1 in the IG's report might be rephrased:

1. The Treasury Department should inform Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by assuring that bank regulators share information that comes to their attention with OFAC. This could be accomplished by amending the RFPA to include OFAC in its definition of a “bank regulator” for the purpose of sharing information with OFAC.

## **II. Recommendations Regarding Internal Controls and Procedures**

***“To effectively control financial transaction statistics OFAC should establish processing procedures for financial transactions reported. These procedures would ensure that all financial transactions are properly recorded and accounted for; are clearly documented and are readily available for examination.”***

***“In conjunction with the financial institution community, OFAC should develop a standardized form which can be used by financial institutions when reporting blocked and/or rejected financial transactions.”***

The IG's comments about the need for form-based processing for blocking and reject reports does not take into account the myriad of different sources for those reports, including SWIFT, CHIPS, Fedwire, and propriety systems, and does not take into account OFAC's need to see



original payment instructions to assure effective enforcement analysis. OFAC has in the past suggested an electronic filing mechanism to the financial community, but there were no takers for such a procedure. The financial community was concerned about interfacing its systems, which are very different from institution to institution, with such a reporting format. Overall, the financial community relayed to OFAC that it prefers the system currently in place—namely faxing a copy of the payment instructions directly to OFAC Compliance. This simple system does not require them to revamp their systems in order to provide OFAC with information. To address the IG's concerns, however, OFAC has already posted a voluntary form for blocking & reject items on its website and has prepared a "concept paper," entitled Potential Online Reporting of Blocked & Rejected Transactions (a copy of which is attached) to proceed with an electronic filing option.

***"OFAC should review its Blocked/Rejected transaction database to identify duplicates and make necessary adjustments to remove the duplicate transactions."***

OFAC's Compliance Programs Division has instituted procedures that emphasize the importance of entering data regarding blocked and rejected items into R-base. For several years, OFAC Compliance has hired interns whose primary responsibility was to enter and file these reports. In most cases, these items are entered into the database within days of receipt, but there are times when this process is "overcome by events"—such as emergency actions in the financial war against terrorism. Given limited resources, data entry has not been among the Office's highest priorities. It should be emphasized that hard copies of reports are available if needed for a particular action item.

***"OFAC should research the feasibility of developing procedures to reconcile the annual blocked property report which is received from the financial institutions to the accounts originally blocked in the Blocked Assets database to, at a minimum, ensure that all blocked accounts are reported."***

OFAC will assess whether staff resources should be redirected to accomplish this. However, we note that the Compliance Division and the Blocked Assets Division collect different data for different purposes. Compliance collects transactional information and uses this information on a daily basis for the primary purpose of pursuing potential enforcement actions against U.S. parties involved in suspect transactions. The Licensing Division also uses the information to verify information regarding blocked funds transfers provided by parties seeking to have the funds unblocked. The database was never intended to be used as a "running total" of blocked assets in the United States. It is a database of transactions blocked, not necessarily accounts blocked. It is used primarily for enforcement purposes, not policy purposes. The database maintained by the Blocked Assets Division, on the other hand, looks at aggregate information, on an annualized basis.

Data from the Annual Reports of Blocked Property is used by the Blocked Assets Division to reconcile and update a database of blocked property. Most of the property contained in the database of blocked property exists in the form of bank accounts blocked at the time a sanctions program was put into effect. The data provided on these reports also takes into account funds that have been unblocked by general or specific license as well as interest earned and service

charges assessed by the banks holding the funds. Data from this database is used for sanctions policy analysis and to produce Treasury's annual Terrorist Assets Report to the Congress.

The dollar amount of blocked or rejected items (usually wire transfers) in any one year is very small relative to the overall dollar amount blocked. It would take a large staff a considerable effort to match each of the transactions reported to the Compliance Division as blocked with what is reported on the Annual Reports of Blocked Property. Even if such resources were devoted to such a task, a 100% reconciliation would be virtually impossible because of funds released by general license (including bank service charges) and interest paid on blocked deposits. The bank is in a far better position to reconcile these figures. If OFAC has reason to think that the figures provided on its annual report are inaccurate, it has the authority to request reconciliation or perform an audit of the blocked accounts. Devoting limited staff resources to routinely reconcile the specific transaction information with the aggregate blocked assets information when such reconciliations are seldom necessary and can be accomplished with sufficient specificity on a case by case basis as required may not be a viable alternative.

***“Financial institutions submit the annual reports in many different formats and in many instances OFAC has no way to identify specific transactions.”***

There is a form for the annual reports (Form TD 90-22.50) that the majority of financial institutions routinely use. In some cases, they have been allowed to submit the information in an alternative format, but the alternative formats must still contain the same data elements and information. In neither case are specific transactions identified. That is not the reason the annual reports are required, nor is it the purpose for which the information is routinely used. Specific transaction information on a routine and regular basis is obtained by the transaction reports and the issuance of administrative demands for information tailored to the individual situations involved.

Alternative formats on the annual reports may be permitted, on a pre-approved case by case basis, to make it easier for financial institutions with different types of accounting and computer systems to comply with the reporting requirements. For example, some financial institutions choose to hold blocked wire transfers in “omnibus” or “global” accounts. Others choose to establish a separate account for each blocked transfer. How these accounts are reported annually will vary accordingly.

Financial institutions hold assets in different ways and they all have different computer systems. Accepting reports in different formats is a service we provide to our customers – namely the financial community – to make it easier for the banks to comply with the reporting requirements. For example, some financial institutions choose to hold blocked wire transfers in “omnibus” or “global” accounts. Others choose to set up a separate account for each blocked transfer. How these accounts are reported annually will vary accordingly. With regard to the IG's assertion that this prevents OFAC from identifying specific transactions, this is the role of the Compliance database of blocked and rejected funds transfers – not the annual report of blocked property. In either case, OFAC can, and does, obtain specific transaction information on a regular basis by use of administrative demands for information.

**CIVIL PENALTIES ISSUES**

**IG Findings**

1. OFAC does not use a notification memorandum to FMD to set up an account receivable containing due dates or payors' addresses.
2. The absence of this information causes delays in the debt collection process undertaken by FMD.

The first finding does not recognize accurately all of the written accounting procedures established within the OFAC penalty guidelines reviewed by the IG and in place since the 1992 IG audit. The finding also runs contrary to the request made by FMD to amend procedures to facilitate FMD's establishment and maintenance of account receivable records.

The second finding does not recognize that departmental debt collection is initiated solely upon written request by OFAC to FMD. This written request is a separate and distinct document from the accounts receivable set up and examined by the IG. The IG incorrectly defines FMD's role in the debt collection process and does not address the requirements placed upon OFAC in 1992 within the departmental debt collection process.

With respect to OFAC's provision of SSNs and TINs to FMD, OFAC has done so wherever known to this agency. The Debt Collection Improvement Act of 1996, however, did not mandate this function solely to OFAC. The Act required a person against whom a penalty is assessed by a federal agency to provide that number. Although there is no a written Departmental requirement for OFAC to request SSNs/TINs, OFAC has complied with the Act by requesting that number and by including the provision of the Act in all of its penalty regulations promulgated since 1996.

**3. The Findings Misstate FMD's Role in the Collection Process**

The findings misstate FMD's role in the debt collection process. The findings state that "FMD is responsible for establishing the accounts receivable, recording all collections, following up on unpaid accounts, and referring cases to the Financial Management System for collection, when necessary." As discussed above, the findings inaccurately describe both the existing process and the actual roles of OFAC and FMD.

First, OFAC creates the underlying debt during its enforcement actions under specific civil penalty regulations for OFAC programs. OFAC establishes those accounts receivable and reports that establishment to FMD. FMD then records the debt on the Department's books.

Second, OFAC has revised the system in place for collecting penalty debt. Formerly, all collections were sent to OFAC for recording on OFAC's books. Then, OFAC hand-delivered all checks to FMD for FMD's deposit. After the June 2001, FMD began to receive all collections, not OFAC.

While FMD may record the collections on FMD's books, it does not report OFAC's collections to OFAC. At any given time, OFAC lacks information on the status of its accounts receivable. The extension of this information deficit is that OFAC does not know whether its

penalty enforcement action has ended and possesses insufficient information to report accurately to Congress in our statutory semi-annual reports

**Improvements In OFAC Record-keeping Procedure**

OFAC has undertaken certain improvements in its record-keeping procedures. First, we have halted establishing accounts receivable electronically with FMD. Those accounts receivable cited in the IG's report as missing documentation in OFAC's files occurred during a period where FMD requested that we send the account establishment information via email. OFAC later discovered that, due to the turn-over in FMD personnel, almost all of those emails were lost by FMD. OFAC expended considerable time in providing duplicates to FMD for its own auditors. Those identified by the IG as deficient at OFAC reflect the attempt to meet the GPEA goals of reduced paperwork and FMD's own request. Because of the inefficiencies of that electronic system and FMD's general lack of cooperation with OFAC, we have halted that system entirely.

Second, OFAC has developed the attached expedited initial account set-up form now criticized by the IG. The form conserves numerous personnel hours at OFAC. Since FMD has notified the IG, cited in the report, that the vast majority of OFAC penalties are received timely, the shortened form is beneficial to the Department in all but the default debt cases. Part two of the account form addresses those defaults with the provision of full information at the time OFAC requests FMD's initiation of debt collection.

Attachments

#### ATTACHMENT

##### **Potential Online Reporting of Blocked & Rejected Transactions An Initial Technical Concept Paper**

###### **Goal:**

The goal is to allow banks and financial institutions to report rejected and blocked transactions to OFAC using an electronic interface--specifically one that would allow direct reporting from a web-based front-end--in order to standardize reporting, reduce the overall workload of OFAC staff, and create a quicker turn-around of vital information. Not all financial institutions will be in a position to utilize such electronic reporting.

###### **Specifications:**

- **Web-access** would need to be “least common denominator” in order to allow individuals with primitive software, hardware, or low bandwidth to connect to the site with little trouble. This will require limitation of the use of Java and a bare minimum of graphics in order to decrease load time.
- **Security** will need to be a key feature of this site. The database that the web front-end dumps to will contain information of a privileged nature. As a result, both the web front-end, and the database will have to be protected. In addition a secure connection provided by a program such as SSL would be an added level of protection from packet sniffing.
- **Authentication** is extremely important. It is imperative that OFAC be able to ensure that all received records are, in fact, authentic. This may require the use of certificates or digital signatures that would need to be provided to banks and institutions after a registration process.
- The **Database** that is employed with this system will need to be versatile with the capability of handling data imported from legacy systems. Oracle is proposed to meet this need.

###### **SECURITY**

- **User accounts:** Any bank and/or financial institution that wants to use the system will need to be provided with a single user account and way of authenticating to that account. Each user must be allowed a single authenticated login. This would need to be accomplished using **digital signatures or certificates**.
- **Connections** must be kept secure from those who might use packet sniffers and other tools to gain access to important data. This can be accomplished using SSL technology, however, the implementation of such a system will be more complex than the design of a simple web form that feeds to a back-end database.
- **Registration:** In order to track those institutions that will use electronic reporting procedures, it will be necessary to maintain some kind of “account database” where individual institutions can be tracked and contact information can be maintained.

###### **PAPER VERSUS ELECTRONIC REPORTING ISSUES:**

- **Direct Interface** with the myriad of proprietary systems that handle funds transfers in specific financial institutions does not appear to be a realistic expectation.
- **Records Keeping:** In order to encourage financial institutions to use this system, OFAC must provide them with a “one-stop-shop” for data entry. In essence, this would require the

Appendix 6  
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