

## Tribal Casinos are Being Audited by the IRS for Anti-Money Laundering Compliance

# What Should You Expect in an Audit?

By Greg Baldwin and William Wood

**T**he Bank Secrecy Act (BSA) requires that designated "financial institutions" implement and maintain anti-money laundering (AML) programs. The Internal Revenue Service (IRS) oversees tribal casino BSA compliance through a periodic audit process. Because the BSA has been codified at Title 31 of the United States Code, such audits are often referred to as "Title 31 Audits." The IRS has stepped up its efforts at monitoring tribal casino BSA compliance, and plans to continue and expand these audits on a three- to four-year rotation. This Alert provides an overview of what to expect during the course of an IRS BSA audit.

### OVERVIEW OF THE AUDIT PROCESS

Unlike a tax audit, the aim of a BSA audit is not to collect money; it is to ensure BSA compliance. While a Title 31 Audit may result in disclosure of BSA violations (referred to by the IRS as "deficiencies") that can be subject to financial penalties, imposing penalties is not usual and occurs only in the most egregious situations. Thus, taking an adversarial or defensive attitude in a Title 31 Audit is almost always counter-productive and not in the casino's best interest.

A Title 31 Audit will usually be conducted at the casino and the process will take several months. It is usually accomplished in three stages: 1) review the adequacy of the casino's AML program; 2) a determination of whether the written AML program has been adequately implemented; and 3) an assessment of whether breakdowns in the program places the casino at risk for BSA violations, money laundering or other financial crimes.

*The Beginning of the Audit:* A Title 31 Audit is conducted primarily by a field agent working under the direction and supervision of a case manager. Typically, a Title 31 Audit is initiated by written communication from the IRS in an IRS Letter 1052. The letter will notify the casino of the BSA/AML audit, the period covered and the date of the initial IRS meeting with the casino.

The Letter 1052 will be accompanied by a formal Information Document Request (IDR).

The initial documents reviewed will also include the casino's money laundering "Risk Assessment." This is a key document that formally analyzes the money laundering risk faced by a particular casino.<sup>1</sup> The procedures in the casino's BSA/AML program will be assessed in light of the Risk Assessment. The IDR will also request correspondence with law enforcement or regulatory agencies.

*Initial Appointment Meeting:* The initial interview will typically be held at the casino and will be attended by all IRS personnel who will be involved in the audit. The IRS will advise the casino that the IRS audit team will only be reviewing information relative to BSA compliance. However, the agents will also probably give the standard warning that if, in the course of the examination, information relative to possible violations of other laws or regulations is discovered, a referral will be made.

The IRS will ask a number of questions at this meeting about any related institutions, branches, entities or other businesses operating within the casino, especially including the ownership and relationship of any money services businesses and ATMs. The IRS will also want to know the identity of

key BSA compliance employees, how records are kept (whether manually or by computer), how those records can be accessed, what the gaming day used by the casino for aggregating reportable currency transactions is, and whether the casino cage and gaming floor are both using the same gaming day cut-off time (including the computerized player rating system).

*IRS Interviews of Employees:* The IRS BSA/AML audit will include a substantial number of interviews of management and staff level personnel. Expect the IRS interviewers to focus on the casino's BSA policies and procedures, internal controls and cash controls, BSA knowledge, BSA and AML training, BSA reporting and recordkeeping responsibilities and procedures, management oversight, the history of filing SAR-Cs and CTR-Cs, and identification, review and reporting of suspicious activity.

The IRS will interview the Title 31 Compliance Officer and the BSA/AML compliance staff to assess not only of the overall compliance program, but also the BSA competence of the Compliance Officer and staff. The IRS can be expected to interview senior management. The general purpose of these interviews will be to determine knowledge of BSA requirements, the casino's BSA program, management commitment to the program and the level of support and resources provided by to the Compliance Officer.<sup>2</sup>

### THE SCOPE OF THE AUDIT

The IRS will review and test the casino's files, reports and other documentation to ensure compliance with BSA record-keeping regulations. In particular, the IRS audit team will closely examine and test the casino's internal controls and records for identifying and reporting reportable cash transactions and suspicious activity.

*Suspicious Activity Reporting:* The IRS audit team will review casino records and internal controls to ensure all suspicious activity was identified, reviewed and reported on SAR-Cs, and that the casino did, in fact, use all available records to identify suspicious activity. It will also review the SAR-Cs to ensure that the forms were correctly filled out, and that the supporting documentation underlying the reported suspicious activity is available and complete.

*Cash Transactions Reporting:* The IRS audit team will look for cash transactions that were not reported. It will also examine the casino's filed CRT-Cs in order to determine that all reportable transactions were reported were reported accurately and completely. A random selection of CTR-Cs will usually be reviewed, although IRS audit teams establish their own criteria for selecting which CTR-Cs to review.

*Related Controls and Procedures:* There are several controls and procedures closely related to CTR-C filing and to identifying suspicious activity that the IRS will concentrate on. Checking the required BSA records is an obvious part of this aspect of the audit. Less expected by casinos (because not expressly required by the BSA regulations) is that the IRS will expect reviews of internally reported suspicious activity, as well as the decision-making process on filing a SAR-C, be documented and internally filed. The Internal Revenue Manual, Section 4.26.9.2, reviews these and other topics in greater detail and provides a good idea of what specific areas a casino can expect will be covered

in a Title 31 Audit. The Manual can be accessed online at <http://www.irs.gov>.

**BSA/AML Employee Training:** Another area of focus will be on employee BSA training. The IRS audit team will request the casino's training records to determine: 1) that employee training has been conducted; 2) that it is conducted on a periodic basis; 3) that records of employee attendance are kept so the casino knows who has been trained and when; 4) that new employees are trained before undertaking duties; and 5) that training materials are accurate and the instructors competent.

#### THE POST-AUDIT PROCESS

The IRS audit team will conduct an audit closing meeting. If no BSA deficiencies have been found, the IRS will present a closing letter, known as a Letter 4029. More likely, though, deficiencies will have been identified, and a Letter 1112 will be issued. Receiving a Letter 1112 does not mean that a financial penalty will be imposed on the casino.

Deficiencies that remain uncorrected can be expected to be treated more harshly. The key is not to argue about whether a deficiency reported by the audit team is a deficiency, but rather to take the reported deficiencies seriously and take immediate steps to correct them.<sup>3</sup> The Letter 1112 will contain corrective recommendations as well as findings.

The casino will have 30 days to respond in writing to the Letter 1112. In this response the casino can dispute a finding and/or explain the steps it has already taken and will be taking to address the IRS findings. After it receives the casino's response, the IRS will submit it together with its Letter 1112 findings to FinCEN, which will then decide whether or not any enforcement action is appropriate. After the BSA/AML audit has been completed, the IRS may ask to see an updated written compliance plan that incorporates changes made based on the audit.

<sup>1</sup> An AML Risk Assessment is *not* an "off the shelf" item. One size does *not* fit all. An effective Risk Assessment must be specifically tailored to the particular casino whose risk it purports to assess.

<sup>2</sup> The level of detailed knowledge expected from senior management will be lower than that expected of the Compliance Officer and compliance staff, but at least a general understanding of the BSA/AML laws and regulations will be expected.

<sup>3</sup> Of course, if the reported deficiency is based on erroneous premises, then the casino should respond accordingly. Quite often, however, the IRS audit team will report as a deficiency something that is actually *not* required by the BSA, e.g., the lack of a Risk Assessment. No regulation requires a written Risk Assessment, but the lack of one will invariably be considered as a deficiency. Arguing this point with the IRS is an exercise in futility. **NAC**

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