Audit Report

OIG-07-032

FOREIGN ASSETS CONTROL: Hundreds of OFAC Civil Penalty Cases Expired Before Enforcement Action Could Be Completed

March 2, 2007

Office of
Inspector General
Department of the Treasury

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

Contents

Audit Report 1

Results in Brief 2

Background 4

Finding 7

The Statute of Limitations Expired for Hundreds of Cases Before Enforcement Action Was Completed by OFAC 7

Recommendations 19

Appendices

Appendix 1: Objective, Scope, and Methodology 26
Appendix 2: Civil Penalties: Selected Definitions 27
Appendix 3: Management Response 28
Appendix 4 OIG Comments to Management Response 46
Appendix 4: Major Contributors to This Report 50
Appendix 5: Report Distribution 51

Abbreviations

ALJ	administrative law judge
FinCEN	Financial Crimes Enforcement Network
FTE	full-time equivalent
OFAC	Office of Foreign Assets Control
SOL	statute of limitations

This page intentionally left blank.

March 2, 2007

Mr. Adam Szubin
Director
Office of Foreign Assets Control

In April 2002, we reported that the Office of Foreign Assets Control (OFAC) was limited in its ability to monitor financial institution compliance with foreign sanction requirements due to legislative impairments.[1] During a follow-up audit to that report, we identified concerns with the OFAC Civil Penalties Division's case closures and, as a result, initiated a separate review of penalty case handling. Specifically, we were told by OFAC personnel that OFAC did not have sufficient resources to handle increasing penalty case workload. Accordingly, OFAC often closed cases without determining whether penalties should have been assessed or collected.

The objective of our separate review is to determine whether the Civil Penalties Division had effective controls to ensure that penalty cases were finalized before expiration of the statute of limitations (SOL). Accordingly, we reviewed civil penalty policies and procedures, interviewed Civil Penalties Division officials, and reviewed reports of open and closed cases. We also identified cases that were closed before penalties had been determined to be valid or collected and identified the reasons for such closures. We conducted our audit work from March 2005 to April 2006, with the field work being performed at OFAC's headquarters in Washington, D.C. A more detailed description of our objective, scope and methodology is included in appendix 1.

[1] *FOREIGN ASSETS CONTROL: OFAC's Ability To Monitor Financial Institution Compliance Is Limited Due To Legislative Impairments* (OIG-02-082; April 26, 2002).

Results in Brief

During fiscal years 2002 through 2005, the Civil Penalties Division took enforcement action against approximately 3,800 violators and collected $10.32 million in civil penalties.[2] Nonetheless, due to a 5-year SOL on imposing penalties, the Civil Penalties Division failed to complete enforcement actions during this period for 295 cases. The potential penalty assessments for these 295 cases totaled $3.87 million.[3] In 3 other cases, the expiration or impending expiration of the SOL adversely affected the amount of penalties assessed and collected. Out of $3.79 million in potential penalties for these cases, which involved multiple violations, $2.70 million was not pursued because the SOL expired for some of the violations. After applying mitigating factors, Civil Penalties settled for about $0.29 million of the $1.09 million of assessed penalties on these three cases. Two cases related to frequent illegal commercial exportations to Cuba. The third involved a travel company sponsoring prohibited trips.

Several factors contributed to the failure to take timely penalty action. Civil Penalties Division managers were hampered in the monitoring and handling of penalty cases by the lack of sufficient, accurate, and reliable information about case status and disposition. In addition, OFAC management cited the following other factors: (1) OFAC resources were not adequate to address the number of sanction programs and violations, which increased from 21 to 29 programs (as of fiscal year 2004) and by a reported 900 cases over a 4-year period; (2) administrative law judges (ALJ) were not always available when needed to conduct required hearings; and (3) the time other divisions or agencies took to review the cases reduced the time available for the Civil Penalties Division to complete its work. We believe these additional factors could be alleviated if managers had sufficient, accurate, and

[2] When violations of OFAC-related laws or regulations occur, OFAC may take one or more of the following actions—issue a warning or cautionary letter, revoke or suspend a license, make a criminal referral, or assess civil penalties.

[3] The $3.87 million understates the potential penalties. OFAC did not have electronic data available on the potential penalties for 37 administratively closed penalty cases.

reliable data from an improved case database to use in making more informed case management decisions.

We are recommending that the OFAC Director take the necessary steps to assure that enforcement actions are completed prior to the SOL expiring. These steps include: (1) improving the civil penalty case database, (2) developing and implementing new policies and procedures and associated monitoring systems and reports to ensure that penalty cases are adjudicated timely and within the SOL period, (3) implementing an effective case tracking mechanism to ensure penalty cases are being addressed by the appropriate OFAC offices in a timely manner, and (4) ensuring the resources needed to process penalty cases are available in a timely manner.

In its response to our draft report, OFAC agreed with our recommendations. The stated actions that had been taken or planned are generally responsive to the intent of our recommendations. OFAC, however, indicated our report had factual errors and was misleading. Specifically, we incorrectly assumed in the report that the purpose and operation of OFAC's civil penalties process is for OFAC to impose the maximum penalty allowed by statute, when OFAC's goal is to maximize enforcement and compliance. OFAC also said we incorrectly calculated the civil penalty amounts that would or could have been imposed in certain instances. OFAC further maintained that it applied a reasoned decision-making process regarding which cases it pursued, weighing the relevance of its cases to improving OFAC compliance against OFAC staffing constraints.

We have considered OFAC's position on these points and have made changes to our report where appropriate. However, we disagree with OFAC on several points. We do not state, nor do we mean for a reader to infer from the report, that maximizing revenue through penalty assessments should be a goal of OFAC's penalty program, and we agree with OFAC that the program should be conducted in a manner to maximize enforcement and compliance. The penalty amounts we cite in the report are based on OFAC's own documents and discussions with OFAC Civil Penalties Division staff. We recognize, as OFAC also states in its response, that OFAC has the authority to mitigate or waive penalties for violations in certain circumstances, and we do not question the

appropriateness of such actions when warranted. Also, although OFAC said it applied a reasoned decision-making approach to its cases, the evidence we obtained and cited in the report did not support this assertion.

Background

OFAC's Mission and Sanctions Programs

The mission of OFAC, an office within the Department of the Treasury (Treasury), is to administer and enforce economic and trade sanctions, based on U.S. foreign policy and national security goals, against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. All U.S. persons must comply with OFAC regulations.

OFAC regulations involve blocking accounts and other assets of the specified countries, entities, and individuals and rejecting financial transactions with specified countries, entities, and individuals. OFAC currently administers 30 economic sanctions programs against foreign governments (such as Iraq, Iran, Sudan, Libya, Liberia, Syria, Zimbabwe, Burma, and Cuba), entities, and individuals.[4] Through these sanctions programs, OFAC plays a key role in efforts to stop the flow of funds to terrorist organizations. In addition, OFAC implements sanctions programs against narcotics kingpins of the so-called Cali Cartel and administers the Foreign Narcotics Kingpin Sanctions Regulations. The restrictions provided for in these programs affect both foreign and U.S. persons.

[4] On June 29, 2005, a sanction program on blocking weapons of mass destruction proliferators and their supporters was added to bring the total to 30. This program was established by Executive Order 13382.

OFAC Divisions With Principal Responsibility for Penalty Cases

We reviewed the penalty case process that was followed when OFAC consisted of 10 functional divisions.[5] During our review, the 10 OFAC divisions and their responsibilities were realigned and placed under two operational offices and an administrative office. The three offices are the Office of Program Policy and Implementation, the Office of Investigations and Enforcement, and the Office of Resource Management. The Office of Investigations and Enforcement's Civil Penalties and Enforcement divisions have the primary responsibilities for imposing appropriate administrative measures.

The Civil Penalties Division acts as OFAC's civil enforcement arm by imposing or settling civil penalties. Based upon the significance of an apparent violation, it initiates penalty enforcement actions after a decision that a warning letter cannot be justified. The Civil Penalties Division determines the appropriate final OFAC penalty action, completing the proceedings with either a settlement or penalty imposition. In issuing prepenalty notices regarding Cuban-related violations, OFAC informs the alleged violator that a hearing before an ALJ can be requested.[6]

The Enforcement Division conducts civil investigations of alleged OFAC violations that can result in any of the following actions: (1) issue a warning letter, if the matter is determined not to warrant a civil monetary penalty; (2) issue a prepenalty notice initiating the civil monetary penalty process; or (3) refer the matter for criminal investigation by another law enforcement agency.

The Civil Penalty Case Process

The Civil Penalties Division receives numerous referrals from OFAC's Enforcement and Compliance divisions. In addition, the Civil Penalties Division receives civil and criminal referrals from the

[5] At the time of our audit, OFAC's had 10 functional divisions: Licensing, Foreign Terrorist, International Programs, Enforcement, Civil Penalties, Compliance Programs, Policy Planning, Blocked Assets, Information Technology and Records.

[6] The ALJ process came about by statute, the Cuban Democracy Act of 1992, which amended the Trading with the Enemy Act. The process involves only Cuban cases.

Department of Justice and U.S. Customs and Border Protection, a bureau of the Department of Homeland Security.

Civil Penalties Division personnel evaluate the evidence in each referral and determine whether a violation of OFAC regulations has occurred. If no violation has occurred, the case is administratively closed. In the case of voluntary disclosures, the Civil Penalties Division may negotiate and reach a settlement without issuing a formal prepenalty notice.

If no settlement is reached, the Civil Penalties Division sends a prepenalty notice to the alleged violator. Within 60 days of the mailing, the alleged violator has the right to respond in writing. In the response, the alleged violator can present evidence as to why there is no basis for a penalty. In prepenalty notices that involve Cuban-related violations, the individual or organization, in a response, can request a formal hearing before an ALJ. Under these circumstances, no further action is taken until the hearing is conducted.

Civil Penalties Division staff review responses received to prepenalty notices. Depending on the responses, the Civil Penalties Division can mitigate the penalty. OFAC guidelines allow the Civil Penalties Division to mitigate a civil monetary penalty by 25 to 75 percent, but all proposed mitigations are subject to internal review before being submitted to the OFAC Director. The Civil Penalties Division then prepares, for the OFAC Director's signature, either a letter stating that there was no violation or a proposed penalty notice. Once a penalty notice is issued, the violator has 30 days to make payment.

The key deadline for all Civil Penalties Division action is 5 years from the date of the alleged infraction, based on an interpretation of the pertinent SOL. Once a case is 5 years old, OFAC generally cannot impose or successfully conclude a sanction action, unless the violator is willing to waive (toll) the SOL for a certain time to negotiate a settlement. The Civil Penalties Division publishes completed enforcement actions on OFAC's Web site each month.

Finding

The Statute of Limitations Expired for Hundreds of Cases Before Enforcement Action Was Completed by OFAC

During fiscal years 2002 through 2005, the Civil Penalties Division reported taking enforcement actions against 3,803 violators, with associated collections totaling $10.32 million.[7] Nonetheless, during this period, the Civil Penalties Division failed to complete actions on 295 sanction cases, with potential OFAC penalties totaling $3.87 million, within the 5-year SOL on imposing penalties. In three additional cases, the potential monetary penalties amounted to $3.79 million, but $2.70 million was not pursued because the SOL expired. In its response to the draft report, OFAC indicated that the proposed penalties for these three cases should have been $1.09 million. Mitigating factors reduced the settlements to $290,361.

Several factors contributed to the failure to take timely penalty action. Most important, Civil Penalties Division managers were hampered in their monitoring and handling of penalty cases by the lack of sufficient, accurate, and reliable information about case status and disposition. We also found the following:

- The former OFAC Director testified that resources were not adequate to address the number of sanction programs and violations, which increased from 21 to 29 programs and by a reported 900 cases over a 4-year period.
- ALJs were not always available when needed to conduct required hearings.
- The time other divisions or agencies took to review the cases reduced the time available for the Civil Penalties Division to complete its work.

To improve the civil penalty program, Treasury advised Congress that a performance baseline would be established for OFAC during fiscal year 2006. The measure, as outlined in *Department of the*

[7] When a violation occurs, OFAC may take one or more of the following actions—issue a warning or cautionary letter, revoke or suspend a license, make a criminal referral, or assess a civil penalty.

Treasury – Congressional Justification FY 2007, is to be the number of civil penalty cases that are resolved within the SOL period. We believe establishing such a baseline is a good first step to determining resource needs for the OFAC penalty function. An effective penalty program, both civil and criminal, serves as an important deterrent to those who would conduct activities that undermine or prevent these sanctions from achieving their foreign policy and national security goals. When substantial numbers of penalty cases must be administratively closed because the SOL was exceeded, the deterrent value of OFAC's penalty authority is significantly weakened, and the wrong message is sent to those conducting illegal transactions, trade, or travel.

Cases Were Closed With No or Minimal Penalty Collections

Because of the expiration of the 5-year SOL on imposing penalties for OFAC violations, the Civil Penalties Division did not collect penalties from at least $6.57 million in assessments during the 4-year period covering fiscal years 2002 through 2005. The Civil Penalties Division did not complete actions on 295 sanction cases, which were associated with potential OFAC penalties totaling $3.87 million. The 295 included: (1) 163 cases closed administratively, with potential OFAC penalties totaling $2.26 million; (2) 73 cases that were cancelled because OFAC could not provide ALJs to conduct hearings involving Cuban-related violations, with potential penalties totaling $0.67 million; and (3) 59 cases in the process of being closed, with potential penalties totaling $0.94 million.

In three additional cases, which had potential monetary penalties of $3.79 million, $2.70 million was not pursued because the SOL expired. OFAC indicated that $1.09 million was proposed as penalties for these three cases. The eventual settlements totaled $290,361, after Civil Penalties took into consideration mitigating factors in the penalty phase dialogue. Normally, civil penalties are mitigated by 25 to 75 percent.

Table 1: Summary of Potential Penalties That Were not Assessed (dollars in millions)

Case actions	Number of cases	Potential penalties not assessed
Administratively closed	163	$2.26
No ALJs available to conduct hearings	73	.67
In process of being closed	59	.94
Subtotals	295	$3.87
Amounts not pursued due to SOL expiration	3	2.70
Totals	298	$6.57

Source: Civil Penalties Division case files.

The categories in table 1 are explained more fully in the sections that follow.

Cases Administratively Closed

The Civil Penalties Division provided us with copies of reports that identified and summarized penalty cases closed during the period covering fiscal years 2002 through 2005. By reviewing the history files for each case, we identified cases closed because the SOL had expired. We also noted the amount of the potential penalty assessment if the information was available. From these data, we identified 163 penalty cases, involving at least $2.26 million in potential penalty assessments that had been closed because of SOL expirations.[8]

As table 2 illustrates, the number (and associated potential penalty assessments) of cases administratively closed because of SOL expirations rose steadily, from 23 cases in 2002 to 66 cases in 2005.

[8] For 37 of the 163 penalty cases, the penalty assessment amounts were not recorded in the automated case management system. Accordingly, the $2.26 million estimate in potential penalties not assessed is understated.

Table 2: Cases Closed During Fiscal Years 2002 Through 2005

Case report fiscal year	Number of cases	Potential penalty assessment
2002	23	$24,460
2003	28	273,510
2004	46	1,057,888
2005	66	904,073
Totals	163	$2,259,931

Source: Civil Penalty Division's closed case reports.

Cases Being Prepared for Closure Because of OFAC's Inability to Conduct Required Hearings

At the conclusion of our field work, the Civil Penalties Division was preparing to close 73 Cuban-related penalty cases, involving $665,427 in potential penalty assessments, because OFAC was unable to provide ALJs to conduct required hearings requested by the alleged violators. OFAC's inability to conduct hearings is highlighted on several legal advocacy Web sites to alert those who may be subject to Cuban-related sanctions. As a result, OFAC's ability to ensure compliance with these sanctions has been negatively affected.

Other Cases Being Prepared for Closure

During our review, Civil Penalties Division personnel brought to our attention additional penalty cases that were in the process of being closed because their SOLs had expired. We reviewed the documentation and confirmed that 59 cases involving potential penalty assessments totaling $939,479 were being readied for closure due to SOL expiration.

Proposed Penalties Affected by SOL

OFAC personnel also reported instances in which the expiration or impending expiration of the SOL had adversely affected the amount of penalties assessed and collected. Specifically, we identified three penalty cases in which violators either refused to extend the SOL on older violations or were delaying the resolution of existing

violations because of impending SOL expiration dates. These delaying tactics were part of the cause for the SOL expiring and potential penalties not being pursued for many individual transactions.

The former Acting Chief of Civil Penalties indicated that, because many cases had already expired, OFAC was eager to settle the three cases and accepted smaller amounts. These three penalty cases had potential monetary penalty assessments amounting to $3.79 million, but $2.70 million was not pursued due to the SOL expiring. For example, for Violator A, the January 2001 prepenalty notice indicated a proposed penalty of $1,279,521. OFAC, in its response to our draft report, indicated that the correct proposed amount should have been $1,009,651, meaning that $269,870 was not pursued because the SOL expired. However, the prepenalty notice also indicated that 19 additional transactions were not assessed as penalties since the SOL could be raised as a defense. In total, OFAC did not pursue penalties of $753,644 due to the SOL expiring.

OFAC proposed penalties of $1.09 million to the three violators. Ultimately, mitigating factors reduced settlements to $290,361. Many mitigating factors caused the actual penalties collected to be reduced to $290,361. For Violator B, these factors included eight different conditions, such as voluntary disclosure, first offense, and a conflict of law with another country. OFAC stated that any of these conditions would warrant significant mitigation. Similarly, Violator C had factors to warrant mitigation such as jail time served, remedial actions taken, and the fact that the violator no longer conducts business.

The cases in question are listed below.

Table 3: Examples of Cases Where Penalties Were Affected by SOL Expiration

Violator	Potential penalty	Amount potential penalty was reduced when SOL expired for selected transactions	Proposed penalty	Final mitigated penalty
A	$1,763,295	$753,644	$1,009,651	$250,000
B	1,739,969	1,689,181	50,788	32,500
C	285,895	254,451	31,444	7,861
Totals	$3,789,159	$2,697,276	$1,091,883	$290,361

Source: OIG analysis.

Data Indicated Lack of Progress in Case Status Over Several Years

The Civil Penalties Division maintained reports that listed, for each sanction program, the number of cases assigned to status categories such as alternative dispute resolution, prepenalty, penalty, hold, and pending.[9] Over a 3-year period, the annual totals reported for the majority of categories remained the same. Table 4 on the next page contains a sample of these data.

[9] See appendix 2 for definitions of these terms.

Table 4: Examples of Cases Where Status Remained Unchanged During Fiscal Years 2002-2004 (note a)

Sanction program/status	2002	2003	2004
Cuba			
Alternative dispute resolution	497	497	497
ALJ	72	72	72
Hold	45	45	45
Pending	108	108	108
Prepenalty	140	140	140
Penalty	213	213	213
Iran			
Hold	22	22	22
Prepenalty	186	186	186
Penalty	13	13	13
Pending	10	10	10
Weapons of mass destruction			
Prepenalty	13	13	13
Penalty	1	1	1
Pending	2	2	2

Source: Civil Penalties Division's annual status reports.
Note a: We did not review penalty files for the cases in this schedule and have no additional information about the specifics of each case.

The lack of movement within the program and status categories shown in Table 4 should have indicated to OFAC management that numerous cases were not being promptly addressed. However, when we asked why the status of these cases had not alerted the Civil Penalties Division to a problem, we were informed by the Acting Chief of Civil Penalties that the reports containing these data were never requested, reviewed, or monitored by OFAC management or Civil Penalties Division personnel.

Our analysis of open penalty cases as of December 20, 2005, identified an additional 232 penalty cases in which the alleged violations took place prior to 2001. These penalty cases appear to have also exceeded their SOL expiration dates and are in addition to the 132 penalty cases previously identified and earmarked for closure by OFAC personnel.[10]

[10] The 132 penalty cases are a total of the 73 cases with no ALJs available to conduct hearings and the 59 cases with expired SOL.

Penalty Database Lacks Sufficient, Accurate, and Reliable Information

The information in the Civil Penalties Division database is not sufficient, accurate, or reliable, and therefore does not allow managers to effectively monitor the disposition and aging of cases. A database containing higher-quality information would allow OFAC management to periodically review and evaluate case status reports. As an example of the database not containing adequate information to monitor the status of cases, a date field specific to SOL was not added formally to the database until August 2005. Additionally, OFAC employees responsible for keeping the data up to date and accurate did not consistently add penalty data to the system, as required. These problems were compounded because OFAC lacked effective policies and procedures to ensure that all penalty case data were entered in a uniform and timely manner.

Penalty Database Is Hampered by Missing Data

According to Civil Penalties Division personnel, staff often failed to enter SOL dates into the database. Prior to the recent change to the database formatting to accept SOL dates in a distinct field, staff would sometimes enter SOL data into the comments field. More often, Civil Penalties Division personnel manually recorded SOL information in the hard-copy penalty records. As a result, Civil Penalties Division managers and personnel were unable to use the database to retrieve and monitor SOL data efficiently and promptly. The lack of SOL information in the Civil Penalties Division database made it difficult for managers to effectively monitor cases and contributed to the number of cases that had to be closed because of SOL expiration.

Minor modifications to the database fields, such as adding the date field specific to SOL earlier, could have resulted in more efficient monitoring efforts and avoided many of the SOL problems. However, during the period under review, there was a general lack of coordination and communication between the Civil Penalties Division and the Information Technology Division regarding the data fields required and the use of the database.

Civil Penalties Personnel Did Not Enter All Required Data

During our review, OFAC personnel modified the data fields in the penalty case modules to allow the SOL date to be entered into each penalty record. Civil Penalties Division personnel are trying to ensure that this information is entered into each current record. However, our review of open penalty case files as of December 20, 2005, revealed that 670 out of 2,111 penalty cases (31 percent) were still missing the date of the alleged violation. Therefore, once the process of entering the date of the alleged violation for each case is completed, additional penalty cases may need to be closed due to SOL expirations.

Former OFAC Director Cited Staffing and Workload Issues for Lack of Progress on Cases

According to the former OFAC Director, cases were often closed because resources were insufficient to ensure timely disposition of penalty cases. He indicated that excessive case workloads resulted from an increase in the number of sanction programs without a corresponding increase in personnel. In September 2004, the former OFAC Director testified in a court hearing that the number of OFAC sanction programs increased from 21 to 29 from fiscal year 2001 through fiscal year 2004 but that staffing had not grown commensurately. In fiscal year 2002, he said the Civil Penalties Division had from 3 to 4 personnel handling cases, and each handled a workload of 736 cases. During fiscal year 2004, staffing doubled to 6 to 8 personnel, and each had an average workload of 477 cases.[11] When Civil Penalties Division personnel were unable to address penalty cases in a timely manner, case closures due to SOL expirations increased.

No data currently exists to quantify the average amount of time to process a penalty case. Because the Civil Penalties Division process is subject to many reviews and reviewers within OFAC, estimating a time frame to complete an average case would be difficult. Further, the former OFAC Director cited many mitigating factors, such as Freedom of Information Act requests and increased focus

[11] The caseload and cases per staff data come from the September 30, 2004, testimony of the former OFAC Director before the U.S. District Court for the District of Columbia on Civil No. 03-1356 (JDB).

on Cuban enforcement sanctions, which lengthened the time to process cases.

Despite the information presented in the court testimony, we could not readily establish whether OFAC had assigned adequate resources, in the past or currently, to address the Civil Penalties Division workload. OFAC's database was not sufficiently reliable to allow us to determine the number of open cases at any point in time. For example, 670 penalty cases listed in a December 2005 report lacked the date of the alleged violation, which is required to determine whether a case's SOL has expired. To find those dates would have meant reviewing the paper files for each case. Such a manual process appears to have been a contributing factor in the Civil Penalties Division not being able to effectively track the status of cases. Without complete case data, the Civil Penalties Division lacked an accurate inventory of the number of open cases at any point in time.

The Acting Director of the Civil Penalties Division has instructed his staff to perform a thorough review of all OFAC penalty cases to determine how many valid cases are in the database. Once that review is completed, OFAC should be able to more accurately determine the resources needed to address its penalty case workload.

ALJs Were Not Always Available to Conduct Hearings

In 2001, Treasury placed a renewed emphasis on OFAC's enforcement capabilities involving Cuba. As a result, the number of enforcement letters sent by OFAC for travel-related violations increased, from 188 prepenalty notices in 2000 to 697 in 2001. The level dropped to 447 in 2002 and to 350 in 2003. According to a Congressional Research Service report,[12] this drop occurred because of the public's attention to increased enforcement.

OFAC is required to offer the option of a hearing conducted by an ALJ for individuals and entities alleged to have violated Cuban-related travel sanctions. These violations typically involve penalty assessments that range from $3,000 to $7,500 before mitigation. Once a hearing is requested, no further action is taken by OFAC until the hearing is conducted.

[12] CRS Report: Cuba: US Restrictions on Travel and Remittances, Updated May 10, 2005.

During our review of the OFAC penalty database, we noted a large number of older cases involving Cuban-related violations that were awaiting hearings. Civil Penalties Division personnel told us that a number of such cases were in the process of being closed because OFAC was unable to provide the ALJs required to conduct the hearings. We identified 73 cases, involving a total of $665,427 in potential penalty assessments that were being prepared for closure. We also identified an additional 43 cases that had been awaiting hearings but are subject to closure because their SOLs had expired.

The inability of OFAC to conduct hearings was publicized by several organizations that oppose any Cuba-related travel restrictions. On their Web sites, these organizations advised alleged violators to obstruct efforts by OFAC to prosecute such violations by requesting a hearing when responding to the prepenalty notice. In addition to OFAC's inability to provide ALJs, the Web sites noted that OFAC had historically filed such hearing requests without conducting any further follow-up penalty action.

Internal Tracking of OFAC Penalty Cases Needs Improvement

In his September 2004 testimony, the former OFAC Director stated that it often took a long time to process a large number of civil penalty actions. He noted that delays occurred for a number of reasons, including lack of resources, shifting priorities, and external factors such as extensive Freedom of Information Act requests and a congressionally mandated review of OFAC operations.

The Civil Penalties Division receives cases as referrals from other groups, such as OFAC's Compliance and Enforcement divisions, and from U.S. Customs and Border Protection. These entities can expend considerable amounts of time reviewing the cases before sending them to the Civil Penalties Division, and the SOL continues during these reviews. The longer these entities take to refer cases to the Civil Penalties Division, the less time the Civil Penalties Division has to adjudicate cases before their SOLs expire. OFAC refers to the time it takes other divisions or entities to work on a case before referring it to the Civil Penalties Division as "upstream aging."

Our review of the fiscal year 2005 Civil Penalties Division case report dated December 2, 2005, identified 272 cases that had both the date of the alleged violation and the date on which the case was entered into the database. From the date of the alleged violation, it took an average of 21 months for these cases to be entered into the database. Six cases were not entered into the system until after the SOL had expired. Another 23 cases were entered after 4 years of the 5-year SOL had lapsed.

When the Civil Penalties Division decides that a penalty case is warranted, the proposed case goes through an internal OFAC review process, during which the case can be transferred among the various OFAC divisions. During our examination of the 66 penalty cases closed in fiscal year 2005 due to SOL expiration, we found that it took an average of nearly 4 years for OFAC personnel to conduct these reviews before closure action was eventually undertaken.

For example, penalty cases can be reviewed by OFAC's Office of Chief Counsel at any time during the adjudication process. Cases often remain with the General Counsel for extended periods of time because of resource limitations and changing priorities. An OFAC report, titled *General Counsel Report*, identifies the penalty cases being reviewed by the Office of General Counsel and the number of days that the office has had possession of the cases. The November 30, 2005, report listed 53 penalty cases that had been under review from 9 days to nearly 17 months.

Further, we found that data entry into the Civil Penalties Division database was sporadic and inconsistent. At times, the case history portion of the database contained SOL dates. However, the notations recorded in the case history files were at times difficult to understand because of cryptic notes entered by and the use of nonstandard acronyms and abbreviations devised by the various penalty personnel assigned to the cases. In addition, some personnel lacked a copy of applicable policies and procedures to refer to when processing penalty cases. The copy that we were provided was more than 10 years old.

OFAC's lack of an effective system and accessible, up-to-date policies and procedures for tracking civil penalty cases, including

the status of reviews and referrals within OFAC, hinders its ability to take timely action on cases and to avoid case closures due to SOL expiration.

OFAC Efforts to Address Deficiencies

Treasury recently informed Congress that a performance baseline for Civil Penalties would be established during fiscal year 2006. The measure, as outlined in the *Department of Treasury – Congressional Justification FY 2007*, is to be the number of civil penalty cases resolved within the SOL period. To meet its goal, the Civil Penalties Division has undertaken efforts to address the deficiencies that are hampering its operations.

The Civil Penalties Division's Acting Director and his staff have been developing an inventory of all cases so that they have an accurate baseline of cases that require adjudication. The staff is also ensuring that SOL expiration dates are being entered into the Civil Penalties Division database for all penalty cases. The Civil Penalties Division and the Information Technology Division are coordinating efforts to determine the types of reports and data needed to ensure that penalty cases are processed and monitored in a timely manner.

We believe that OFAC's current efforts and the priority assigned by Treasury to resolve the SOL issue will help address the problems identified in our report. We are making several recommendations to focus and assist these efforts.

Recommendations

We recommend that the OFAC Director assure that enforcement actions are completed prior to the SOL expiring by doing the following:

1. Ensure that the information, including accurate SOL data, in the civil penalty database is brought up to date and maintained in a complete and accurate manner going forward.

Management Response

OFAC agrees with the recommendation to maintain SOL data in the case management database in a complete and accurate manner going forward. As of August 3, 2005, an SOL field has been added and since that date, the SOL field has been accurately filled in for all cases, and management is ensuring that this data and other data are maintained in a complete and accurate manner going forward. This enhancement was a further refinement of the enhancements made in 2004 when a data field was added to capture the violation date. Because the SOL is the same for all cases (5 years from the date of the violation), it has been possible since 2004 to run a report on the SOL dates using the violation date fields that were populated. Thus, OFAC can adequately determine SOL data from the database beginning with cases opened in 2004. All cases since 2003 have been assigned to Civil Penalties officers. The Civil Penalties officers continually review and prioritize their caseloads based on a number of factors including the SOL.

OIG Comment

We believe OFAC's action to add the SOL data field, fill in the data for all cases, and ensure that this and other data are maintained in a complete and accurate manner satisfies the intent of our recommendation. Although OFAC indicated in its response that the violation data field can provide the same information and has been available since 2004, we found during our review of a December 2005 report of 2,111 open cases that 670 (31 percent) were missing the date of the alleged violation (see p. 16).

2. Develop and implement policies and procedures and associated monitoring systems, management reports, and other controls to ensure that penalty cases are adjudicated in a timely manner and within the SOL period.

Management Response

OFAC management agrees with this recommendation to develop and implement controls to ensure penalty cases are adjudicated

in a timely manner. Some of these controls already have been implemented; others are expected to be implemented within the next few months. Previously, Civil Penalties officers brought cases nearing the SOL to the attention of their manager; management is now using the case management database to pro-actively initiate a review of cases with the relevant Civil Penalties officers. The Assistant Director for Civil Penalties is in the process of instituting a weekly review of the case management database to identify high priority cases, including those nearing the SOL. This weekly review process is expected to be in place by March 1, 2007. The Assistant Director has already instituted a weekly meeting with all Civil Penalties officers to review each officer's caseload and to determine the proper case disposition of individual cases, taking into account the SOL expiration date, the potential for encouraging compliance, the size of the caseload, and the available staffing. Although these new controls will ensure that OFAC stays aware of all penalty file SOL data, on occasion cases may still be closed due in part to nearing SOL dates. If OFAC faces a choice between devoting limited resources to moving forward either (1) a case nearing SOL with no compliance or deterrence value or (2) a more recent case that, if acted on quickly, would have a much greater compliance or deterrence value, OFAC may choose to close the older case in order to focus on the more recent one, which will more effectively implement the President's sanctions policy.

OIG Comment

Recognizing that current staffing constraints may preclude the timely adjudication of all cases before SOL expiration and that case prioritization is necessary, we believe OFAC actions and planned actions, if fully implemented, generally meet the intent of our recommendation. OFAC should, however, ensure the reasoning behind administratively closing cases that are nearing SOL with no compliance or deterrence value is documented in the applicable case files, and concurred with by management.

3. Implement an effective tracking system to help ensure that potential penalty cases being reviewed by the various OFAC offices are addressed in a timely manner.

Management Response

OFAC agrees with this recommendation and already has implemented it. In 2005, the former OFAC Director ordered a review of the development of OFAC violation cases. In mid-2005, the former Director reorganized OFAC. According to OFAC, the reorganization clarified and in some cases shifted responsibility to perform certain enforcement and civil penalties functions. Functions previously shared between divisions are now assigned to a single division. The reorganization was aimed at facilitating the development of sanctions violation cases, clarifying who reviewed the cases and when, and clarifying the process for determining which OFAC enforcement action should be applied.

Since August 3, 2005, an SOL field for penalty cases has been added and accurately filled out in the case management database. As discussed in its response to recommendation 2, the Assistant Director for Civil Penalties (1) has instituted weekly meetings to review Civil Penalties officers' caseload and prioritize them taking into consideration the relevant SOL dates and (2) is in the process of implementing weekly reviews of the case management database. The case management database allows complete tracking of every penalty file from its entry into the system and assignment to a Civil Penalties officer, through the drafting of prepenalty and penalty notices, through review by the Office of Chief Counsel, and to final disposition. The database allows Civil Penalties officers to review all information about a particular file at any time, including the file's current location and the number of days it has been at that location. The Civil Penalties officers now use the case management database on a regular basis to track the files that make up their respective caseloads. Through this regular use of the database and the weekly meeting of the Assistant Director for Civil Penalties, OFAC is ensuring that Civil Penalties cases are handled in a timely manner.

OIG Comment

We believe OFAC's actions, if implemented as described, meet the intent of our recommendations.

4. Once the active penalty case workload is determined, ensure the resources (including ALJs) needed to process penalty cases are available in a timely manner.

Management Response

OFAC agrees with the recommendation. OFAC has improved its case management process, as described in the response to recommendation 3. According to OFAC, even after the reforms are undertaken, the OFAC Civil Penalties caseload is substantial; it currently averages in excess of 166 cases per Civil Penalties officer. The Civil Penalties Division conducted a manual desk audit of all pending civil penalties cases, and reconciled them to the database.

OFAC disagrees that civil penalties cases were inadvertently dropped due to OFAC's inability to track its cases and their SOL expiration dates. During 2002 to 2005, staff and management actively reviewed and discussed cases nearing their SOL expiration dates and decided which cases, given the staffing limitation, to pursue and which cases to drop to best ensure OFAC sanctions compliance. The Civil Penalties Division's problem, in part, has been that it has a large caseload and previously received many of these cases close to their SOL expiration date.

Most cases are settled through a negotiating process that is time consuming and involves mitigating the potential penalty considering the circumstances of the violation and the possible commitment on the part of the violator to employ a more robust compliance effort. Maximizing the civil penalties collection is not the objective of the civil penalties process, and in some cases, resolving a case without imposing a penalty may be the best solution.

Having an accurate case count and an improved case development and tracking process may give Civil Penalties staff more lead time to consider the disposition of its cases before the SOL expiration date nears. Under current staffing levels, however, cases with minimal impact on improving sanctions compliance may not be pursued. Increasing staffing levels would permit the Civil Penalties Division to more fully address these latter cases. The needs of the Civil Penalties Division, however, will continue to be addressed in light of the needs of OFAC's other divisions and their responsibilities, such as identifying and blocking terrorist assets.

With respect to ALJ resources, OFAC noted that the use of ALJs applies to sanctions programs premised on the Trading With the Enemy Act (TWEA) and that most current TWEA cases are related to the Cuba sanctions program. Once a U.S. person requests an ALJ hearing, the SOL is suspended for the case and the timing of the hearing depends upon the availability of an ALJ. This means the case does not have to be dropped, but its ultimate adjudication may be delayed. Even after the case is assigned to an ALJ, the Office of Chief Counsel still may engage in settlement discussions. Nevertheless, OFAC seeks to expedite the ALJ process. OFAC currently has contracts with a number of ALJs, which have facilitated a more timely hearing of these cases. The backlog has been cleared out and OFAC anticipates that new requests for administrative hearings will be handled in a more expeditious manner. In November 2006, the Office of Chief Counsel hired a paralegal who will assist in handling future ALJ hearing requests.

OIG Comment

We believe OFAC's actions should improve its case management process going forward. We did not see evidence during our review to support OFAC's assertion that it used a reasoned decision making process to close cases without imposing sanctions or taking other enforcement action. As indicated in the response, staffing of the Civil Penalties function relative to caseload remains a serious concern, especially should it lead to OFAC administratively closing cases for which it would otherwise take enforcement action. OFAC management

should continue to monitor this area and reassign or request additional resources if necessary.

* * * * * *

We would like to extend our appreciation to OFAC for its cooperation and courtesies extended to our audit staff during the audit. If you have any questions, please contact me at (617) 223-8640, or Stephen Syriala, Audit Manager, at (617) 223-8643.

/s/
Donald P. Benson
Director

In April 2002, we reported that the Office of Foreign Assets Control (OFAC) was limited in its ability to monitor financial institution compliance with foreign sanction requirements due to legislative impairments.[13] During a follow-up audit to that report, we identified concerns with the OFAC Civil Penalties Division's case closures and, as a result, initiated a separate review of penalty case handling. Specifically, we were told by OFAC personnel that OFAC did not have sufficient resources to handle increasing penalty case workload. Accordingly, OFAC often closed cases without determining whether penalties should have been assessed or collected. The objective of this audit was to determine whether OFAC Civil Penalties Division had effective controls to ensure that penalty cases were finalized before the statute of limitation (SOL) expired.

We reviewed OFAC civil penalty policies and procedures. We interviewed appropriate OFAC Civil Penalties Division officials, including the Director of the Civil Penalties Division, as well as Information Technology Division personnel. We reviewed pertinent management reports covering fiscal years 2002 through 2005, including the General Counsel Report, Civil Penalties Annual Status Report, Civil Penalties Collected Report, Civil Penalties Closed Report, Case Report, Civil Penalties by Due Date Report, and Year of Violation Report.

We evaluated the reliability and validity of the OFAC Civil Penalties Division database. We identified cases that expired before penalties were assessed and evaluated the factors that led to the OFAC Civil Penalties Division's failure to resolve cases before the expiration of the 5-year SOL. We examined the staffing and caseloads and evaluated the information available to management to monitor case status.

We conducted our audit from March 2005 to April 2006, and updated the information in November and December 2006. We performed the audit in accordance with generally accepted government auditing standards.

[13] *FOREIGN ASSETS CONTROL: OFAC's Ability To Monitor Financial Institution Compliance Is Limited Due To Legislative Impairments* (OIG-02-082, April 26, 2002).

OFAC Civil Penalties Division provided the following definitions.

Alternative dispute resolution: Used to reduce Cuban travel case backlog by employing an informal settlement offer process to resolve cases

Prepenalty notice: The first notice that goes out to inform a violator of a civil monetary penalty

Penalty notice: A notice that goes 60 days after the prepenalty notice

Hold: Further investigation needed

Pending: Has not yet been assigned

Closed: Case answered without penalty issued

Settlement: An arrangement reached in a financial proceeding

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 31, 2007

Stephen Syriala
Office of Inspector General
Audit Manager
Suite 330
408 Atlantic Avenue
Boston, MA 02210

Re: OFAC's Response to IG Audit Report on Civil Penalties

Dear Mr. Syriala,

Attached please find OFAC's response to the draft Inspector General report on OFAC's imposition of civil penalties. If you have any follow up questions, please do not hesitate to contact Elton Ellison, Assistant Director for Civil Penalties, at 202-622-1628 or Matthew Tuchband, Deputy Chief Counsel (Foreign Assets Control), at 202-622-1654.

Sincerely,

Adam J. Szubin, Director
Office of Foreign Assets Control

OFAC Comments on IG Audit Report on Civil Penalties

Introduction

OFAC submits these comments in response to the latest draft IG Audit Report on OFAC's imposition of civil penalties ("*Report*"). OFAC already has implemented a number of the *Report's* recommendations with respect to administration of its civil penalties program. OFAC appreciates and is receptive to the IG's recommendations to improve its case management process so as to enhance its ability to negotiate and process more civil penalty cases under given resource constraints. The IG has made four recommendations relating to these areas. As discussed in greater detail below, OFAC has addressed these recommendations by improving OFAC's process for developing civil penalty cases and determining which OFAC enforcement action to apply, and by improving OFAC's case database system and the use of this system to improve proactive management oversight of civil penalty cases.

It should be borne in mind that, despite these improvements, OFAC Civil Penalties staff remains small relative to the caseload. The OFAC Civil Penalties Division is comprised of a total of eight persons: six civil penalties officers, one administrative specialist, and one manager. The Division's case docket consistently has been in excess of 1,000 cases. Even at full strength, then, each Civil Penalties officer would be responsible for over 166 cases – a massive caseload given the complexity of the cases and timing considerations.

Management and staff will continue to have to assess which cases to pursue most aggressively and expend time negotiating, and which cases to drop or to offer higher levels of mitigation in order to facilitate a quicker settlement pursuant to the goal of ensuring OFAC compliance.

Finally, OFAC believes that the *Report* contains material errors of fact and analysis premised on misunderstanding of the purpose and operation of OFAC's civil penalties process. In short:

OIG Comment 1

- The *Report* incorrectly assumes that in all cases the optimal result is for OFAC to impose the maximum penalty amount allowed by statute. Like virtually all other enforcement bodies, however, OFAC takes a more nuanced approach to imposing penalties.

OIG Comment 2

- The *Report* incorrectly calculates the civil penalty amounts that would or could have been imposed.

OIG Comment 3

An earlier draft of the *Report* provided a fuller description of OFAC's enforcement options and purpose. That description is missing from the current version. The earlier draft also cited the 295 cases that were closed out and the four cases that received substantial mitigation. OFAC noted at the Exit Interview meeting that the description of

these cases and the penalty revenue estimates were incorrect and asked that these numbers be corrected and better explained. This was not done.

1. Background on OFAC's Choice of Enforcement Options

OFAC takes its civil penalty enforcement authority very seriously, as this authority provides a major tool for implementing sanctions. Imposition of civil penalties is, however, only one of several enforcement options available to OFAC. OFAC's Enforcement Guidelines highlight this point, stating that "[t]he type of enforcement action undertaken by OFAC depends on the nature of the apparent violation and the foreign policy goals of the particular sanctions program involved." (68 *Fed. Reg.* at 4422.) OFAC's mission is to impair, impede, isolate, and financially incapacitate actors whose conduct threatens the national security, foreign policy, or economy of the United States. OFAC must ensure that U.S. persons comply with prohibitions on financial dealings with sanctioned countries, individuals, and entities.

There are several actions that OFAC can take to achieve this goal—it may suspend a license, assess a civil penalty,[1] or refer a matter to criminal enforcement agencies. In other instances, it may issue a cautionary letter, issue a warning letter, or, when appropriate, decline to take action. OFAC chooses the enforcement action that has the best chance of ensuring that U.S. persons comply with their sanctions obligations. For example:

- OFAC may issue a warning letter to a first-time offender, which puts the violator on specific notice, and this may be sufficient to ensure future compliance.
- If OFAC concludes a violator has a compliance program and is in good faith attempting to comply with sanctions, and the violation could not have been anticipated or was unintended, OFAC may choose to take no action.[2]

When OFAC chooses to pursue a civil penalty against a violator, OFAC's purpose is not to maximize its penalty revenue but rather to engage the violator in a manner that best promotes OFAC compliance.

---

[1] A description of these OFAC enforcement actions can be found in the Enforcement Guidelines.

[2] In fact, OFAC recently amended its regulations to put in place separate enforcement guidelines for financial institutions, providing for a periodic review of a bank's violations rather than treating them individually, to assess whether there is a systematic problem in the bank's compliance:

> Except for those significant violations for which prompt action, such as a civil penalty proceeding or referral to other federal law enforcement agencies, is appropriate, OFAC will review institutions with violations or suspected violations on a periodic basis. OFAC will review each such institution's apparent violations over a time deemed appropriate in light of the number and severity of apparent violations and the institution's OFAC compliance history.

(*See* Section III of 31 CFR 501, Appendix A.) If a bank's violations are not systemic, the bank has addressed deficiencies in its compliance program, and the violations are unlikely to occur again, OFAC may opt to mitigate civil penalties or choose not to issue a penalty if this would serve no useful purpose toward promoting effective compliance.

2

OIG Comment 4

OIG Comment 5

OIG Comment 6

OIG Comment 7

2. The Report Incorrectly Concludes that OFAC Inadvertently Dropped Cases, Lost Penalty Revenue, and Exceeded its Own Guidelines

While much in the *Report* recommendations is useful to OFAC, the *Report* contains incorrect analysis of OFAC data and incorrect assumptions about OFAC's enforcement policies. These have led to errors regarding OFAC's processes in negotiating civil penalties. The *Report* charges OFAC with a failure to complete enforcement actions and concludes that OFAC inadvertently lost $3.87 million from 295 dropped cases. (*Report* at p. 2.) It also concludes that OFAC improperly mitigated four cases, resulting in the collection of only $321,100 out of $4.06 million in potential assessments.[3]

OFAC, like any agency that is understaffed and faced with a heavy case load, must decide which cases to pursue in order to best serve its mission. The *Report* correctly recommends that OFAC management could benefit from improved automated case tracking and a better case development process. It mistakenly concludes, however, that certain cases were closed or heavily mitigated because OFAC Civil Penalties officers and management were unaware that the cases were nearing the expiration of the statute of limitations ("SOL"). In fact, OFAC Civil Penalty officers were quite aware of the nearing SOL expiration dates of the cases they were assigned (some cases were received by the Civil Penalties Division when their SOL expiration dates were already near) and so informed management. Civil Penalties staff and management considered which cases were most important to ensuring public compliance with sanctions and which cases could be closed or more heavily mitigated.

The *Report* uses the data in Table 3 to argue that because certain categories of cases were not being processed, OFAC management was unaware of the situation and was not taking the necessary steps to remedy the problem. To the contrary, OFAC was aware of the status of those cases but determined to devote its limited resources to higher priority areas, knowing that some cases would not be concluded within the SOL. When additional civil penalty staff was later hired, some of the new staff was assigned to those areas and the cases were processed as appropriate at that time.

Additionally, the *Report* wrongly concludes that a case must be settled before it reaches its SOL expiration date or it must be dropped. (*Report* at p. 5) The *Report* assumes that once a case is five years old, OFAC generally cannot impose or conclude a sanctions action. Although a case ideally should be concluded before the SOL expires, there are a number of ways to conclude a case beyond that date, and due to staffing constraints, this has been done with greater frequency than OFAC would like.

3. OFAC's Penalty Negotiating Process

[3] The *Report's* description of mitigation is problematic: "OFAC guidelines allow the Civil Penalties Division to mitigate a civil monetary penalty by 25 to 75 percent . . . ." (*Report* at p. 5.) In fact, OFAC has the flexibility under its regulations and guidelines to mitigate greater than 25% to75% if the facts warrant, and it has mitigated more than 75% when it determined such mitigation promoted effective OFAC compliance and that imposing a larger penalty would have served no useful purpose. *See* Enforcement Guidelines at 4427.

3

Significantly, the *Report*, by focusing on the "potential" loss of penalty revenue from cases that were closed by OFAC, misunderstands OFAC's purposes, processes, and resources, and this shapes the thrust of the Recommendations.

For example, by using a measure of "potential" loss of civil money penalties in analyzing these cases, the *Report* concludes that the closed cases were of equal or greater importance than the cases that OFAC chose to negotiate. This incorrectly assumes that OFAC was unaware of the SOL and dropped the cases inadvertently. The focus on "potential" loss also overlooks the fact that cases to which OFAC gave lesser priority, and which it allowed to lapse, most likely if negotiated would have received equal or greater mitigation than the cases OFAC did negotiate. Thus, while the fourth Recommendation calls upon OFAC to make a determination regarding the additional resources it may need, it does not acknowledge that even with greater resources, OFAC still may appropriately close the lower-priority cases or mitigate them more heavily. The best outcome for a civil penalties case is not necessarily to obtain the largest possible monetary penalty. In fact, the vast majority of OFAC civil penalty cases are mitigated.

When a civil penalty is chosen as the best enforcement route, the first step is to engage the violator, which usually leads to the issuance of a prepenalty notice. (As the *Report* correctly notes, OFAC may engage in discussions with the violator prior to the issuance of a prepenalty notice, especially in instances of a voluntary disclosure.) This gives the violator an opportunity to explain the circumstances of the violation and to provide assurances that steps will be taken to prevent any future violations. An overview of the process for negotiating a settlement in a case involving the Trading With the Enemy Act, such as a violation of the Cuba sanctions, is provided in 31 CFR § 501.703 (*see* Annex A, attached), and for a case involving the International Emergency Economic Powers Act, such as the Iranian Transactions Regulations, is provided in 31 CFR 560.702-704. The mitigation process and factors considered for giving mitigation at the prepenalty notice stage are found in the Enforcement Guidelines (at 4427-4428).[4]

---

[4] OFAC also has discretion regarding which violations it will include in the prepenalty notice and how much it assesses for these violations. The prepenalty notice therefore may not include all possible violations or assess violations at the theoretical maximum This is made clear from the following excerpt from the Enforcement Guidelines:

B. Evaluation of Mitigating and Aggravating Factors

In determining a settlement amount or penalty assessment at the penalty notice stage, OFAC generally will balance the mitigating and aggravating factors present in the administrative record, as well as weigh any administrative considerations that the agency may deem appropriate.

1. Mitigation and mitigating factors.
The degree to which a proposed penalty is mitigated is determined by the blend of mitigating factors and aggravating factors present. The history of mitigation with respect to cases having substantially identical fact patterns generally will govern the degree of mitigation to be applied in subsequent cases. However, departures from these Guidelines or from prior history will be considered where appropriate. OFAC may attach more importance to a particular factor, and administrative considerations may also be taken into account. The individual circumstances of a violation, including the balance of factors present, will also influence the outcome. OFAC encourages evidentiary submissions indicating the presence or absence of a mitigating or aggravating factor. In the case of funds transfer violations by banks or other financial

4

This civil penalties process is time consuming, but it provides OFAC with needed information about the violation and serves to improve compliance with its programs. Although the Enforcement Guidelines provide general mitigation ranges, they do not foreclose settlements outside of these ranges. Indeed, in some cases, not imposing a penalty may be the best outcome if the violator implements a robust compliance program.

---

institutions, depending on the balance of mitigating and aggravating factors present, penalties generally will be mitigated 25–50% from the amount proposed in the prepenalty notice. In all other instances, penalties for violations generally will be mitigated 10% to 75% from the amount proposed in the prepenalty notice, depending upon the balance of mitigating and aggravating factors present. Typical mitigating factors include, but are not limited to, the following:

(a) Voluntary disclosure;
(b) First offense (but see the appendix to 31 CFR part 515 for certain Cuba travel-related violations);
(c) Compliance program in place at time of violation;
(d) If no compliance program, implementation of one upon the respondent's discovery of or OFAC notification of the violation;
(e) Other remedial measures taken;
(f) Provision of a written response to a prepenalty notice;
(g) Useful enforcement information provided during an OFAC audit, investigation, or penalty proceeding;
(h) Part of comprehensive settlement with U.S. Customs Service;
(i) Other U.S. government enforcement action already completed;
(j) Lack of relevant commercial experience;
(k) Clerical error, inadvertence, or mistake of fact;
(l) Evidence in the administrative record that a transaction(s) could have been licensed by OFAC under an existing licensing policy had an application been submitted;
(m) Apparent language barrier or other impediment to understanding of regulations (individuals only);
(n) Humanitarian nature of transaction;
(o) Such other matters as justice may require.

...

3. *Voluntary Disclosure.* When apparent violations are voluntarily disclosed by the actor to OFAC, the proposed penalty generally will be mitigated at least 50% from the amount that would otherwise be proposed under these Guidelines. A disclosure to OFAC is considered to be a voluntary disclosure when OFAC is notified of possible sanctions violations. Notification to OFAC may not be considered to be a voluntary disclosure if OFAC previously received information concerning the transactions from another source, including but not limited to another regulatory or law enforcement agency or another person's blocking or funds-transfer rejection report. Responding to an administrative subpoena or other inquiry from OFAC does not constitute a voluntary disclosure. Similarly, the submission of a license application does not constitute a voluntary disclosure unless it is also accompanied by a separate disclosure.

4. *First Offense.* Proposed penalties for apparent violations that constitute a first offense generally will be mitigated at least 25% in the penalty notice, unless aggravating factors are also present. Significant exceptions to this rule include apparent violations involving willful misconduct or gross negligence and those involving certain travel-related transactions described in the appendix to 31 CFR part 515 (where the proposed penalties already distinguish between first and subsequent offenses). In determining whether an apparent violation constitutes a first or subsequent offense, a distinction generally will be made between prior OFAC penalty cases ending in an assessed civil monetary penalty and those settled prior to a finding of violation. Another factor considered is whether the OFAC regulations previously violated were similar to those of the new case under review. For example, all apparent reporting violations will be considered to be similar, as will those involving a failure to block financial transfers or failure to respond to a request for information. An apparent violation generally will be considered a first offense if no similar violation has been found within the past five years.

5

For example, if a violator is a first-time offender, or the infraction is determined to be minor in scope and has a minimal impact on sanctions enforcement, or if the violator is engaged in what would otherwise be licensable activity but failed to properly apply for a license, the need for a penalty could either be more heavily mitigated or even be obviated on appropriate facts.

4. Negotiating Beyond the SOL Expiration Date: Waiving or Tolling the Statute of Limitations

Once OFAC has engaged a violator by issuing a prepenalty notice, the violator is normally willing to waive or toll the SOL for a certain time on the assumption that given additional time to negotiate, OFAC may accept a settlement offer below the prepenalty amount based upon OFAC's mitigation guidelines. If OFAC and the violator cannot agree on the amount of mitigation, OFAC still may issue a penalty notice during the period the SOL is waived or tolled.

5. Errors in the Report in Regard to the 295 Cases Dropped, the Penalty and Mitigation Amounts in the Four Cases Cited, and Estimated Potential Amounts Forgone

OIG Comment 8

The bulk of the 295 cases referred to in the *Report* were dropped because they could have been heavily mitigated or were less important to pursue when compared to other outstanding case. Rushing to further process these cases prior to the SOL expiration date would have absorbed limited staff time that instead was better used to pursue other cases.

In addition, the *Report* cited four cases of some importance to OFAC, which it claims were mitigated outside of the mitigation guidelines. In three of the four cases cited, the IG did not properly estimate the potential penalties and thus did not understand the mitigation amount. These are discussed below:

A. Alleged Violator A. According to e-mail communication received from the IG, OFAC understands that in drafting the *Report,* the IG relied on the following assumptions:

- There were four mitigating factors, but the SOL was pending and OFAC wanted to settle quickly.
- Instead of the original penalty assessment of $1,279,521, Alleged Violator A paid $250,000.

OFAC's review of this case file, however, revealed the following:

- The Civil Penalties Division received the case with less than two weeks before the first alleged violation would be beyond the SOL and less than seven months before the last alleged violation would be beyond the SOL.

6

OIG Comment 9

- OFAC issued a prepenalty notice approximately two months after receiving the file.

- The respondent filed a response to the prepenalty notice and requested a hearing before an administrative law judge. Under the then-applicable rules, this request for an ALJ hearing was deemed to toll the SOL. At the time the SOL was tolled, there still remained 37 counts amounting to $1,009,651 in proposed penalties. Because the SOL was tolled, there was no threat of any further loss of counts due to the SOL.

- The settlement memorandum signed by the Director of OFAC lists four mitigating factors: first offense, compliance program in place, OFAC's lack of a complete set of records, and expeditious resolution of the proceedings. The memorandum does not include the SOL as a mitigating factor. In fact, the SOL was tolled due to the respondent's request for an ALJ hearing and therefore should not have been (and apparently was not) a factor in the Director's determination of an appropriate mitigation amount.

- OFAC mitigated the remaining possible penalties of $1,009,651 to $250,000, which is approximately 75% mitigation and within the normal mitigation range.

OIG Note: This is Violator C in the report.

B. Alleged Violator B. According to e-mail communication received from the IG, OFAC understands that in drafting the *Report*, the IG relied on the following assumptions:

- OFAC took too long to review the case, so the SOL was about to expire.

- Instead of paying the $254,000 penalty assessment, the violator ended up agreeing to $7,800.

OFAC's review of this case file, however, revealed the following:

OIG Comment 10

- The prepenalty notice proposed a total penalty of $31,444. There was never any $254,000 penalty assessment.

- The settlement memorandum signed by the Director of OFAC lists the following four mitigating factors: other U.S. agency action completed (jail time served), other remedial measures taken (follow-up reports submitted), no longer conducts business, and financial hardship. The memorandum does not list the SOL as a mitigating factor. The matter was settled more than five months before the SOL would have begun to run on the alleged violations listed in the prepenalty notice.

- The settlement memorandum shows a settlement of $7,861, amounting to 75% mitigation, which is within the normal mitigation range.

7

C. Alleged Violator C. According to e-mail communication received from the IG, OFAC understands that in drafting the *Report*, the IG relied on the following assumptions:

- The bank was not willing to waive the SOL to include any transactions prior to June 1999.
- The civil monetary penalties would have been $1,944,834.39. However, the amount assessed at the time of the settlement was $44,000, which was further reduced to $30,800.

OFAC's review of this case file, however, revealed the following:

OIG Comment 11

- *There is no evidence in the file that OFAC ever considered proposing a penalty of $1,944,834.39.* That inflated number appears to have been derived from adding all of the credits and debits to the bank accounts at issue. But this is not how OFAC calculated its possible proposed penalty. Instead, as evidenced in the settlement memorandum and elsewhere in the case file, OFAC saw the operation of each account as one violation and could not confirm that the individual credits and debits were violations. *Using the then-applicable statutory maximum penalty of $11,000, the settlement memorandum noted a possible proposed penalty of $44,000 for operation of the four accounts, not approximately $1.9 million.*
- The settlement memorandum signed by the Director of OFAC lists four mitigating factors: first offense, compliance program in place, the respondent is a successor to the actual violator, and expeditious resolution of the matter. The memorandum does not list the SOL as a mitigating factor. The OFAC Director does not appear to have considered the SOL in agreeing to the settlement.
- While some of the activities within the accounts may have been nearing the SOL expiration date at the time of the settlement agreement, there were other transactions indicating operation of accounts with more than four years to go before the SOL ran, further demonstrating that the SOL was not a significant consideration in settling the matter.
- The settlement memorandum shows a settlement of $30,800, amounting to 30% mitigation, which is within the normal mitigation range.

OIG Note: This is Violator B in the report.

D. Alleged Violator D. According to e-mail communication received from the IG, OFAC understands that in drafting the *Report*, the IG relied on the following assumptions:

- OFAC had to drop several of the counts because the SOL had already expired.
- The Company ended up agreeing to pay $32,500 instead of the original assessment of $1,739,968.

8

OIG Comment 12

OIG Comment 13

OIG Comment 14

OFAC's review of this case file, however, revealed the following:

- OFAC took positive action from the beginning of the civil penalty matter to avoid SOL problems by getting multiple SOL waivers.
- OFAC mistakenly received and accepted a waiver of the SOL from the wrong company because OFAC erroneously concluded it was dealing simultaneously with the parent company and its foreign subsidiary through the same law firm. Because of this error, OFAC lost all counts against that entity that were already beyond the SOL expiration date, leaving only one remaining count, with a possible penalty of $50,788.31. Thus, counts were lost to the SOL not due to OFAC inaction, but due to a mistake of fact.
- *The prepenalty notice shows only one count and a proposed penalty of $50,788.31. There was no "original assessment" of $1,739,968.*
- In addition to the SOL, the settlement memorandum signed by the Director of OFAC includes seven other mitigating factors. Four of those, each standing alone, normally would result in significant mitigation -- voluntary disclosure, first offense, provision of a written response to the prepenalty notice, and a conflict of law with a Mexican statute forbidding the respondent from complying with the U.S. Cuba embargo laws.
- The settlement memorandum shows mitigation of a proposed penalty of $50,788.31, which was settled at $32,500, amounting to 35% mitigation, which is within the normal mitigation range.

In sum, in three of the four cases cited in the *Report* as having major significance, the IG did not properly estimate the potential penalties and thus arrived at mitigation amounts that are incorrect, sometimes grossly so. In the fourth case, several penalties were dropped, not because of a lack of attention to the SOL by OFAC, but due to other factors relating to the representation of the parties. This is not confusion or an error that is likely to be repeated in the future.

Conclusion

OFAC applied a reasoned decision-making process regarding which cases it pursued, weighing the relevance of its cases to improving OFAC compliance against OFAC staffing constraints. The *Report*, by citing a potential revenue loss of $3.87 million for 295 cases, and by assuming OFAC improperly granted mitigation in four other cases from 2002-2005, makes a number of incorrect assumptions, as discussed in the body of this response. The *Report* also incorrectly concludes OFAC was caught unaware by the nearing SOL expiration dates on these cases, and it significantly miscalculates the potential penalty that could or would have been imposed. The *Report* also assumes that an enforcement agency's goal in handling civil enforcement penalties is to maximize

9

penalty revenue, when in fact the goal is to maximize enforcement and compliance. OFAC therefore respectfully requests that the report not be issued until these errors can be addressed.

The report's incorrect conclusions of fact mischaracterize OFAC's actions, and they may raise a false expectation as to what what will be accomplished by OFAC following the *Report* Recommendations. The implemented Recommendations may help OFAC by improving its process for determining which OFAC enforcement action to pursue, by ensuring civil penalty cases are received by the Civil Penalties Division further in advance of their SOL expiration dates, and by helping Civil Penalties management be more proactive in engaging the alleged violators. The improved process may give Civil Penalties staff time to handle more cases, but this may not and should not necessarily result in the collection of higher civil penalty amounts.

OFAC has addressed most of the Recommendations. As noted above, despite these improvements, OFAC Civil Penalties staff remains small relative to the large caseload. The OFAC Civil Penalties Division is comprised of a total of eight persons: six civil penalties officers, one administrative specialist, and one manager. The Division's case docket consistently has been in excess of 1,000 cases. Even at full strength, each Civil Penalties officer would be responsible for over 166 cases, which is a massive caseload based upon the complexity of the cases and timing considerations.

Management and staff will continue to have to assess which cases to pursue most aggressively and expend time negotiating, and which cases to drop or to offer higher levels of mitigation in order to facilitate a quicker settlement pursuant to the goal of ensuring OFAC compliance.

OFAC Responses to Report Recommendations

Report Recommendation 1:

Ensure that the information, including accurate SOL data, in the civil penalty database is brought up to date and maintained in a complete and accurate manner going forward.

OFAC Response:

OFAC agrees with the recommendation to maintain SOL data in the case management database in a complete and accurate manner going forward. OFAC already has fully implemented this recommendation. OFAC's Civil Penalties and Information Technology Divisions have worked together to refine the data field for the case management database for civil penalties cases. As of August 3, 2005, an SOL field has been added and since that date, the SOL field has been accurately filled in for all cases, and management is ensuring that this data and other data are maintained in a complete and accurate manner going forward. This enhancement to the date field was a further refinement of the enhancements made in 2004 when a date field was added to capture the violation date. Because the statute of limitations is the same for all cases (five years from the date of

10

violation), it has been possible since 2004 to run a report on the statute of limitation dates using the violation date fields that were populated. Thus, OFAC can adequately determine SOL data from the database beginning with cases opened in 2004. All cases opened in 2003 have been assigned to Civil Penalties officers. The Civil Penalties officers continually review and prioritize their caseloads based on a number of factors including the SOL.

Report Recommendation 2:

Develop and implement policies and procedures and associated monitoring systems, management reports, and other controls to ensure that penalty cases are adjudicated in a timely manner and within the SOL period.

OFAC Response:

OFAC agrees with this recommendation to develop and implement controls to ensure that penalty cases are adjudicated in a timely manner. Some of these controls already have been implemented; other are expected to be implemented within the next few months.

Previously Civil Penalties officers brought cases nearing the SOL expiration date to the attention of their manager; now management is using the case management database to pro-actively initiate a review of cases with the relevant Civil Penalties officers. The Assistant Director for Civil Penalties is in the process of instituting a weekly review of the case management database to identify high priority cases, including those nearing the SOL. This weekly review process is expected to be in place by March 1, 2007. The Assistant Director for Civil Penalties already has instituted a weekly meeting with all of the Civil Penalties officers to review each officer's caseload and to determine the proper case disposition for individual cases taking into account the SOL expiration date, the potential for encouraging compliance, the size of the case load, and the available staffing (see further discussion below regarding the factors considered in determining the disposition of cases). Although these new controls will ensure that OFAC stays aware of all penalty file SOL data, on occasion cases may still be closed due in part to nearing SOL dates. If OFAC faces a choice between devoting its limited resources to moving forward either (1) a case nearing its SOL that will have limited to no compliance or deterrence value or (2) a more recent case that, if acted on quickly, would have a much greater compliance and deterrence value, OFAC may choose to close the older case in order to focus on the more recent one, which will more effectively implement the President's sanctions policy.

Report Recommendation 3:

Implement an effective tracking system to help ensure that potential penalty cases being reviewed by the various OFAC offices are addressed in a timely manner.

OFAC Response:

11

OFAC agrees with this recommendation and already has implemented it. In 2005, the former OFAC Director ordered a review of the development of OFAC violation cases. In mid-2005, the former OFAC Director reorganized OFAC. The reorganization clarified and in some cases shifted responsibility to perform certain enforcement and civil penalties functions. Functions that previously had been shared between divisions are now assigned to a single division. This reorganization was aimed at facilitating the development of sanctions violation cases, clarifying who reviewed the cases and when, and clarifying the process for determining which OFAC enforcement action should be applied. Some examples of the clarified function assignments are:

- Identification and investigation of a sanctions violation (Enforcement Division).
- Initiation and organization of a case file (Enforcement Division).
- Interaction with other US agencies in the development of a case (Enforcement Division)
- Internal determination of the administrative enforcement action to be applied, one of which is pursuing a civil penalty (in banking cases, a periodic review process was implemented and a committee staffed by the OFAC divisions involved with enforcement and compliance issues—including Compliance, Enforcement and Civil Penalties Divisions).
- Drafting of prepenalty and penalty notices and settlement negotiation (Civil Penalties Division).

Since August 3, 2005, an SOL field for penalty cases has been added and accurately filled out in the case management database. As noted in OFAC's Answer to Recommendation 2, the Assistant Director for Civil Penalties (1) has instituted weekly meetings to review Civil Penalties officers' case load and prioritize them taking into consideration the relevant SOL dates and (2) is in the process of implementing weekly reviews of the case management database. The case management database allows complete tracking of every penalty file from its entry into the system and assignment to a Civil Penalties officer, through the drafting of Prepenalty and Penalty Notices, through review by the Office of Chief Counsel, and to final disposition. The database allows all Civil Penalties officers to review all information about a particular file at any time, including the file's current location and the number of days it has been at that location. The Civil Penalties officers now use the case management database on a regular basis to track the files that make up their respective caseloads. Through this regular use of the database and the weekly meeting of the Assistant Director for Civil Penalties, OFAC is ensuring that Civil Penalties cases are handled in a timely manner.

Report Recommendation 4:

Once the active penalty case workload is determined, ensure the resources (including ALJs) needed to process penalty cases are available in a timely manner.

OFAC Response:

OFAC agrees with this recommendation.

12

(a) *General resources.*

As mentioned in the response to Recommendation 3, OFAC has improved the manner in which cases are developed through its reorganization. Even after the reforms OFAC has undertaken, the OFAC Civil Penalties caseload is substantial; it currently averages in excess of 166 cases per Civil Penalties officer. Under the supervision of the former Assistant Director for Civil Penalties, the division conducted a manual desk audit of all pending civil penalties cases. The database was reconciled and the number of pending cases can be stated with confidence.

A troubling assumption in the *Report* is that civil penalties cases were inadvertently dropped due to OFAC's inability to track its cases and their SOL expiration dates. As explained above, staff and management during the 2002-2005 period actively reviewed and discussed cases nearing their SOL expiration dates and decided which cases—given the staffing limitations—to pursue and which cases to drop to best ensure OFAC sanctions compliance. The Civil Penalties Division's problem, in part, has been that it has a large caseload and previously received many of these cases close to their SOL expiration date.[5]

Most cases are settled through a negotiating process that is time-consuming and involves mitigating the potential penalty considering the circumstances of the violation and the possible commitment on the part of the violator to employ a more robust compliance effort. Maximizing the civil penalties collection is not the objective of the civil penalties process, and in some cases, resolving a case without imposing a penalty may be the best solution.

Having an accurate case count and an improved case development and tracking process may give Civil Penalties staff more lead time to consider the disposition of its cases before the SOL expiration date nears. Under current staffing levels, however, cases with minimal impact on improving sanctions compliance may not be pursued.

Increasing staffing levels would permit the Civil Penalties Division to more fully address these latter cases. The needs of the Civil Penalties Division, however, will continue to be addressed in light of the needs of OFAC's other divisions and their responsibilities, such as identifying and blocking terrorist assets.

(b) *ALJ-related resource.* The use of Administrative Law Judges applies to sanctions programs premised on the Trading With the Enemy Act (TWEA). Most current TWEA cases are related to the Cuba sanctions program. Once a U.S. person requests an ALJ hearing and OFAC files an Order Instituting Proceedings, there is no SOL issue—the SOL is suspended—and the timing of the hearing depends upon the availability of an

[5] Often, as a case nears its SOL expiration date, a violator who receives a prepenalty notice is willing to waive or toll the SOL in order to negotiate for mitigation. An approaching SOL expiration date does not mean a case must be closed. Because the OFAC caseload is heavy and the negotiating process is often time-consuming, OFAC must make a determination which cases to pursue that meet OFAC's national security goals.

13

ALJ. This means the case does not have to be dropped, but its ultimate adjudication may be delayed. Even after the case is assigned to an ALJ and throughout the hearing process, the Office of Chief Counsel still may engage in settlement discussions. Nevertheless, OFAC seeks to expedite the ALJ process.

OFAC currently has contracts with a number of ALJs, which have facilitated a more timely hearing of these cases. The backlog has been cleared out and OFAC anticipates that new requests for administrative hearings will be handled in a much more expeditious manner. In November 2006, the Office of Chief Counsel hired a paralegal who will assist in handling future ALJ hearing requests.

14

ANNEX A

Examples of the Civil Penalties Negotiating Process
Under the Trading with the Enemy Act (TWEA) and
Under the International Emergency Powers Act (IEEPA)

A TWEA Program - Cuba

§ 501.703 Overview of civil penalty process and construction of rules.

(a) The administrative process for enforcing TWEA sanctions programs proceeds as follows:
(1) The Director of the Office of Foreign Assets Control will notify a suspected violator (hereinafter ``respondent") of an alleged violation by issuing a ``Prepenalty Notice." The Prepenalty Notice shall describe the alleged violation(s) and include a proposed civil penalty amount.
(2) The respondent will have 60 days from the date the Prepenalty Notice is served to make a written presentation either defending against the alleged violation or admitting the violation. A respondent who admits a violation may offer information as to why a monetary penalty should not be imposed or why, if imposed, the monetary penalty should be in a lesser amount than proposed.
(3) Absent a settlement agreement or a finding that no violation occurred, the Director of the Office of Foreign Assets Control will issue a ``Penalty Notice." The respondent will have 30 days from the date of service to either pay the penalty or request a hearing.
(4) If the respondent requests a hearing, the Director of the Office of Foreign Assets Control will have two options:
(i) The Director may issue an ``Order Instituting Proceedings" and refer the matter to an Administrative Law Judge for a hearing and decision; or
(ii) The Director may determine to discontinue the penalty action based on information presented by the respondent.
(5) Absent review by a Secretary's designee, the decision of the Administrative Law Judge will become the final decision of the Department without further proceedings.
(6) If review is taken by a Secretary's designee, the Secretary's designee reaches the final decision of the Department.
(7) A respondent may seek judicial review of the final decision of the Department.
(b) Construction of rules. The rules contained in this subpart shall be construed and administered to promote the just, speedy, and inexpensive determination of every action. To the extent there is a conflict between the rules contained in this subpart and a procedural requirement contained in any statute, the requirement in the statute shall control.

15

An IEEPA Program - Weapons of Mass Destruction

§ 539.702 Prepenalty notice.

(a) When required. If the Director of the Office of Foreign Assets Control has reasonable cause to believe that there has occurred a violation of any provision of this part or a violation of the provisions of any license, ruling, regulation, order, direction, or instruction issued by or pursuant to the direction or authorization of the Secretary of the Treasury pursuant to this part or otherwise under the International Emergency Economic Powers Act, and the Director determines that further proceedings are warranted, the Director shall issue to the person concerned a notice of intent to impose a monetary penalty. This prepenalty notice shall be issued whether or not another agency has taken any action with respect to this matter.

(b) Contents--(1) Facts of violation. The prepenalty notice shall describe the violation, specify the laws and regulations allegedly violated, and state the amount of the proposed monetary penalty.

(2) Right to respond. The prepenalty notice also shall inform the respondent of respondent's right to make a written presentation within 30 days of the date of mailing of the notice as to why a monetary penalty should not be imposed or why, if imposed, the monetary penalty should be in a lesser amount than proposed.

§ 539.703 Response to prepenalty notice; informal settlement.

(a) Deadline for response. The respondent shall have 30 days from the date of mailing of the prepenalty notice to make a written response to the Director of the Office of Foreign Assets Control.

(b) Form and contents of response. The written response need not be in any particular form, but must contain information sufficient to indicate that it is in response to the prepenalty notice. It should contain responses to the allegations in the prepenalty notice and set forth the reasons why the respondent believes the penalty should not be imposed or why, if imposed, it should be in a lesser amount than proposed.

(c) Informal settlement. In addition or as an alternative to a written response to a prepenalty notice issued pursuant to this section, the respondent or respondent's representative may contact the Office of Foreign Assets Control as advised in the prepenalty notice to propose the settlement of allegations contained in the prepenalty notice and related matters. In the event of settlement at the prepenalty stage, the claim proposed in the prepenalty notice will be withdrawn, the respondent is not required to take a written position on allegations contained in the prepenalty notice, and the Office of Foreign Assets Control will make no final determination as to whether a violation occurred. The amount accepted in settlement of allegations in a prepenalty notice may vary from the civil penalty that might finally be imposed in the event of a formal determination of violation. In the event no settlement is reached, the 30-day period specified in paragraph (a) of this section for written response to the prepenalty notice remains in effect unless additional time is granted by the Office of Foreign Assets Control.

16

§ 539.704 Penalty imposition or withdrawal.

(a) No violation. If, after considering any response to a prepenalty notice and any relevant facts, the Director of the Office of Foreign Assets Control determines that there was no violation by the respondent named in the prepenalty notice, the Director promptly shall notify the respondent in writing of that determination and that no monetary penalty will be imposed.

(b) Violation. If, after considering any response to a prepenalty notice and any relevant facts, the Director of the Office of Foreign Assets Control determines that there was a violation by the respondent named in the prepenalty notice, the Director promptly shall issue a written notice of the imposition of the monetary penalty to the respondent.

(1) The penalty notice shall inform the respondent that payment of the assessed penalty must be made within 30 days of the date of mailing of the penalty notice.

(2) The penalty notice shall inform the respondent of the requirement to furnish the respondent's taxpayer identification number pursuant to 31 U.S.C. 7701 and that such number will be used for purposes of collecting and reporting on any delinquent penalty amount.

17

OIG Comment 1 We do not assume that the optimal result is for OFAC to impose maximum penalty amounts allowed by statute. We understand that penalties are mitigated and do not take exception to that process. Our concern was that potential penalties were not being assessed, in a large number of cases, because of OFAC's lack of timely action. We believe that when substantial numbers of penalty cases are administratively closed in this manner, the deterrent value of the penalty program is significantly weakened and the wrong message is sent to those conducting illegal transactions or activities.

OIG Comment 2 We disagree with the assertion that the report incorrectly calculates the civil penalty amounts that would or could be imposed. OFAC's Office of Chief Counsel provided official documentation prepared by the Civil Penalties Division, such as prepenalty notices provided to the parties involved. The numbers used in the report were based on those documents. We also recognize in our report that penalty amounts may be reduced, often substantially, if there are mitigating factors.

OIG Comment 3 Contrary to OFAC's assertion in the management response, OFAC officials attending the audit exit conference raised no issues with the description of these cases and the penalty estimates, other than to ask for additional details which we provided. Subsequent to the exit conference, OFAC provided additional information about the cases which we have considered where appropriate in preparing this final report.

OIG Comment 4 As indicated in OIG Comment 2, the penalty numbers we used in this report were provided by the Office of Chief Counsel and were contained in official documentation. OFAC's comments also do not recognize that we made changes to our draft report following suggestions that an earlier version used certain terminology, such as "lost" when describing penalty dollars not collected, that could be misinterpreted. We removed those terms from the report. We also did not conclude that OFAC improperly mitigated four cases. We had stated in an earlier draft that the mitigation in these cases was significant. However, OFAC's Office of Chief Counsel provided clarifying information to show that the expiration of SOL on a number of transactions

associated with the cases had resulted in the reduction of potential penalties. We adjusted our report accordingly.

OIG Comment 5 We do not state that certain cases were closed or heavily mitigated because OFAC Civil Penalties officers and management were unaware that the cases were nearing the expiration of the SOL. However, we do state that the lack of sufficient, accurate, and reliable information about case status and disposition hampered Civil Penalties Division monitoring and handling of the cases. We also cite other problematic factors, stated by OFAC officials and staff during our audit, including insufficient resources to address the increasing number of sanctions programs and caseload, the unavailability of ALJs to conduct required hearings, and the time other divisions or agencies took to review the cases prior to cases being forwarded to the Civil Penalties Division.

OIG Comment 6 We were not provided evidence to support the assertion in the management response that OFAC made a conscious decision to allow cases to expire because it knew that some cases would not be concluded within the SOL.

OIG Comment 7 We clarified in the report that a violator could waive (toll) the SOL for a certain time to negotiate a settlement.

OIG Comment 8 We were provided no evidence to support that the 295 cases were dropped because they could have been heavily mitigated or were less important to pursue, nor did Civil Penalties Division officials suggest this to be the case during our interviews with them.

OIG Comment 9 For Violator A, OFAC Civil Penalties Division documentation shows that OFAC originally identified potential penalties of $1,763,295. However, the Prepenalty Notice to the violator proposed a penalty of $1,279,521. OFAC reduced the $1,783,295 originally identified by $483,774 to $1,279,521 because at the time of the Prepenalty Notice, the SOL had expired on a number of counts. The Prepenalty Notice stated that "it is policy not to file a complaint ...in a debt collection action ...where the statute of limitations could be raised by the debtor as a

defense." Subsequent to issuance of the notice, the SOL expired on additional counts totaling $269,870 in potential penalties. As a result, the potential penalties not pursued totaled $753,644 ($269,870 plus $483,774), reducing the potential penalty from $1,763,295 to $1,009,651 for the remaining counts still within the SOL.

OIG Comment 10 OFAC is correct in stating that the prepenalty notice cites $31,444 as the proposed penalty. Similar to OIG Comment 9, our review of the case file revealed that OFAC did not pursue counts totaling an additional $254,451 since the SOL could be raised by the violator as a defense. OFAC's response in appendix 3 refers to this case as alleged violator B (p. 7 of the response).

OIG Comment 11 Our draft report included four cases. Based on OFAC's response, we dropped one case example involving a U.S. bank for the operation of 4 accounts in violation of OFAC sanctions. Although OFAC staff told us during our field work that as much as $1.9 million in penalties could have been assessed based on the transactions that flowed through the accounts, OFAC subsequently provided additional materials which showed that the maximum penalty that could be assessed was $44,000 ($11,000 per account). Based on mitigating factors, OFAC settled the matter for $30,800. OFAC's response in appendix 3 refers to this case as alleged violator C (p. 8 of the response).

OIG Comment 12 For Violator B (which OFAC referred to as alleged violator D in its response), the proposed prepenalty notice and an internal memo cited the penalty as $1,739,969, which was the total for 238 transactions in violation of the Cuban Assets Control Regulations. When the prepenalty notice was issued on June 3, 2004, the only amount still within the SOL was $50,788. The penalties not pursued due to expiration of the SOL are the difference between these two figures. OFAC's response notes that the counts were lost due an OFAC error which caused it to lose all counts that were already beyond the SOL expiration date.

OIG Comment 13 As discussed above (OIG Comments 9-12), we based the potential penalty amounts for these cases on prepenalty

notices and/or other supporting documentation in the case files. References we make to mitigated amounts are supported by OFAC documentation.

OIG Comment 14 OFAC asserts in its management response that it applied a reasoned decision-making process regarding which cases it pursued, weighing the relevance of its cases to improving OFAC compliance against OFAC staffing constraints. The evidence we obtained during the audit does not support this statement. When the SOL expired for the cases reviewed, we found no evidence that this was intentional or occurred following a reasoned decision-making process.

Stephen Syriala, Audit Manager
Thomas Mason, Auditor-In-Charge
Shaneasha Edwards, Referencer
Esther Tepper, Communications Analyst

The Department of the Treasury

Under Secretary for Terrorism and Financial Intelligence
Office of Strategic Planning and Performance Management
Office of Accounting and Internal Controls

Office of Foreign Assets Control

Director

Office of Management and Budget

OIG Budget Examiner