



*Criminal Investigation Can Take
Steps to Strengthen Oversight of
Its Undercover Operations*

February 3, 2012

Reference Number: 2012-30-014

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

- 1 = Tax Return/Return Information
- 2(d) = Law Enforcement Technique
- 2(e) = Law Enforcement Procedure
- 2(f) = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

CRIMINAL INVESTIGATION CAN TAKE STEPS TO STRENGTHEN OVERSIGHT OF ITS UNDERCOVER OPERATIONS

Highlights

Final Report issued on February 3, 2012

Highlights of Reference Number: 2012-30-014 to the Internal Revenue Service Chief, Criminal Investigation.

IMPACT ON TAXPAYERS

Criminal Investigation (CI) uses undercover operations as an essential technique in the detection and investigation of criminal activity involving tax and money laundering offenses. Our review determined that weaknesses in the controls over undercover operations continue to exist. Given the risks associated with undercover operations, stronger oversight helps ensure that undercover operations are properly managed and meet operational objectives, and that Federal tax dollars are used in the most efficient manner to ensure the public's confidence in CI's investigative techniques.

WHY TIGTA DID THE AUDIT

This audit was part of TIGTA's Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives. This review is a follow-up to TIGTA's Fiscal Years 2001 and 2002 reviews of CI undercover operations. The overall objective of this review was to determine whether CI has effective policies and procedures to ensure undercover operations are properly monitored, expenses are appropriate, and any income earned is properly controlled. In addition, TIGTA evaluated the practices used to protect the safety of special agents working on undercover operations.

WHAT TIGTA FOUND

TIGTA found that other Federal law enforcement agencies respect CI's undercover program because of the financial expertise CI special agents bring to a joint investigation. TIGTA also found that CI's undercover practices appear to be more

thorough in some aspects than other Federal agencies.

Although CI took steps to strengthen controls over its undercover operations in response to our Fiscal Year 2002 review, TIGTA identified repeat findings and determined that internal control weaknesses continue to exist because corrective actions were not implemented sufficiently. In addition, some undercover expenditures that could be considered as questionable did not have documentation indicating the expenditures were preapproved.

Although CI's undercover agents expressed their training was sufficient and safety was emphasized, TIGTA believes that additional steps could be taken to protect the identity of undercover agents. TIGTA also determined that financial reviews of undercover operations that earned income were not conducted timely.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief, CI: 1) modify existing guidance to include specific criteria regarding when operational and financial reviews are required, 2) develop a process to alert CI officials that operational and financial reviews are due, 3) strengthen controls to ensure that expenditures are properly and timely approved and documented, 4) strengthen procedures to protect the identity of undercover agents, and 5) ensure that the financial reviews of undercover operations with churning authority are requested within 90 calendar days after the undercover operation portion of the investigation is concluded.

IRS management agreed with our recommendations and plan to take corrective actions to address the recommendations.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 3, 2012

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

FROM: *Michael R. Phillips*
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Criminal Investigation Can Take Steps to
Strengthen Oversight of Its Undercover Operations
(Audit #201030037)

This report presents the results of our review to determine whether Criminal Investigation has effective policies and procedures to ensure undercover operations are properly monitored, expenses are appropriate, and any income earned is properly controlled. In addition, we evaluated the practices used to protect the safety of special agents working on undercover operations. This audit was included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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Abbreviations

CI	Criminal Investigation
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LEM	Law Enforcement Manual
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration



Criminal Investigation Can Take Steps to Strengthen Oversight of Its Undercover Operations

Background

Criminal Investigation's (CI) primary mission is to serve the American public by investigating potential criminal violations of the Internal Revenue Code (I.R.C.)¹ and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law. To accomplish its mission, CI uses undercover operations as an essential technique in the detection and investigation of criminal activity involving tax and money laundering offenses. An undercover operation is a law enforcement technique whereby a special agent, acting under an assumed identity, infiltrates a suspected criminal organization without the knowledge of the perpetrators for the purpose of acquiring evidence of criminal activity. CI has special agents who are trained in undercover techniques and are commonly referred to as undercover agents. In addition to the undercover agent(s) assigned to an undercover operation, other CI personnel, *i.e.*, cover agent, case agent, Supervisory Special Agent, and technical special agents, referred to as the undercover team, normally participate in the undercover operation.

CI's Office of Special Investigative Techniques has oversight responsibility for the approval and execution of all undercover operations. This responsibility includes recommending corrective actions to CI officials to address areas for improvement. Undercover operations are also subject to review during Review and Program Evaluations of each field office.

During Fiscal Years (FY) 2008 through 2010, CI closed ***2(f)*** undercover operations that expended ***2(f)*** in confidential expenditures. The majority of these undercover operations were classified as grand jury. An undercover operation categorized as grand jury has had evidence brought before a Federal grand jury to seek an indictment against the target(s) of the investigation. According to Rule 6(e) of the Federal Rules of Criminal Procedure, only those persons authorized have the ability to review evidence presented before the grand jury.² The Assistant United States Attorney's Office makes the final decision regarding individuals who are authorized access to grand jury information. In addition, authorized persons are prohibited from disclosing, to those that do not have authorized access, any evidence presented to the grand jury. Figure 1 provides information for the ***2(f)*** undercover operations by classification, *i.e.*, grand jury or non-grand jury, and the amount of confidential expenditures.

¹ See Appendix IV for glossary of terms.

² Federal Rules of Criminal Procedures, Rule 6(e).



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Figure 1: Closed FYs 2008 – 2010 Undercover Operations and Expenditures

Type	FY 2008		FY 2009		FY 2010		Total	
	#	Expenditures	#	Expenditures	#	Expenditures	#	Expenditures
Grand Jury	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*
Non-Grand Jury	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*
Total*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*	*2(f)*

Source: CI Headquarters files and the Criminal Investigation Management Information System.

Since Treasury Inspector General for Tax Administration (TIGTA) auditors are not authorized access to grand jury case information, we were limited to reviewing only non-grand jury undercover operations. In addition, we did not have access to the case files for **2(f)** of the **2(f)** non-grand jury undercover operations because the related investigations were ongoing. Ultimately, of the **2(f)** closed undercover operations, **2(f)** with confidential expenditures totaling ***2(f)*** were made available for our review. However, regardless of whether the classification of the undercover operation is grand jury or non-grand jury, CI procedures for conducting the undercover operation are the same. Because the procedures are the same, we believe our review of the **2(f)** non-grand jury undercover operations allows us to make an assessment of CI’s undercover operations.

For the **2(f)** non-grand jury undercover operation administrative case files and the **2(f)** cover agent case files we reviewed, the names of special agents and undercover agents were redacted. CI officials advised that agents’ true identity and undercover identity were redacted for safety and security concerns. The redactions of special agent and undercover agent names limited our ability to evaluate CI’s controls and oversight of undercover operations. The redactions also made it impossible to conduct our planned review of documentation to determine if special agents received training prior to being assigned to an undercover operation. Despite the redaction of special agent names, we were able to review information in the undercover operation case files to determine if special agents followed procedures to protect undercover identities. In addition, we reviewed training agenda and conducted anonymous interviews with undercover agents to discuss the adequacy of their training.

This review is a follow-up to two prior TIGTA reports. In our September 2001 report, we determined that undercover operations which earned income, *i.e.*, churning, were not consistently treating earned income to offset expenditures of the undercover operation.³ We recommended

³ TIGTA, Ref. No. 2001-10-174, *Financial Review of Criminal Investigation’s Group 1 Undercover Operations* (Sept. 2001).



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that the Chief, CI, issue guidance regarding the handling of income and expenses for churning purposes and reporting expenditures of applicable operations to Congress. In addition, CI was to ensure that guidance issued to account for funds used in undercover operations promotes accuracy, uniformity, and consistency in accounting for undercover operations. The Chief, CI agreed to implement these recommendations.

As part of our efforts to evaluate the effectiveness of corrective actions taken by CI in response to recommendations made in our September 2001 report, we attempted to review the (b) (7)(F) undercover operations that involved churning that were closed during FYs 2008 through 2010. Specifically, we planned to determine if CI adhered to congressional guidelines regarding the accounting of income and expenses. However, for (b) (7)(F) of the (b) (7)(F) undercover operations,⁴ the undercover and churning portions of the investigations were concluded prior to CI taking corrective actions in response to our report. Therefore, reviewing these undercover operations would not provide an assessment of the effectiveness of the corrective actions taken. Further, we did not review the remaining (b) (7)(F) undercover operations because results of so few undercover operations would not provide sufficient assurance to CI that the corrective actions were successfully implemented. As an alternative method to accomplish this test, we requested access to current investigations where the undercover operation portion of the investigation was concluded. We were advised that information from any ongoing investigation could not be provided because it could compromise the investigation. As a result, we could not determine if corrective actions taken to address previously identified internal control weaknesses over undercover operations with churning were effective. However, we were able to evaluate if the reviews of expenditures of churning operations were timely reported to Congress.

In our September 2002 report, we identified numerous instances where the identities of undercover agents' undercover entities were in jeopardy of being breached.⁵ We also determined that CI management needed to focus more attention on some categories of expenses because these expenses were unauthorized, unsupported, or unrelated to ongoing investigations. In addition, we found that periodic operational and financial reviews were not always performed as frequently as required. We made seven recommendations and the Chief, CI, responded that corrective actions would be taken to address the weaknesses found. These corrective actions included conducting training that emphasized security issues and implementing new procedures that emphasized the requirement to perform timely financial and operational reviews to identify potential security and identity breaches.

Our audit work was limited to investigations and undercover operations that were neither presented before the grand jury nor had grand jury implications. This review was performed at CI's National Headquarters Office in Washington, D.C., and CI field offices in (b) (7)(F),

⁴ *****1*****

⁵ TIGTA, Ref. No. 2002-10-196, *Criminal Investigation's Use of Confidential Funds for Undercover Operations Is Appropriate; However, Certain Aspects of Undercover Operations Need Improvement* (Sept. 2002).



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*****2(f)*****. We also contacted the Small Business/Self-Employed (SB/SE) Division personnel and discussed its process for auditing undercover operations that had churning income. Additionally, we met with four Federal law enforcement agency officials located in Washington, D.C., to discuss undercover operation best practices.

With exception to the scope limitations noted above, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Criminal Investigation's Policies and Practices Are Similar to Other Federal Law Enforcement Agencies

We met with officials from CI and four other Federal law enforcement agencies that carry out undercover operations to gain perspectives regarding the administration and oversight of undercover operations. Our meetings included discussions regarding undercover agent training and safety and security procedures. Representatives from the other Federal agencies expressed that they value CI's assistance because of the financial expertise CI special agents bring to an investigation. One Federal agency official indicated they conduct joint investigations with CI frequently and they have found CI to be an invaluable resource.

With the exception of one Federal agency that rarely conducts undercover operations, we found that the other three Federal law enforcement agencies' undercover operation policies and procedures have some similarities to CI's; however, CI's practices appear to be more thorough in some aspects. For example:

- One agency allows agents who have not received basic undercover training to participate in a minor role during an undercover operation.
- Another agency does not require periodic mandatory operational reviews unless triggered by circumstances of the operation.
- None of the agencies require independent headquarters oversight of every undercover operation.

We attribute these differences to the inherent differences in the types of crimes investigated and the overall mission of CI and the other Federal agencies. Figure 2 provides a comparison of oversight and training requirements for CI undercover operations and the three Federal agencies that conduct a significant number of undercover operations.



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Figure 2: Comparison of Oversight and Training Requirements for Undercover Operations Among Federal Law Enforcement Agencies

	Agency (x = agency has this policy)			
	Agency 1	Agency 2	Agency 3	CI
Agency requires a periodic operational review of undercover operations within a standardized time period.	X	X		X
Undercover agents receive basic undercover training before participating in a major role during an undercover operation.	X	X	X	X
Agency offers multiple levels of undercover training or specialization courses.	X	X	X	X
Headquarters oversight on every undercover operation.				X

Source: Discussions with CI and three other Federal law enforcement agencies.

Corrective Actions to Address Previously Identified Internal Control Weaknesses Were Not Sufficient

Due to the sensitive nature of criminal investigations, CI has detailed guidelines in the Internal Revenue Manual (IRM) governing how undercover operations should be approved, conducted, and monitored. The request to conduct an undercover operation is made by a field office’s Special Agent in Charge and is to include sufficient information for the approving official to evaluate the risks, potential benefits, and resources needed. A preoperational meeting is also required before any undercover activity on the investigation takes place. Further, any significant deviations from the objective or proposed plan of action may not be made without the approving official’s consent.

We reviewed the administrative case files for the ***2(f)***non-grand jury undercover operations that were closed during FYs 2008 through 2010 to determine if CI followed established Internal Revenue Service (IRS) procedures and internal controls to approve, conduct, and monitor undercover operations. We determined that requests for undercover operations were approved, preoperational meetings were conducted, and any extensions of time and deviations from original investigative plans were approved and documented as required. However, during our current review, we determined some of the previously reported deficiencies we identified in our FY 2002 report continue to exist. Specifically, operational reviews and financial reviews were not being timely conducted, and some expenditures that could be considered as questionable were not documented as being preapproved. Given the risks associated with undercover operations, stronger oversight would provide greater assurance that undercover operations were properly managed and the objectives were met. This includes ensuring that



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expenditures were reasonable, proper accounting procedures were followed, and Federal tax dollars were used in the most efficient manner to ensure the public's confidence in CI's investigative techniques.

Periodic operational and financial reviews were not always timely performed

In our FY 2002 review, we recommended CI officials reemphasize procedures to ensure that operational and financial reviews are timely performed. In response to our recommendation, CI officials stated they had implemented new procedures emphasizing the requirement to perform timely operational and financial reviews. The IRM requires that operational and financial reviews of all ongoing undercover operations should be conducted every 90 calendar days, at a minimum, and a final financial review at the conclusion of the undercover operation (referred to as the closing financial review). If either an operational or financial review is not conducted when required, a brief memorandum stating why should be substituted in the undercover operation case file.

The purpose of the operational and financial reviews is to ensure: 1) the undercover operation is being conducted within the authority of the plan, 2) managerial involvement is adequate, 3) the expenses are reasonable and necessary, and 4) proper accounting procedures are being followed. The Undercover Program Manager, assigned by the Office of Special Investigative Techniques to oversee each undercover operation, is responsible for determining when the review is required and for conducting the reviews. Our review of the ***2(f)*** administrative case files identified:

- ***2(f)*** (47 percent) of the required ***2(f)*** periodic operational reviews were conducted or an explanatory memorandum was placed in the file stating why it was not conducted.⁶
- ***2(f)*** (42 percent) of the required ***2(f)*** periodic financial reviews and ***2(f)*** (86 percent) of the ***2(f)*** closing financial reviews were conducted.⁷

The IRM does not define the circumstances when an operational review is not required, which could lead to varying interpretations of whether, or when, a review is needed. Similarly, the absence of financial reviews may have been due to CI field personnel interpretations regarding when reviews are required because the Law Enforcement Manual (LEM) for Undercover Operations does not specify when the 90-calendar-day time period is to start. When either type

⁶ ***2(f)*** undercover operations were closed within 90 calendar days and were not required to have an operational review. To determine the number of required operational reviews for the ***2(f)*** remaining undercover operations, we used the date of the preoperational meeting through the date the undercover operation was closed to calculate the number of 90-calendar-day periods for each undercover operation.

⁷ To determine the number of required financial reviews, we used the date of the preoperational meeting through the date the undercover operation was closed to calculate the number of 90-calendar-day periods for each undercover operation.



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of review is not timely completed, it is difficult for CI to have assurance that undercover operations are being properly managed and meeting operational objectives.

Not all confidential expenditures were properly preauthorized

In our FY 2002 review, we recommended that CI officials provide more emphasis on reviewing expenses related to the undercover operation for proper authorization and documentation. In response to our recommendation, CI officials stated they issued a reference guide governing the documentation necessary to obtain, review, and approve confidential expenditures. CI officials also planned to use operational reviews to ensure the appropriate authorization and documentation of expenditures were in the undercover operation case files.

CI approves and establishes funding to support undercover operations through investigative imprest funds for such things as purchasing necessary and approved items and services for completing the undercover portion of the investigation. Each disbursement of the approved funding is to be properly authorized and documented. Any unused funds are required to be returned to the imprest fund.

To evaluate the effectiveness of field office oversight procedures to account for and control expenditures, we reviewed the cover agent case files for ***2(f)*** of the ***2(f)*** undercover operations to determine whether the approximately ***2(f)*** in confidential expenditures were authorized, approved, and documented. We found that most confidential expenditures appeared to have been appropriate and were well documented. However, the following examples identified where additional oversight may have been needed to reduce the risk of expenditures being unauthorized or inappropriate due to the lack of documentation in the cover agent case files and to ensure cover agents adhere to procedures. Specifically,

- *****1*****2(f)*****
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*****1*****2(f)*****
*****1*****2(f)*****
- *****1*****2(f)*****
*****1*****2(f)*****
*****1*****2(f)*****
*****1*****2(e)*****.
- *****1*****2(f)*****
*****1*****2(f)*****
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- *****1*****2(f)*****
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When confidential expenditures are not properly preauthorized and reviewed, the risk of misappropriation increases and can result in funds not being available for other authorized Government use. For example, if CI had conducted a timely financial review as required, the \$20,000 check that had not been negotiated would have been discovered and would have been timely returned. Timely return of unused funds ensures accountability and availability for other authorized Federal Government use.

Recommendations

To address previously identified control weaknesses, the Chief, CI, should:

Recommendation 1: Modify existing IRM and LEM procedures to include specific criteria stating when operational and financial reviews are not required to be performed. Also, define a specific starting point for the 90-calendar-day period when operational and financial reviews are first required to be conducted, *e.g.*, 90 calendar days after the preoperational meeting.

Management's Response: IRS management agreed with this recommendation. The Office of Special Investigative Techniques will modify existing IRM 9.4.8.11 to include a specific starting date for the 90-calendar-day period when operational and financial reviews are first required to be conducted.

Recommendation 2: Develop a monitoring process to ensure the Undercover Program Manager, cover agent, and Supervisory Special Agent are alerted and timely complete all required operational and financial reviews.

Management's Response: IRS management agreed with this recommendation. The Office of Special Investigative Techniques will develop an internal monitoring process to ensure the Undercover Program Manager, cover agent, and Supervisory Special Agent are alerted and timely complete all required operational and financial reviews. This monitoring process will utilize a new Special Investigative Techniques-CI Management Information System report which will indicate the due dates of reports and will be used by Headquarters personnel to alert the appropriate field personnel to timely complete all required operational and financial reviews.

Recommendation 3: Strengthen controls to ensure all undercover expenditures are properly and timely approved and documented. This includes ensuring that the purchase of personal



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items are properly accounted for and controlled in CI inventory and that any extraordinary travel expenses are preapproved and documented.

Management's Response: IRS management agreed with this recommendation; however, they believe the controls are already in place and included in their established Pre-Operational Meeting Checklist and IRM 9.4.8 and 9.11.1. Nevertheless, the Director, Operations, Policy and Support, agreed to issue a memorandum to all Special Agents in Charge and Undercover Program Managers reemphasizing the importance of following the established procedures and checklists.

Undercover Training Has Improved, but Opportunities Exist to Reduce the Risk of Undercover Agents Being Identified

CI procedures emphasize that the safety and security of undercover identities is the most important component in managing and executing CI undercover operations. It is imperative that, when conducting undercover operations, there be no link between the undercover and true identities of the undercover agent. In our FY 2002 review, we reported numerous instances where the identities of undercover agents were in jeopardy of being breached. Many of these security lapses resulted when the true identities were shown on travel documents and financial records. In response to our recommendation to increase awareness about security issues and potential identity breaches, CI management stated they would conduct training to emphasize security issues and conduct operational reviews to monitor and identify potential security breaches.

CI's training incorporated safety and security of undercover agents

CI's procedures emphasize that standardized training will be provided for all undercover agents. CI officials stated they were extremely proud of CI's undercover training program and believe each undercover agent has had sufficient training and is adequately prepared for each assignment. For example, CI officials stated new training has been developed that incorporates and requires attendees to assume the role of their undercover identity during the training class. This change is considered a proactive step to assist undercover agents in adapting to being undercover and to develop a level of comfort using their fictitious name and background story to support their undercover persona.

Part of the training is also dedicated *****2(d)*****
*****2(d)*****. We reviewed an agenda from the most recent training class for undercover agents and confirmed the topics addressed included: *****2(d)*****
*****2(d)*****
*****2(d)*****
*****2(d)*****. We were unable to



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determine if undercover agents received training prior to their assignments because neither the names of special agents nor training records were provided. However, CI officials assured us that all undercover agents had received the required training.

We also conducted telephone interviews with four anonymous undercover agents about their training. All four agents stated the training they received adequately prepared them for their undercover roles. In addition, each individual stated safety and security, and the protection of identities, were stressed throughout the training. However, three of the four agents believed periodic refresher training would be beneficial. Also, one of the agents indicated that additional training on the financial aspects of the undercover operation would be helpful.

Steps can be taken to protect the identity of undercover agents

We were unable to determine if the security lapses identified in our FY 2002 review were recurring due to the redaction of information in undercover operation case files provided to us for review. For example, in some instances, CI redacted all names (including those that did not have undercover identities), phone numbers, and addresses contained in the file. As a result, we could not adequately evaluate the effectiveness of corrective actions, established procedures, and internal controls designed to protect the identity of special agents.

However, observations during this review identified that the risk of an undercover agent's name being compromised continues to exist because undercover and case agents did not always adhere to security protocol. During our review of undercover operation case files and discussions with special agents, we identified the following areas where CI can take steps and strengthen existing internal controls to ensure the identities of undercover agents are not compromised.

For **2(f)** (14 percent) of the **2(f)** undercover operations reviewed, existing procedures designed to ensure the safety and security of undercover agents were not followed. For example, we believe these instances, from the **2(f)** undercover operations described below, are situations where undercover agents put themselves and the undercover operation at risk:

- *****1*****2(f)*****
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- *****1*****2(f)*****
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*****1*****2(f)*****



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*****1*****2(f)*****
*****1*****2(f)*****
*****1*****2(f)*****. CI officials added
that the chance of a link between an undercover agent and CI employees being detected
in situations such as these examples is unlikely. *****1*****2(f)***
*****1*****2(f)*****. ***1*****
*****1*****2(e)*****
*****1*****2(e)*****
*****1*****2(e)*****.

We recognize that there may be factors that necessitate deviations from established procedures and protocol. However, since the deviations above relate to risks that could compromise the identity of the undercover agents and the undercover operation, we believe approvals for the deviation should have been documented. Although our review of undercover operation case files did not identify any actual security breaches resulting from the instances noted above, when security is not maintained at the highest possible level, the risk of detection is increased and identities can be compromised.

Recommendation

Recommendation 4: To address previously identified control weaknesses, the Chief, CI, should emphasize procedures to ensure special agents take the necessary steps to reduce the risk of their undercover identity being breached. This includes ensuring deviations from LEM procedures are approved and documented in undercover operation case files.

Management’s Response: IRS management agreed with this recommendation. An appropriate memorandum will be prepared for the field clarifying and emphasizing IRM and LEM requirements. Additionally, the Pre-Operational Meeting Checklist will be changed and clarified to emphasize procedures to ensure special agents take the necessary steps to reduce the risk of their undercover identity being breached.

Financial Data From Undercover Operations That Earned Income Were Not Timely Provided for Review

The IRS’s SB/SE Division is responsible for conducting financial reviews of undercover operations that were authorized to churn funds. The purpose of these reviews is to provide Congress and CI officials with assurance that the financial records fairly represent the results of the operations. Specifically, upon the closing of an undercover operation that involved churning, the I.R.C. requires the IRS to conduct a detailed financial review and submit the results in writing to the Secretary of the Treasury, and report to Congress, no later than 180 calendar days after the undercover operation is closed. According to the I.R.C., the term “closed” means the



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date on which the latter of the following occurs: all criminal proceedings are concluded or all covert activities are concluded. However, during Calendar Year 2006, CI instituted procedures that acknowledged the related criminal proceedings might take several years to conclude. The procedures recognized the need for the financial review to be conducted soon after the undercover portion of the investigation was completed.

During FY 2010, CI requested that the SB/SE Division perform financial reviews of ***2(f)*** undercover operations that were authorized to churn funds. The ***2(f)*** reviews were completed in an average of 988 calendar days (ranging from 768 to 1,247 calendar days) after the undercover portion of the investigation was completed. Based on discussions with CI and SB/SE Division personnel, we determined the extended length of time to complete these reviews occurred because CI did not timely refer these undercover operations to SB/SE Division for review.

According to the procedures established in Calendar Year 2006, undercover operations are to be referred for review within 90 calendar days after the conclusion of undercover activity. We believe the effectiveness of these reviews is greatly diminished when not conducted in closer proximity to the events of the undercover operation and, therefore, the reviews may not provide CI, the Secretary of the Treasury, or Congress with an accurate determination on whether undercover operations were conducted in adherence with congressional guidelines.

Recommendation

Recommendation 5: The Chief, CI, should strengthen controls to ensure the financial review of undercover operations with churning authority are requested within 90 calendar days after the undercover operation portion of the investigation is concluded.

Management's Response: IRS management agreed with this recommendation. The Office of Special Investigative Techniques will develop an internal monitoring process to ensure the financial review of undercover operations with churning authority is requested within 90 calendar days after the undercover operation portion of the investigation is concluded. Headquarters CI personnel will alert the appropriate field personnel to timely complete the financial review of undercover operations with churning authority.



Appendix I

Detailed Objectives, Scope, and Methodology

This review was a follow-up to our FYs 2001 and 2002 reviews of CI's undercover operations.¹ The overall objective was to determine whether CI has effective policies and procedures to ensure undercover operations are properly monitored, expenses are appropriate, and any income earned is properly controlled. In addition, we evaluated the practices used to protect the safety of special agents working on undercover operations. To accomplish our objectives, we:

- I. Determined whether corrective actions to address recommendations made in prior reports² were implemented and are effective.
- II. Determined if CI established effective internal controls to approve, monitor, and track undercover operations.
 - A. Reviewed IRM and LEM guidance and identified applicable procedures regarding the approval, monitoring, and closing of undercover operations.
 - B. Determined if CI provided effective oversight of undercover operations by reviewing the population of **2(f)** non-grand jury undercover operations out of the total **2(f)** grand jury and non-grand jury undercover operations that were closed during FYs 2008 through 2010. We reviewed the undercover operation administrative case files to determine if those contained evidence of proper approval, preoperational meetings, operational and financial reviews, and closing reports.
- III. Evaluated the effectiveness of field office procedures for conducting undercover operations, and accounting for and controlling confidential expenditures.
 - A. Judgmentally selected the following four of the 26 field offices with closed non-grand jury undercover operations during FYs 2008 through 2010 for site visits:
*******2(f)*******
2(f). Selection factors were 1) location of the field office, 2) amounts of approved and actual expenditures, 3) amount of recoverable funds, 4) undercover operation category, and 5) length of time the undercover operation was open. At these **2(f)** field offices, **2(f)** of the **2(f)** non-grand jury undercover

¹ See Appendix IV for glossary of terms.

² TIGTA, Ref. No. 2001-10-174, *Financial Review of Criminal Investigation's Group 1 Undercover Operations* (Sept. 2001) and TIGTA, Ref. No. 2002-10-196, *Criminal Investigation's Use of Confidential Funds for Undercover Operations Is Appropriate; However, Certain Aspects of Undercover Operations Need Improvement* (Sept. 2002).



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- operations were conducted. We used judgmental sampling because we did not intend to project any of our results.
- B. At the **2(f)** field offices, reviewed the cover agent case files for **2(f)** of the **2(f)** non-grand jury undercover operations to evaluate the appropriateness of confidential expenditures and determine if any capital item expenditures were properly controlled in inventory.
 - C. Interviewed eight cover agents, four anonymous undercover agents, and one Undercover Program Manager to discuss their roles and responsibilities for ensuring undercover operations were conducted in accordance with CI's guidelines and procedures.
 - D. Determined if CI field offices adhered to IRM guidelines for closing undercover operations.
- IV. Discussed with SB/SE Division officials the process for conducting financial reviews of undercover operations that involved churning. This included determining the length of time it took to conduct the **2(f)** financial reviews during FY 2010.
- V. Evaluated CI's procedures to protect the safety of undercover agents or undercover entities.
- A. Determined what actions the Office of Special Investigative Techniques had taken to increase undercover agent awareness regarding security, safety, and steps to reduce the risk of identity breaches.
 - B. Interviewed personnel from Step III. C. and discussed the procedures used to ensure the safety of the undercover agent and others involved in the undercover operation.
 - C. Interviewed representatives from CI and four other Federal law enforcement agencies and discussed the procedures and practices used to protect the safety and confidentiality of undercover agents.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: CI's policies, procedures, and practices relating to undercover operations. We evaluated these controls by interviewing CI and SB/SE Division staff, analyzing data related to undercover operations, and reviewing the administrative undercover operation case files and imprest fund files for selected undercover operations.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
Deputy Chief, Criminal Investigation SE:CI
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Operations Policy and Support, Criminal Investigation SE:CI:OPS
Director, Strategy, Criminal Investigation SE:CI:S
Director, Special Investigative Techniques, Criminal Investigation SE:CI:OPS:SIT
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Chief, Criminal Investigation SE:CI:S:PS
 Chief, GAO/TIGTA/Legislative Implementation, Small Business/Self-Employed
 Division SE:S:CLD:PSP:GTL



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Appendix IV

Glossary of Terms

Administrative Case Files – Files maintained by the Office of Special Investigative Techniques for each undercover operation containing the request(s) for approval, preoperational meeting documentation, operational and financial reviews, and closing report.

Assistant United States Attorneys – As attorneys for the Federal Government, Assistant United States Attorneys are responsible to the United States Attorney for the performance of duties assigned by that official. The United States Attorney serves as the chief law enforcement officer in each judicial district and is responsible for coordinating multiple agency investigations within that district.

Case Agent – Special agent who conducts the overall criminal investigation associated with the undercover operation.

Churning Income – Income earned during an undercover operation. The IRS has the authority to use income earned from undercover operations to offset necessary and reasonable expenses incurred pursuant to the undercover activities.

Confidential Expenditures – Costs and expenses associated with conducting an undercover operation. Advances for these expenditures are obtained from the imprest fund cashier.

Cover Agent – Special agent who serves as the direct link to the undercover agent and is the individual primarily responsible for the safety of the undercover agent.

Field Office – Offices within the four CI geographical areas throughout the country with boundaries that range from a portion of a single State to multi-State areas.

Fiscal Year – A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Grand Jury – A grand jury is established to hear testimony to determine whether there is probable cause to believe the person to be indicted committed the crime in question. The grand jury adheres to the strictest of secrecy, and violators are subject to severe penalties.

Imprest Fund – An imprest fund represents cash advanced to a duly authorized cashier and is charged against a Government appropriation account.

Internal Revenue Code – Federal tax law begins with the I.R.C., enacted by Congress in Title 26 of the United States Code. It is the main body of domestic statutory tax law of the



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United States organized topically, including laws covering the income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.

Operational Review – A review to ensure that the undercover operation is being conducted in compliance with the stated objectives, plan of action, and conditions as approved by the Chief, CI.

Preoperational Meeting – At the initiation of the undercover operation, the long- and short-term objectives of the undercover operation are reviewed and the operational plan is discussed. Participants are to openly discuss their concerns, and conflicts must be resolved.

Recoverable Funds – Advances of funds which are issued for use in an undercover operation that are expected to be returned in full when the investigation is completed; *e.g.*, funds which are to be laundered through a bank.

Review and Program Evaluation – Independent review conducted by CI's Office of Strategy and field personnel to assess CI operations and managerial effectiveness. It ensures alignment with CI's Compliance Strategy and IRS internal standards.

Special Agent – A law enforcement employee who investigates potential criminal violations of the tax laws and related financial crimes.

Special Agent in Charge – A law enforcement employee responsible for directing, monitoring, and coordinating the criminal investigation activities within a field office's area of responsibility.

Supervisory Special Agent – A supervisory law enforcement employee who oversees the overall criminal investigation, including the undercover operation.

Undercover Agent – A special agent who assumes a covert identity or purpose who takes action to gain evidence or information which would be unavailable but for the target's reliance on the undercover agent's covert role.

Undercover Program Manager – Operating out of the Office of Special Investigative Techniques and assigned to a geographic area, an Undercover Program Manager is responsible for 1) providing advice to the Director, Field Operations, for all special investigative techniques for which the Director, Field Operations, has approval authority, 2) maintaining administrative control of undercover agents assigned to the area, 3) monitoring and providing support and assistance to all undercover operations in their assigned areas, 4) participating in preoperational meetings prior to the initiation of the undercover operation and post-operational meetings at the conclusion of the undercover operation, and 5) conducting reviews of undercover operations within the area.



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Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CRIMINAL INVESTIGATION

January 13, 2012

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Rick A. Raven /s/ Patricia J. Haynes
Acting Chief, Criminal Investigation (SE:CI)

SUBJECT: Response to Draft Audit Report - Criminal Investigation Can Take Steps to Strengthen
Oversight of Its Undercover Operations (Audit #201030037)

Criminal Investigation's (CI) primary mission is to serve the American public by investigating potential criminal violations of the Internal Revenue Code (I.R.C.) and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law. To accomplish its mission, CI uses undercover operations as an essential technique in the detection and investigation of criminal activity involving tax and money laundering offenses.

Criminal Investigations - Office of Special Investigative Techniques (SIT) has oversight responsibility for the approval and execution of all undercover operations. This responsibility includes recommending corrective actions to CI officials to address areas for improvement. During Fiscal Years (FY) 2008 through 2010, CI closed *****2(f)***** undercover operations that expended *****2(f)******* in confidential expenditures.

The overall objective of your review was to determine if CI has effective policies and procedures to ensure undercover operations are properly monitored, expenses are appropriate, and any income earned is properly controlled. In addition, your review evaluated the practices used to protect the safety of special agents working on undercover operations.

Your report recognizes that other Federal law enforcement agencies respect CI's undercover program because of the financial expertise CI special agents bring to a joint investigation. Your report also found that CI's undercover practices are more thorough in some aspects than other Federal agencies.

During this past year, SIT has worked to enhance CI's Undercover Program while proactively responding to emerging income tax related and money laundering trends. I want to assure you that CI will continue to strengthen and improve what your report recognizes as an Undercover Program that is respected in the law enforcement community.



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Our comments on the specific recommendations in this report are as follows:

IDENTITY OF RECOMMENDATION #1

Modify existing Internal Revenue Manual (IRM) and Law Enforcement Manual (LEM) procedures to include specific criteria stating when operational and financial reviews are not required to be performed. Also, define a specific starting point for the 90-calendar-day period when operational and financial reviews are first required to be conducted, e.g., 90 calendar days after the preoperational meeting.

CORRECTIVE ACTION

We agree with this recommendation. Special Investigative Techniques will modify the existing IRM Section 9.4.8.11 to include a specific starting date for the ninety (90) calendar day period when operational and financial reviews are first required to be conducted.

IMPLEMENTATION DATE

September 15, 2012

RESPONSIBLE OFFICIAL

Director, Operations, Policy and Support, Criminal Investigation

CORRECTIVE ACTION (S) MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management system of controls.

IDENTITY OF RECOMMENDATION #2

Develop a monitoring process to ensure the Undercover Program Manager, cover agent, and Supervisory Special Agent are alerted and timely complete all required operational and financial reviews.

CORRECTIVE ACTION

We agree with this recommendation. Special Investigative Techniques will develop an internal monitoring process to ensure the Undercover Program Manager, Cover Agent, and Supervisory Special Agent are alerted and timely complete all required operational and financial reviews. This monitoring process will utilize the new SIT-Criminal Investigation Management Information System (CIMIS) report INV-053. The report INV-053, called SIT-Listing, will indicate the due dates of reports and will be used by Headquarters (HQ) personnel to alert the appropriate field personnel to timely complete all required operational and financial reviews.

IMPLEMENTATION DATE

July 15, 2012

RESPONSIBLE OFFICIAL

Director, Operations, Policy and Support, Criminal Investigation



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CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management system of controls.

IDENTITY OF RECOMMENDATION #3

Strengthen controls to ensure all undercover expenditures are properly and timely approved and documented. This includes ensuring that the purchase of personal items are properly accounted for and controlled in CI inventory and that any extraordinary travel expenses are preapproved and documented.

CORRECTIVE ACTION (S)

We agree with this recommendation. However, we believe the controls are already in place and included in our established Pre-Operational Meeting check list and IRM sections 9.4.8 and 9.11.1. The checklist and IRM sections specifically address the requirements that are to be followed if the purchase of personal items is necessary, and how these items are to be properly accounted for and controlled in CI inventory. The checklist also specifies how any extraordinary travel expenses are to be preapproved and documented. The Director, Operations, Policy and Support will issue a memorandum to all Special Agents in Charge and Undercover Program Managers reemphasizing the importance of following the established procedures and checklists.

IMPLEMENTATION DATE

July 15, 2012

RESPONSIBLE OFFICIAL

Director, Operations, Policy and Support, Criminal Investigation

CORRECTIVE ACTION (S) MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management system of controls.

IDENTITY OF RECOMMENDATION #4

To address previously identified control weaknesses, the Chief, CI, should emphasize procedures to ensure special agents take the necessary steps to reduce the risk of their undercover identity being breached. This includes ensuring deviations from LEM procedures are approved and documented in undercover operation case files.

CORRECTIVE ACTION

We agree with this recommendation. An appropriate memorandum will be prepared for the field clarifying and emphasizing IRM and LEM requirements. Additionally, the Pre-Operational Meeting check list will be changed and clarified to emphasize procedures to ensure special agents take the necessary steps to reduce the risk of their undercover identity being breached.

IMPLEMENTATION DATE

July 15, 2012



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RESPONSIBLE OFFICIAL

Director, Operations, Policy and Support, Criminal Investigation

CORRECTIVE ACTION (S) MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management system of controls.

IDENTITY OF RECOMMENDATION #5

The Chief, CI, should strengthen controls to ensure the financial review of undercover operations with churning authority are requested within 90 calendar days after the undercover operation portion of the investigation is concluded.

CORRECTIVE ACTION

We agree with this recommendation. Special Investigative Techniques will develop an internal monitoring process to ensure the financial review of undercover operations with churning authority are requested within 90 calendar days after the undercover operation portion of the investigation is concluded. Headquarters, IRS-CI personnel, will alert the appropriate field personnel to timely complete the financial review of undercover operations with churning authority.

IMPLEMENTATION DATE

July 15, 2012

RESPONSIBLE OFFICIAL

Director, Operations, Policy and Support, Criminal Investigation

CORRECTIVE ACTION (S) MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management system of controls.