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TREASURY FORFEITURE FUND

***ANNUAL REPORT
FISCAL YEAR 1996***



**DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.**

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Washington, D.C.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

Department of the Treasury
Office of the Under Secretary
Washington, DC

TO TREASURY LAW ENFORCEMENT:

Fiscal year 1996 marked the fourth year of operation for the Department of the Treasury's Forfeiture Fund. During these years, the Fund has taken in hundreds of millions of dollars in receipts and disbursed comparable amounts according to the various payment categories authorized by law. In doing this, the Fund has served a very valuable purpose. It has taken profit out of crime and turned it back to constructive societal use. It has provided significant resources not only for Treasury law enforcement but also for federal, state and local police agencies throughout the United States and for those foreign governments who have assisted our international investigations.

We have a double obligation to manage wisely the costs related to our forfeiture program. First, these expenses are paid from the public monies of the Fund and American citizens deserve sound financial management. Second, holding down direct costs leaves additional monies available to support and strengthen law enforcement. The financial statements of the Fund, along with their notes and accompanying reports and exhibits, are a measure of how we have performed in meeting that obligation.

This annual report also looks at the four goals of the Treasury forfeiture program and some related occurrences and achievements. Protecting individual rights, deterring crime, promoting cooperation and strengthening law enforcement guide the actions of forfeiture program personnel each day. All the Fund has accomplished in the past fiscal year and since its inception is a tribute to all the women and men of Treasury law enforcement, to their dedication, to their service and to their sacrifice. It merits the public's trust and my gratitude.

RAYMOND W. KELLY
Under Secretary (Enforcement)

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Table of Contents

Page No.

Section I: Overview

| | |
|--|----|
| Chapter 1 | |
| Safeguarding Individual Rights | 1 |
| Chapter 2 | |
| Deterring Criminal Activity | 4 |
| Chapter 3 | |
| Fostering Law Enforcement Cooperation | 8 |
| Chapter 4 | |
| Strengthening Law Enforcement | 12 |
| Chapter 5 | |
| Program Performance and Financial Highlights | 16 |

Section II: Financial Statements

| | |
|--|----|
| Independent Auditor's Report on Financial Statements | 24 |
| Financial Statements: | |
| Statement of Financial Position | 26 |
| Statement of Operations and Changes in Net Position | 28 |
| Notes to Financial Statements | 30 |

Section III: Independent Auditor's Reports on Compliance and Internal Control Structure

| | |
|--|----|
| Independent Auditor's Report on Compliance | 43 |
| Independent Auditor's Report on Internal Control Structure | 45 |
| Exhibit I. Material Weaknesses | 49 |
| Exhibit II. Reportable Conditions | 54 |

Section IV: Supplemental Financial and Management Information 57

SECTION I
OVERVIEW

CHAPTER 1

SAFEGUARDING INDIVIDUAL RIGHTS

The Department of the Treasury's Forfeiture Fund (Treasury Forfeiture Fund or the Fund) was established by the Treasury Forfeiture Fund Act of 1992, also known as Public Law 102-393 and codified at 31 USC 9703. With its creation, all Treasury law enforcement organizations were consolidated under a single forfeiture fund program administered by the Department of the Treasury. Before the Treasury Forfeiture Fund came into being, the Bureau of Alcohol, Tobacco and Firearms, the Internal Revenue Service and the United States Secret Service were members of the Asset Forfeiture Fund of the Department of Justice. The U.S. Customs Service had had its own forfeiture fund, into which deposits of all Customs and U.S. Coast Guard forfeitures were made. Today, the Treasury Forfeiture Fund is a Departmentwide fund servicing the forfeiture program needs of all Treasury enforcement bureaus.

As a repository for the value of all non-tax forfeitures made pursuant to laws enforced or administered by the Department of the Treasury, the Fund has become an increasingly valuable source of resources for law enforcement efforts. Its monies are invested in a variety of ways to support law enforcement at all levels of government. The funding provided is used to defray the direct expenses of seizure and forfeiture incurred by Treasury law enforcement in the daily pursuit of its mission, or more generally used to support the Treasury forfeiture program. Additionally, the statutory authorities of the Fund permit it to serve law enforcement agencies and police departments throughout the United States and internationally as well.

Forfeiture has been an authority of law enforcement that dates back to the earliest days of the American Republic. In the last dozen years, however, Congress has developed and expanded forfeiture to address the many varied manifestations of sophisticated, modern and financially profitable crime. By enabling federal law enforcement to go

after the proceeds and instrumentalities of crime, asset forfeiture has evolved to the point where it strikes at the very core of criminal organizations and has become an essential part of an overall law enforcement strategy. By relentlessly focusing on the profitability of crime, it is a very powerful enforcement tool keeping pace with evermore well-financed and internationalized criminal groups.

Despite this recent and accelerated evolution, the effectiveness of asset forfeiture still rests fundamentally upon public confidence in the integrity of the program. In this vein, safeguarding individual rights has been a goal in the administration of the Treasury Forfeiture Fund since its inception. That asset forfeiture not transgress upon rights guaranteed by the Constitution of the United States is essential, if this law enforcement resource is to merit the public trust. In 1996, a most significant issue involving civil asset forfeiture and the matter of double jeopardy was addressed by the Supreme Court of the United States.

Prelude to the Supreme Courts Ruling on Double Jeopardy

Civil forfeitures proceed against property rather than persons. Often they are the only available means by which the government can confiscate the instrumentalities of crime. When the leaders of drug cartels are outside of the United States and beyond the reach of extradition laws, when a pilot smuggles drugs in a plane owned by another, when tenants use a residence for the sale and consumption of drugs with the knowledge of the landlord, civil forfeiture is the law enforcement tool that allows the properties involved to be taken by the government. Criminal forfeiture, on the other hand, proceeds against a person and requires a criminal trial and a conviction. It can only target property that is owned by the defendant. If the aircraft's pilot, the vessel's captain, or the drug courier carrying the satchel full of cash is not the owner, then criminal forfeiture is not effective by itself. Together, civil and criminal

forfeitures complement each other and provide for a comprehensive response to the modern criminal challenge.

This traditional working together of civil and criminal forfeiture as effective law enforcement resources was seriously questioned by rulings of the United States Court of Appeals for the Sixth and Ninth Circuits, holding that a criminal prosecution and a civil forfeiture action for the same offense violated the double jeopardy clause of the fifth amendment to the United States Constitution. In the Sixth Circuit case, *United States v. Ursery*, the defendant had agreed to pay cash in lieu of forfeiting real property that had been involved in the production of marijuana. Afterwards, the defendant was convicted on criminal drug charges and sentenced to prison. The Court of Appeals for the Sixth Circuit held that any civil forfeiture under the federal drug statute in this case was punishment for double jeopardy purposes. In the Ninth Circuit case, *United States v. \$405,089.23 in United States Currency*, the government had obtained indictments against the defendants for trafficking in methamphetamines and money laundering when it filed a separate civil forfeiture action against the proceeds of the narcotics offenses. That civil action was stayed until the conclusion of the criminal case, when the district court entered a summary judgement of forfeiture for the government. Similar to the *Ursery* case, the Court of Appeals for the Ninth Circuit held that all civil forfeitures constitute punishment and, therefore, are barred by an earlier criminal prosecution of the property owner.

Treasury law enforcement bureaus would have been faced with significant difficulties enforcing the forfeiture provisions under their jurisdictions if the determination that a civil forfeiture action and a criminal prosecution for the offense violated the double jeopardy clause was allowed to stand. Forfeiture as a critical enforcement tool in the battle against narcotics and weapons trafficking, smuggling, financial institution fraud and money laundering would have been severely limited. The Department of Justice's Solicitor General filed a petition for certiorari on August 28th, 1995, and just over four months later the Supreme Court agreed to

review these rulings of the Sixth and Ninth Circuit Courts of Appeals.

The Government's Case

The government based its case that parallel criminal convictions and civil *in rem* forfeitures do not violate the double jeopardy clause of the fifth amendment on five key arguments:

- Civil *in rem* forfeiture, that is a forfeiture against the thing or the property, does not place a defendant in jeopardy. As a civil sanction, it does not violate the prohibition against multiple prosecutions.
- Although defendants should have an expectation of finality in a criminal judgement, such an expectation is not disturbed by a civil forfeiture proceeding because the government is not seeking to increase a sentence with which it is dissatisfied. Since the defendants were not in double jeopardy in the civil forfeiture, there can be no double jeopardy situation in a subsequent criminal prosecution.
- All forfeitures are not punishments and to categorically declare them so is incorrect. Forfeiting property that facilitates criminal activity serves a traditional remedial purpose, encouraging owners to take care of the use of their property. Forfeiting other property that represents the proceeds of crime is designed to take the profit out of criminal activity, prevent unjust enrichment, and serves a remedial rather than a punitive goal.
- Double jeopardy becomes an issue if a defendant is prosecuted and punished more than once for the same crime. This key element of sameness is lacking in this case. Even if one grants that civil forfeiture involves an offense, it is not the same offense that leads to a conviction in the related criminal case because the elements of the involved offenses differ. In the civil forfeiture, it is only necessary to prove that the property played a role in the commission of the crime, while in the criminal case, it is necessary to

prove that the property owner knowingly committed the crime to obtain a conviction.

- Even if forfeitures constitute punishment, the civil and criminal sanctions should be considered as part of a single proceeding for purposes of the double jeopardy clause. Because the government does not seek further punishment, the defendant's legitimate expectation of finality in the criminal judgement is not infringed. The conduct of the government reveals a design to seek civil and criminal sanctions in parallel and contemporaneous proceedings.

The Decision of the Court

By the end of June of 1996, the Supreme Court had delivered an 8-1 opinion, written by Chief Justice Rehnquist, reversing the earlier decisions of both the Sixth Circuit in *U.S. v. Ursery* and the Ninth Circuit in *U.S. v. \$405,089.23 in United States Currency*. This decision that civil forfeitures do not constitute punishment for the purposes of the double jeopardy clause ended some two years of uncertainty over just how double jeopardy arguments would affect the most commonly used civil forfeiture statutes.

One foundational point that the Court noted in its opinion, was that the United States has had a long history of proceeding against property through civil *in rem* forfeiture while still bringing criminal charges against the person alleged to have committed the underlying crime. When the Court referred to this historical practice of the United States, mentioning a statute enacted as early as 1789, it was referencing the civil forfeiture authorities used by the Customs Service and Treasury law enforcement since the very founding of our constitutional Republic. This evidence of what the Court called a "longstanding legislative practice" went far towards proving that it was not violative of the protection the Constitution affords individuals against double jeopardy.

Safeguarding the Rights of Individuals

The Supreme Court's decision in this case endorsed federal forfeiture laws as well as federal law

enforcement practices in conformity with those laws. A serious challenge to federal forfeiture was overcome partly because of the lengthy history of forfeiture in the United States but also partly because modern federal law enforcement has carefully applied these substantial authorities to achieve their Congressionally intended purpose - to take the profit out of crime.

The Department of the Treasury's forfeiture program, with its additional support from the resources of the Treasury Forfeiture Fund, recognizes its obligation to observe and respect the rights of affected persons in matters of seizure and forfeiture. That forfeiture authorities always be applied in a fair and even manner, that innocent parties not be deprived of their property, and that no one with a legitimate interest in property be denied the opportunity to protect that interest, are all constant considerations in the administration of the program. In 1996, this goal continued to fundamentally guide Treasury forfeiture activities while the nation's highest court reached a key decision on the suitability of this law enforcement tool in a constitutionally protected society.

CHAPTER 2

DETERRING CRIMINAL ACTIVITY

July of 1789 was a notable month in Customs legislative history. In the course of those thirty-one days, three significant pieces of legislation were passed by the First Congress. One was the Tariff Act of July 4th, followed closely by a duties and tonnage statute mandating a revitalized national Customs Service, and finally, on the last day of the month, an act establishing fifty-nine customs districts in eleven states. Together, these three laws formed the initial basis of a federal enforcement presence aimed at protecting the economic health of the United States and deterring crime that has been vested in the Department of the Treasury for more than two centuries.

Over the years, Treasury enforcement responsibilities have evolved and grown to meet the developing needs of the nation. Today's Internal Revenue Service had its earliest beginnings during the Civil War when the first income tax was imposed to help finance the war effort. At the close of that conflict in April of 1865, one of President Lincoln's last official acts before his death was to establish the United States Secret Service in order to combat the wartime flood of counterfeit currency that was threatening faith in the American dollar. While the Bureau of Alcohol, Tobacco and Firearms was not organized as a separate entity until 1972, its predecessor agency, the Alcohol Tax Unit of the IRS, had long pursued lawbreakers from the hollows of Appalachia to the gangland plagued streets of Chicago, New York and Detroit in the 1920's and 30's.

During the last two decades, the historic law enforcement tool of asset forfeiture, that has been available to the U.S. Customs Service since those early days of the First Congress, has been increasingly applied in the operations of other federal law enforcement agencies. To meet the threats posed today by internationalized and sophisticated criminal enterprises, Customs' original forfeiture authorities have been expanded while the

IRS, the Bureau of Alcohol, Tobacco and Firearms, and the U.S. Secret Service all have authorities to seize and forfeit. A sampling of just some of the various areas in which these authorities have been used in fiscal year (FY) 1996 will provide an idea of the range of Treasury law enforcement responsibilities and how forfeiture seeks to deter related criminal activity by going after its bottom line.

Violating the Libyan Sanctions

Short of military conflict, the imposition of economic sanctions is a traditional means of pursuing a punitive foreign policy against an uncooperative or recalcitrant state. Economic sanctions, however, are only as effective as their enforcement and for sanctions imposed by the United States, much of that key task falls to the Customs Service. A FY 1996 Customs investigation of violations of Libyan sanctions eventually would lead to a payment of \$3 million to the Treasury Forfeiture Fund.

The Great Man-Made River has been an eight year project of Libyan dictator, Moammar Gadhafi. Its aim is to eventually pump water over a thousand miles from a Saharan Desert aquifer in western Libya to Tripoli on the Mediterranean coast. Such an ambitious effort requires the importation of technology and expertise which, in the summer of 1996, ran afoul of trade sanctions against Libya for its support of international terrorist activities.

The case began about a year earlier when the U.S. Customs Service attaché at the American consulate in Milan noted that equipment from the United States was being transshipped from Italy to Libya. A Korean corporation, Dong Ah Construction Co. Ltd., was responsible for completing the infrastructure of the Man-Made River project and was working with an Italian firm to purchase American water well drilling equipment. During the summer, employees

from the Italian subcontractor and Dong Ah Construction came to the United States and met with an undercover Customs agent to look at additional equipment to buy for use in Libya. While on a trip to inspect the prospective purchase in a Pennsylvania warehouse, they were arrested in Parkersburg, West Virginia.

A month after the arrests, the employees along with their parent companies pled guilty in United States District Court in Louisville to violations of criminal laws on conspiracy, false declarations and money laundering. The money laundering involved two transfers totaling over a million dollars made between a bank in Rome and National City Bank in Louisville which were used to finance the export of the equipment. At sentencing, Dong Ah Construction agreed to pay a \$3 million forfeiture. This case represented the Customs Service's effort to use money laundering laws in non-drug investigations. In this instance, the export of U.S. goods to Libya violated regulations issued by Treasury's Office of Foreign Assets Control and are deemed specified unlawful activities under Title 18 of the U.S. Code.

Pursuing the Proceeds of Medicare Fraud

Medicare was established in 1965 as Title 18 of the Social Security Act. This federal system of health care cost reimbursement has been the subject of much recent policy debate as to the best way of ensuring the program's continued fiscal soundness. Cracking down on program fraud is but one means to this end and in FY 1996, the Internal Revenue Service (IRS) helped unmask a scheme that had bilked Medicare out of tens of millions of dollars.

IRS had been joined in the three year investigation by the United States Department of Health and Human Services and their target became a Florida medical supplier, who owned and operated Bulldog Medical of Kissimmee and MLC-Geriatric Health Services in Osceola County. Between the summer of 1993 and September of the following year, Bulldog and MLC characterized the adult diapers they supplied as medical devices and billed Medicare Part B between \$5 and \$9 per item when

the actual value was no more than 50 cents. The firms caused these and other incontinence care supplies to be delivered to nursing homes while knowing that they were not medically necessary for the Medicare beneficiaries of the homes and, therefore, not reimbursable. They would then bill Medicare for the unnecessary supplies and collected close to \$47 million in improper payments. Prosecutors also charged that the owner of the companies paid kickbacks to officers of a national chain of nursing homes for their cooperation in the scheme.

In October 1996, the defendant entered into a plea agreement in U.S. District Court for the Middle District of Florida whereby he agreed to the forfeiture of approximately \$32 million in cash and securities that had been seized by the IRS.

The Viper Militia

Images of asset seizures often entail suitcases full of cash, luxury residences, fast and expensive cars, yachts and other accoutrements of high-living criminals. On the first of July, 1996, agents from ATF's Phoenix Field Division along with dozens of other federal, state and local law enforcement officers made some significant seizures of a different kind - about 650 pounds of ammonium nitrate, 20 gallons of nitromethane, well over a hundred firearms many of which field tested as machine guns, about 8,000 rounds of ammunition, live hand grenades and components, detonation cord, blasting caps, battle dress uniforms, bullet proof vests and gas masks.

The seizures were part of an investigation that led to the indictment and arrest of twelve members of Arizona's Viper Militia for violations of federal explosives and firearms laws. The discovery of the explosives and destructive devices forced ATF agents to evacuate three residential neighborhoods as well as an industrial area due to concerns for the public safety. All twelve of the militia members arrested were charged with conspiracy to make explosive devices and to furnish instruction on their use as part of a plot against the government. Some

of the members were also charged with illegal possession of automatic weapons.

Customs Fraud and a French Fugitive

In February of 1996, the Treasury Forfeiture Fund received almost \$550,000 from the sale of a luxury residence that had been owned by French fugitive, Stephane Pecqueraux. Mr. Pecqueraux had been the subject of a fifty count indictment in 1995 charging him with conspiracy, the smuggling of IBM computer components by false invoice, money laundering, arson and mail fraud. Cash proceeds from these illegal activities had been used to purchase his million dollar plus home.

Despite the absence of Mr. Pecqueraux, the Customs Service was able to file a *lis pendens* against the property, which effectively notified all potential buyers that it was subject to pending litigation, while they proceeded with a civil forfeiture action. Upon forfeiture of the property, the house was sold with distributions from the sale going to the Treasury Forfeiture Fund, his wife under an innocent owner spouse claim and to a lien holder. The case is a modern example of the continued effectiveness of civil forfeiture authority which has been employed by the Customs Service since the eighteenth century. Just as it originally allowed for the forfeiture of vessels engaged in smuggling when the owner resided overseas or was otherwise unavailable, so today it allows Treasury enforcement to forfeit criminally derived assets even when the perpetrator of the crime is currently evading the reach of the law.

The William Jones Organization

William Yancy Jones organized and led a cocaine organization in St. Louis that provided him with a quarter of a million dollar per month in profits from the summer of 1993 until January of 1995. A year later, he was sentenced to 23 years in prison. The organization was brought down through the cooperation of various law enforcement agencies led by the Bureau of Alcohol, Tobacco and Firearms and the IRS, and the application of federal asset forfeiture authorities.

Jones had arrived in St. Louis in 1987 and using California connections for his supply, doggedly built up a cocaine distribution business. During its peak, the operation received, on average, 40 kilograms per month from at least two suppliers and, calculating the markup on street sales, was clearing three quarters of a million dollars in quarterly profits. It was also a family organization, which Jones employing his son and son-in-law in the business.

As a result of the investigation, the government seized over a million dollars in cash, numerous weapons, over a hundred kilos of cocaine and some heroin. Property seized included such items as Mercedes and Jeep Cherokee vehicles, jet skis, several large screen and projection TVs, a motor home, a pontoon boat and nine parcels of real property. The real properties were connected to an entity called Kep-Co, a company Jones had put together to buy real estate and thereby launder some of the proceeds of his drug trafficking. Altogether, assets forfeited in this case were valued at approximately \$2 million.

Smuggling Automatic Weapons

The weapons trade is probably almost as old as human conflict itself. Today, the illegal side of this trade is a significant international criminal threat and can have an impact on anything from random street crime to state sponsored terrorism. Recently, East Asia has become an increasingly active arms market surpassing even the Middle East. In March of 1996, the Customs Service was able to derail a component of this market's illegal activity when Customs and ATF agents conducted the largest seizure of fully operational automatic weapons in the history of U.S. law enforcement.

Like any number of Customs smuggling seizures, this one was much more than simply a serendipitous discovery. Instead, it was the product of a sixteen month investigation of an alleged arms trafficking conspiracy that included Chinese nationals and resident aliens as well as U.S. citizens. Several of the suspects represented corporations known as Polytech and Norinco, munitions manufacturing facilities that were owned and controlled by the

Peoples Republic of China. Initial information was developed that a Taiwanese resident alien living in California had thousands of Chinese manufactured weapons stored in his warehouse. As the investigation developed, this individual served as a middleman between undercover Treasury agents posing as arms traffickers looking for assault weapons for criminal activity and American-based representatives of the Peoples Republic of China munitions companies. After lengthy negotiations, the sale and importation of 2,000 fully automatic weapons from Norinco was arranged.

It was these AK-47 type 7.62 mm machine guns, commonly used as military assault weapons around the world, that were seized by Treasury agents in March of 1996. This smuggling attempt was in violation of the Presidential embargo on the importation of weapons and munitions designated on the United States Munitions List as well as a violation of U.S. law regarding the importation, possession and sale of illegal weapons. Included with this shipment was approximately 4,000 thirty to forty round ammunition magazines. The street value of the cache was estimated to be more than four million dollars.

CHAPTER 3

FOSTERING LAW ENFORCEMENT COOPERATION

William Friedken's 1971 Academy Award winning film, *The French Connection*, is memorable for its fast paced action that followed the pursuit of narcotics traffickers through the streets and transit systems of New York City. A more subtle, yet telling subplot involved the professional tension that existed between the federal officers and city detectives who were supposed to be working together on the case. Confronted today by international criminal enterprises that seem to readily employ sophisticated organizational developments and the latest technological advances, law enforcement cannot afford anything like the wariness depicted in that film if it is to mount an effective response.

When the Comprehensive Crime Control Act of 1984 set up the basic structure of the modern federal forfeiture funds, it went a long way toward tearing down any of the remaining institutional barriers that may have worked against joint operations in the past. It did this by authorizing equitable sharing federally forfeited proceeds with state and local law enforcement agencies who contributed to an investigation that led to a forfeiture. This sharing authority was later extended to include foreign governments whose police agencies similarly assisted these investigations. Fostering law enforcement cooperation, therefore, was a major Congressional intent underlying the forfeiture program and continues to be a primary goal of the Treasury Forfeiture Fund.

For the Treasury Forfeiture Fund, equitable sharing as the program is known, is a two way street. The Fund not only distributes payments to federal, state and local law enforcement agencies and foreign governments who have assisted Treasury enforcement bureaus or the Coast Guard in their forfeiture investigations, but it also receives payments in return for Treasury and Coast Guard contributions to other agency forfeiture activities. While most sharings received by the Fund continue to result from Treasury's help provided to the

Department of Justice law enforcement agencies in their cases, a steady and increasing amount are attributable to the forfeitures of state, local and foreign police agencies who are developing their own authorities to share equitably with contributors to their investigations.

Simply in terms of total dollars, the equitable sharing program is the most prominent way in which the Treasury Forfeiture Fund supports its goal of fostering law enforcement cooperation. There are, however, other permitted disbursement authorities of the Fund that also enhance and facilitate cooperation in joint operations. One of these areas allows the Fund to pay some of the overtime expenses of state and local police officers when it is incurred in operations with Treasury law enforcement. Another lets the Fund defray some of the costs of equipping state and local vehicles and other conveyances when they are used in a Treasury investigation.

The cumulative result of these authorities of the Treasury Forfeiture Fund is the offering of a very real incentive to the various members of the law enforcement community to work together, to complement each other's expertise and to present an effective, coordinated response to the common threat of organized criminal activity. In FY 1996, that cooperation was on display throughout the United States and abroad allowing Treasury law enforcement to meet the criminal challenge.

Help from the Swiss - The Trahan Case

Robert Victor Trahan was an enterprising individual, but, unfortunately, on the wrong side of the law. In 1989, he captained a vessel that smuggled 27,000 pounds of Southeast Asian marijuana into the United States at Cordova, Alaska. Based upon information provided by the Nevada County Sheriff's Department, an Organized Crime Drug Enforcement Task Force (OCDETF) investigation was begun that included the sheriff's office, the Customs Service,

the Internal Revenue Service and the Drug Enforcement Administration.

By 1993, this investigation had resulted in the indictment of sixteen members of the smuggling and related money laundering organization. Knowing that Trahan was residing in Aberdeen, Scotland at the time, the Customs Service office in Sacramento, California, obtained a provisional arrest warrant valid in the United Kingdom. Aberdeen police found that he had left his residence and alerted British Customs to track any travel. Within eight months, British Customs noted that Trahan's wife and children were ticketed to fly to Geneva. In April of 1994, Swiss police approached Trahan at the Geneva airport, where he produced a passport in the name of an Anthony John Adams. He was arrested for using the false passport.

After locating two safety deposit boxes Trahan had at the Credit Suisse Bank in Montreux, Switzerland, Swiss authorities found that they contained over \$900,000 in U.S. currency. These funds were immediately blocked. Based upon information provided by the U.S. Government, the Swiss determined that this money was subject to extradition to the United States and wired it to a Customs Service account in San Francisco where forfeiture proceedings were begun. At the conclusion of the forfeiture, the government of Switzerland was presented with a check for over \$300,000 from the Treasury Forfeiture Fund in recognition of their invaluable assistance in the arrest of Trahan and the forfeiture of his criminal gains.

Retrieving Laundered Funds From the Channel Islands

It was about eleven years ago, when a long-time Texas drug suspect, Victor Stadter, and his cohort, Barry Rosen, set up a company in the Channel Islands called Luftrenser Ltd., for the purpose of receiving funds from the United States, where Stadter and Rosen claimed they owned more than 300 fairgrounds with substantial monthly cash income. During the first six months of Luftrenser Ltd's existence, over \$2 million was paid into this

account through deposits of 362 cashiers checks, each in amounts under \$10,000. By September of 1989, the Jersey bank that serviced Luftrenser's account reported its mounting suspicions to the State of Jersey Police Drug Trafficking Investigation Unit who, in turn, notified the U.S. Customs attaché in London. Thus began an intricate investigation of drug trafficking and money laundering that stretched from the Channel Islands all the way to Texas and California.

All of these efforts came together in 1994 when a civil judicial forfeiture of almost \$2.1 million was ordered in the Northern District of California. Not only did the State of Jersey Police originate the information on the suspected drug proceeds but they were instrumental in conducting surveillance and interviews as well as corroborating information that was critical in the civil forfeiture trial. In FY 1996, the Treasury Forfeiture Fund acknowledged this contribution of the Jersey Police with the disbursement to them of over a million dollars from the net forfeited proceeds as an equitable sharing. Sharings were also made with two assisting Texas law enforcement agencies - the Richardson City Police Department and the Real County Sheriff.

Targeting the Money Side in New York

The operation takes its name from the fabled city of gold, so long and unsuccessfully pursued by Spanish conquistadors in the American southwest during the sixteenth century. Today, in another time and place, Treasury's El Dorado has achieved a significant record of accomplishment as it goes about its work of dismantling the major money laundering organizations that operate around the New York metropolitan area.

El Dorado was begun in 1992 by the Customs Special Agent-in-Charge in Manhattan. It was designed to bring together the expertise and resources of the many federal, state and local law enforcement agencies operating in the designated New York/New Jersey High Intensity Drug Trafficking Area (HIDTA). Suijing such a multi-agency group, El Dorado employs a variety of investigative methods and has at its disposal the full

range of criminal and civil remedies available to the various law enforcement and regulatory agencies that make up its membership. It is headed by the Customs Service and the IRS, and includes the U.S. Secret Service among its participants. Since its inception, El Dorado investigations have resulted in the arrests of over 500 persons, monetary seizures in excess of \$140 million, as well as a number of narcotics seizures including over 3,500 pounds of cocaine. In FY 1996 alone, more than \$60 million was seized.

One typical case involving the El Dorado task force resulted in the Treasury Forfeiture Fund in 1996 disbursing over a million dollars in equitable sharing payments to a dozen state and local law enforcement agencies.

Room Check on 7th Avenue - *It was an April evening in 1995 when the night security officer at the Sheraton Hotel on Seventh Avenue informed task force agents that a hotel guest had paid cash not only for his own room but also for several others. Questioning the persons staying in the room led to competing and conflicting stories and finally a consent to go ahead and search the rooms. That search uncovered a pair of duffel bags containing almost a million and a half dollars in cash that was later forfeited.*

What on the surface appeared to be a straightforward incident was actually the result of a studiously planned and coordinated effort. Recognizing the many contributions made by the non-Treasury agencies to this investigation leading to forfeiture, the Treasury Forfeiture Fund has shared 20 percent of the net proceeds with the New York City Police Department while awarding single digit percentage shares to six northern New Jersey agencies, district attorney offices in the Bronx, Manhattan and Queens and the New Jersey National Guard.

Forfeited Tucson Property Reborn as Drug/Alcohol Rehab Center

In certain circumstances, the equitable share awarded to an assisting state or local law

enforcement agency will take the form of a real property transfer, and, under the Weed and Seed Program, these properties may be passed on to community service agencies to support the endeavor of reclaiming blighted neighborhoods. In 1996, such an occurrence took place in Tucson where a forfeited radio property received new life as a point of hope and renewal for victims of substance abuse.

Radio Pantera, known as KTZR 1450 AM on the dial, was once the most popular Spanish language station in Tucson. Just over five years ago, the Internal Revenue Service received reports from a local bank that the father and son owners of the station were engaged in structuring cash deposits. Shortly thereafter, the Customs Service obtained other information that the pair was also involved in smuggling marijuana into the United States and delivering it to other parts of the country. By early 1992, the Customs Service and the IRS, working as part of the Southern Arizona Financial High Intensity Drug Trafficking Area (HIDTA) task force, opened an investigation of Radio Pantera.

This effort revealed that the father and son were arranging for the movement of the drugs to Columbus, Ohio, for distribution and sale. At one point, during an intercepted telephone call, the father boasted about how he was making lots of money for his Mexican connections and investing the drug proceeds in his radio station. In the spring of 1994, Radio Pantera and its owners were indicted on more than 40 marijuana trafficking and money laundering charges. By June of the following year, a jury found that the defendants' interests in the real estate property where Radio Pantera was located were subject to forfeiture.

Shortly after the close of FY 1996, the Customs Service was able to transfer the station property to the Gateway Foundation, through the Pima County, Arizona, Sheriff's department. Gateway is a private, non-profit organization that was opened in 1972 as one of the first centers in the state to provide help to alcoholics who had no resources. Today, it extends its treatment programs to indigent drug as well as alcohol abusers. The former radio station property on North Jackrabbit Avenue in Tucson will

house Gateway's administrative offices while providing outpatient services, one-to-one counseling and a variety of community awareness seminars.

CHAPTER 4

STRENGTHENING LAW ENFORCEMENT

If federal forfeiture programs stopped at the point of taking the instrumentalities and proceeds of crime away from criminals, they would be of significant service to law enforcement. To some who choose crime, the threat of incarceration is merely one risk attendant upon that choice. A well organized criminal enterprise can survive one member's prison time. What asset forfeiture does, however, is remove the building blocks that actually form the organization. It can, in effect, bankrupt the criminal business by removing its assets, making them unavailable to those who remain or would follow. For this reason alone, it has been a very effective and valuable device in helping to dismantle criminal organizations.

If federal forfeiture programs simply went one additional step and allowed for reimbursement, from forfeited proceeds, of the direct costs of seizure and forfeiture, federal law enforcement would once again be well-served. In a national program with seizures of everything from real property to narcotics to vessels, vehicles, aircraft and an entire range of other commodities, these costs can be substantial. In addition to these property management costs, there are also sizeable costs of noticing any and all parties with any interest in the seized property so that they may have an opportunity to come forward and be heard during the forfeiture proceedings. Before the institution of the modern federal forfeiture funds, these types of expenses had to be borne by the seizing agency out of their limited mission-oriented appropriations. With today's federal forfeiture funds, these costs can be paid for out of the funds themselves, allowing appropriated tax dollars to be used to support the agency's primary law enforcement purpose.

What is uniquely remarkable about modern federal forfeiture funds is that they not only accomplish these first two ends but go beyond them by permitting the re-investment of the proceeds of crime in efforts to fight crime. After property is removed from criminal control, after its value has

been used to pay the direct costs associated with seizure, then, whatever is leftover is retained to be recycled in to strengthening law enforcement. The Treasury Forfeiture Fund has the statutory authority to apply this dividend in a number of ways to help create a stronger law enforcement presence at all levels of government. A look at some specific FY 1996 examples of the application of this authority at the state and local, Treasury law enforcement bureau and foreign levels will give some sense of progress made toward this goal.

Support for Cops

President Clinton's pledge to put an additional 100,000 police officers on America's streets has been coordinated through the Community Oriented Policing Services (COPS) office at the Department of Justice. During FY 1996, that program's resources received multiplier support from the Treasury Forfeiture Fund.

Florida's Broward County is one example of how Fund monies are being used to complement the resources available under the COPS program. The county sheriff's office used some of the almost \$400,000 it received in equitable shares attributable to joint investigations with Treasury law enforcement, to match and extend its share of grants under the program. It used some of these Treasury resources to match COPS Phase I funding in the hiring of 26 new deputies to backfill veteran officers re-assigned to elementary schools. It has applied Treasury equitable sharing monies to purchase laptop computers in support of COPS MORE initiative to re-deploy officers so that they spend more time on the streets and less in moving paper, and finally it has taken a portion of its share of Treasury forfeited proceeds to supplement a COPS grant for community policing to curb domestic violence.

To the uninitiated, Young Talented Children (YTC) is a name likely to connote a suburban school district's program for its most gifted pupils. Instead on the mean streets of the Upper West side of Manhattan, YTC represented a much more sinister program. It was a gang that ran a crack cocaine business, grossing more than a \$100,000 per week. It had taken over its drug dealing territory from a group known as the Natural Born Killers, whose leaders had succumbed to a hazard of the trade. They were murdered in 1993. YTC's main drug gang rival in this part of the city, also known as Manhattan Valley, was the Young City Boys (YCB). Both gangs battled for market share, controlling buildings and entire blocks, with shootings and assaults common. The gangs sold crack cocaine to street customers as well as powdered cocaine and heroin to other dealers. They were also heavily involved in the sale of firearms.

The Manhattan District Attorney's Office has availed itself of Treasury Forfeiture Fund resources to help battle this problem on two fronts. First, in a coordinated effort with the NYPD's Manhattan North Narcotics Gang Task Force, it has successfully pursued Operation Rainbow, arresting, indicting and convicting numerous gang members for murders, attempted murders, assaults and the possession and sale of weapons and drugs. Homicides in the neighborhood have dropped substantially. Second, partly drawing on equitable sharing monies received from the Treasury Forfeiture Fund, the District Attorney's Office has set up a summer playstreet near a City Parks Department playground in the very area once tightly controlled by the drug gangs. The playstreet operates from 9 am to 5 pm during school summer vacation months and during that time, is closed to all traffic. It offers a variety of drug prevention, recreational, educational, cultural and social programs to residents. In this instance, the fruits of cooperation between local and federal law enforcement have paid dividends to the children of a community sorely tested by drugs and crime.

A basic point made in support of the legislation that eventually established a consolidated Department of the Treasury Forfeiture Fund in 1992, was that the Secretary of the Treasury needed direct control over the increasingly significant resources coming from the proceeds of Treasury law enforcement forfeitures. Since then, the Fund has used its statutory authorities to disburse these resources in specific support of the Treasury enforcement bureaus' forfeiture programs and, more generally, to strengthen law enforcement within the Department.

The Fund uses an indefinite, unlimited appropriation of monies it receives to pay certain seizure-specific mandatory expenses of the Treasury forfeiture program, such as the costs of its seized property management contract and certain investigative expenses. It uses another annual, definite, Congressional appropriation, again from its receipts, to pay for other discretionary forfeiture program costs not tied to specific seizures. Finally, from either surpluses available to the Fund after these mandatory and discretionary expenses are met or from equitable sharings received by the Fund because of Treasury bureau contributions to other law enforcement agency forfeitures, it can make payments for law enforcement purposes. Some examples of just how the Fund has made use of its several authorities to strengthen Treasury law enforcement will show the wide range of areas in which it has had an effect.

- **Operation Hardline** - The southwest border of the United States has been a favored point for the smuggling of currency, drugs and other illegal contraband. The Treasury Forfeiture Fund has helped the Customs Service cover the costs of personnel moves under Operation Hardline to redirect resources to where they are acutely needed.
- **Computer Evidence Recovery** - Breakthroughs in microprocessing continue to assist not only legitimate businesses but criminal enterprises as well. To keep up with the pace of technology and allow investigators to recover the often critical evidence stored in computer systems, the

IRS with the help of Treasury forfeiture funding, sponsors a computer laboratory and classroom at the Department's Federal Law Enforcement Training Center in Brunswick, Georgia.

- **Ceasefire** - The Bureau of Alcohol, Tobacco and Firearms has benefited from Fund resources not only in the development of its sophisticated, computerized Ceasefire system that inventories, identifies and matches bullet projectiles but also in the rollout of the system to additional, violence-plagued cities around the country.
- **Federal Wireless Communications** - Convenient, secure and mobile communications among law enforcement officers from various jurisdictions are increasingly important as multi-agency task forces and joint operations become more and more commonplace. The U.S. Secret Service has received discretionary monies from the Treasury Forfeiture Fund to aid its effort to develop a new generation of wireless law enforcement communications.
- **Improvements at JFK** - Anyone flying into or out of New York's John F. Kennedy International Airport knows how busy that location can get. What had been severely taxed facilities of the Customs Service at JFK have been upgraded and enhanced thanks in part to support provided by the Treasury Forfeiture Fund.
- **Gun Dog Program** - Canines have been employed for years by police and military agencies to provide security and to ferret out drugs and explosives where they might not be noticeable to their handlers. Recently, with the support of the Treasury Forfeiture Fund, the Bureau of Alcohol, Tobacco and Firearms has begun to train and use dogs to detect concealed weapons.

Building Law Enforcement Capacity Overseas

The threats we Americans face respect no nation's borders — terrorism, the spread of weapons of mass destruction, organized crime, drug trafficking, ethnic and religious hatred,

aggression by rogue states, environmental degradation. If we fail to address these threats today, we will suffer the consequences of our neglect tomorrow.

President William J. Clinton
State-of-the-Union Address
January 23, 1996

In a post-Cold War World characterized by numerous transformational economies, law enforcement expertise and capabilities can differ widely from one nation to another. The disparities that exist present opportunities to international criminal organizations to move key components of their operations to locales where law enforcement may be less experienced and, therefore, less ready to deal with the sophisticated threats being posed today. In 1996, the Treasury Forfeiture Fund used a portion of its discretionary spending authority to help address the challenge posed by the President by strengthening law enforcement capacity in two overseas locations.

Guyana - A tropical nation about the size of Idaho on the northeast coast of South America, Guyana is one of the poorest countries in the Western hemisphere with a gross domestic product per person of only \$500 in 1992. Its sizeable unpeopled and unpatrolled interior with its numerous airstrips allows transport free of effective government controls. For these reasons, it has afforded criminals an opportunity to transship narcotics from South America through Guyana to the United States and Europe and to smuggle Guyanese gold to the same destinations in money laundering schemes.

In response to a Guyanese government request, a Department of the Treasury delegation consisting of representatives from various law enforcement bureaus presented a week long training seminar for law enforcement and justice ministry officials in the capital city of Georgetown. Assistance was provided regarding the best methods of enforcing newly-enacted currency reporting requirements and how Guyana might go about the drafting and implementation of anti-money laundering legislation.

South Africa - Additional forfeiture funded training was provided in FY 1996 to the Republic of South Africa's National Police Service by Treasury enforcement bureau personnel as a follow-on to initial training presented the previous year. South Africa's location coupled with its developed transportation networks make it a transshipment point for narcotics and other contraband moving between Asia, Europe and North and South America. Additionally, increasing amounts of illegal drugs are being marketed in South Africa itself.

Besides the valuable exchanges of information and the development of strategies for mutual cooperation that took place during this training, the Treasury Forfeiture Fund is also assisting with the establishment of a new U.S. Customs Service attaché office to be located in Pretoria.

CHAPTER 5

PROGRAM PERFORMANCE AND FINANCIAL HIGHLIGHTS

PROGRAM PERFORMANCE

As the second year in which the Fund has had in place performance indicators, results from FY 1996 allowed for comparison with results from FY 1995 as a means of monitoring forfeiture program operations. For FY 1996, the performance measures selected for monitoring were: (1) processing time for equitable sharing payments with a target time frame of 7.5 months; (2) time between forfeiture of real property and disposal through sale with a target time frame of 7 months; (3) maintenance costs of assets sold as a percentage of sales revenue with a target of 0.7 percent and (4) processing time of the administrative seizure inventory with a target time frame of 56 percent being processed in a timely fashion. Among the Fund's four performance measures, some improvements were noted in the age of the administrative seizure inventory. In the other three performance measures, there was a deterioration in the processing time for equitable sharing payments, and slight increases in the time required to dispose of real property and in the maintenance costs of assets sold as a percentage of sales revenue. The tracking of this information and the availability of comparison data are of significant benefit to management of the Fund.

Processing Time for Equitable Sharing Payments

Equitable sharing of the Fund revenue continues to be one of the most visible operations of the Treasury Forfeiture Program. State and local law enforcement agencies derive a valuable benefit from equitable sharing proceeds which assist them in ongoing operations to combat drug trafficking and violent crime. The average time to make an equitable sharing payment in FY 1996 increased from 8 to 10 months. Although this is not the desired progress, there are reasons to believe that this degradation is not permanent. Many of the 2,580 payments made during the year were for forfeitures that had occurred several years earlier as the result of efforts to relieve backlogged sharing

requests, i.e., over half of the Customs and IRS sharing payments were for forfeitures that had occurred prior to FY 1996. These forfeitures inflated the average time that it took to make a payment. The Executive Office for Asset Forfeiture (EOAF) management continues to be concerned with the delay associated with equitable sharing payments and will examine processes that might relieve the situation.

The Average Time Between Forfeiture and Disposal of Real Property

During FY 1996, the average time between forfeiture and disposal of real property was 7.8 months, an increase over FY 1995's average disposal period of 7.2 months. The target range for this measure was 7.0 months. The increase is attributed to the Fund's handling more properties in FY 1996 than in FY 1995 and it is deemed insignificant. The disposal of real property is one of the more complicated activities associated with the forfeiture program. The existence of liens, taxes, mortgages and other encumbrances can complicate the closing of a real property sale. Through close coordination with the national seized property contractor, the seizing agency and the U.S. Attorneys, Fund management was able to identify properties that required closer attention in order to dispose of them in a timely manner.

Maintenance Costs of Assets Sold as a Percentage of Sales Revenue

Maintenance costs are those that the national seized property contractor incurs to ensure that seized property retains its condition and value until sold. For the purposes of this indicator, these expenses were measured only for the costs incurred by the national seized property contractor after consignment from the seizing enforcement bureau. In FY 1996, maintenance costs incurred by the national seized property contractor as a percentage of gross sales were 1.3 percent. While this ratio of

maintenance costs to sales increased from 0.7 percentage in FY 1995, it is still considered to be within an appropriate range. Fund management remains concerned that maintenance costs for property held in inventory be kept as low as possible without jeopardizing the value of the property.

Age of Administrative Seizure Inventory

Administrative forfeitures are those in which an asset is forfeited without judicial involvement. To ensure that the due process rights of citizens are protected and that revenue is collected in a timely manner, a goal of the forfeiture program is to process administrative cases quickly. Fund management established 9 months for the Customs Service and 6 months for all other enforcement bureaus as a reasonable period to process administrative seizure cases.

In FY 1996, the percentage of administrative cases processed within these prescribed time frames increased from 51 to 65 percent. Almost three quarters of the cases remaining outside the standard were ATF cases, principally associated with illegal weapons. Most of ATF's cases are tied to firearms forfeitures and specific statutes require that the criminal proceedings be resolved before the administrative seizure can be closed. This results in a noticeably longer administrative processing procedure for ATF. When ATF is factored out, the Fund achieved a timeliness rate of **85 percent** for processing administrative cases.

FINANCIAL HIGHLIGHTS

The following provides a brief explanation for each major section of the fiscal year 1996 audited financial statements accompanying this report. These statements have been prepared to disclose the financial position, results of operations and changes in net position pursuant to the requirements of the *Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994 (GMRA)*. While the financial statements have been prepared from the books and records of the Fund in accordance with the formats prescribed by the

Office of Management and Budget, the statements are different from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records and are subsequently presented in federal budget documents. Therefore, be advised that direct comparisons are not possible between balances found in this report and similar financial information found in the fiscal year 1996 and fiscal year 1995 *Budget of the United States Government*. Further, the notes to the financial statements and the independent auditor's opinion and reports on internal controls and compliance with laws and regulations are also integral components to understanding fully the financial highlights of the Fund's operations described in this chapter.

Revenues and Financing Sources

A comparison of revenues and financing sources (in millions) for the past two fiscal years is shown in the table below.

| REVENUES AND FINANCING SOURCES (\$ millions) | | |
|---|--------------------|--------------------|
| | <u>1996</u> | <u>1995</u> |
| Forfeited currency and monetary instruments | \$120 | \$146 |
| Forfeited property | 32 | 75 |
| Payments in lieu of forfeiture | 3 | 7 |
| Reimbursed costs | 2 | 3 |
| Proceeds from participating with other federal agencies | 9 | 8 |
| Investment interest income | 9 | 7 |
| Other miscellaneous | 1 | 6 |
| Total | \$176 | \$252 |

• Forfeited Currency and Monetary Instruments

The Fund's primary source of revenue is forfeited currency and monetary instruments. For FY 1996, revenue from forfeited currency and monetary instruments totaled \$120 million, or 68 percent of total revenues, versus \$146 million or 58 percent, in FY 1995. The forfeited currency and monetary instruments of \$120 million for FY 1996 consist of the undistributed forfeited currency and monetary

instruments in the amount of \$74 million, as presented in the statement of operations and changes in net position, and the distributed forfeited currency in the amount of \$46 million, as shown in note 8.

• *Forfeited Property*

The revenue from forfeited property (net of mortgages) was \$32 million in FY 1996 and \$75 million in FY 1995. The \$75 million in FY 1995 was primarily attributed to the sale of properties associated with the final disposition of a significant Customs' case, *United States v. Ken International*. The 32 million of revenues from forfeited property (net of mortgages) consist of \$21 million of sales of forfeited property (net of mortgages and claims), as presented in the statement of operations and change in net position, \$6.8 million of the distributed forfeited assets, and \$4.6 million of the distributed proceeds from sales of forfeited property, as shown in the note 8.

• *Payments in Lieu of Forfeiture*

After property is seized for forfeiture, the government may enter into negotiations with the violator for a cash payment to settle the pending case instead of proceeding with the formal forfeiture process. Such payments in lieu of forfeiture totaled \$3 million in FY 1996, a decrease of \$4 million from FY 1995.

• *Investment Interest Income*

The Fund is authorized to invest cash balances in certain special Treasury securities. On September 30, 1996, investments totaled \$311 million. This included \$145 million invested from balances of the Fund and \$166 million invested from seized balances not yet forfeited. Interest income earned on these investments totaled \$9 million, an increase of \$2 million over FY 1995.

Allocation of Revenues

A comparison of allocation of revenues (in millions) for the past two fiscal years is shown in the table that follows.

| ALLOCATION OF REVENUES (\$ millions) | | |
|--|-------------|--------------|
| | <u>1996</u> | <u>1995</u> |
| Equitable Sharing | | |
| State and local agencies | \$48 | \$58 |
| Foreign countries | * | 7 |
| Other federal agencies | 7 | 8 |
| Victim restitution | 3 | 39 |
| Total | \$58 | \$112 |

* Less than \$500,000

The total revenues allocated from the Fund decreased to \$58 million in FY 1996. Most of this decrease is attributable to \$39 million in restitution that was paid by the Fund to the Federal Bankruptcy Court to reimburse innocent victims of fraud in FY 1995. These victims lost money in the previously cited *United States v. Ken International* money laundering case. Amounts allocated to state and local law enforcement agencies for equitable sharing decreased from 1995 to 1996, but sharing amounts allocated to other federal agencies remained static. The decrease in equitable sharing to state and local agencies is attributable to the decrease in forfeited currency overall. For FY 1996, equitable sharing distributions totaled \$55 million, or 95 percent of the total revenue allocated.

Program Expenses

After allocation of revenues, the remaining net revenues support the law enforcement activities of the Fund and pay for the storage of seized and forfeited property and sales associated with the disposition of forfeited property. Program expenses increased \$4.5 million above the FY 1995 level, or about four percent.

| PROGRAM EXPENSES (\$ millions) | | |
|--|----------------|----------------|
| | 1996 | 1995 |
| Non-discretionary | | |
| Seizure investigative costs and asset management | \$ 36 | \$ 44 |
| Seized property national contract services | 26 | 28 |
| Other asset related contract services | 3 | 1 |
| Awards to informer (moiety payment) | 2 | 3 |
| Other | 11 | 7 |
| Super Surplus | 14 | * |
| Secretary's Enforcement Fund | 13 | 5 |
| Discretionary | | |
| Awards for information or assistance | * | * |
| Purchases of evidence and information | 2 | 2 |
| Federal law enforcement conveyance | 9 | 16 |
| Other | 1 | 4 |
| Total | **\$115 | **\$111 |

* Less than \$500,000

**Columns do not foot due to rounding of amounts

• *Seizure Investigative Costs and Asset Management*

A number of expenses are covered in this category including payroll costs; liens and mortgages; investigative costs leading to a seizure; and purchases of evidence or information that ultimately resulted in a seizure. Payroll costs covered approximately 150 Customs employees, 40 IRS employees, and 20 EOAF employees. Most Customs employees reimbursed by the Fund are Seized Property Custodians or Specialists who are responsible for overseeing property turned over to the national seized property contractor, and for all seized property and narcotics that have not been turned over to the contractor.

• *Seized Property National Contract Services*

The single largest contract paid for by the Fund covers the storage, maintenance and disposal of real and personal property. This function is performed by EG&G Dynatrend, a private firm under contract to the U.S. Customs Service. EG&G provides coverage for Treasury's forfeiture program through

a nationwide system of 17 warehouse facilities with a capacity in excess of 470,000 square feet, as well as supplemental facilities provided by over 200 active vendors under contract to EG&G. In FY 1996, EG&G expenses were approximately \$26 million, somewhat less than the previous year. The higher cost in FY 1995 is largely attributable to the sales activity experienced in FY 1995 related to the properties forfeited under *United States v. Ken International*.

• *Super Surplus and the Secretary's Enforcement Fund*

Super Surplus expenses totaled approximately \$14 million in FY 1996. The Super Surplus is one of the Fund's permanent spending authorities, authorized under 31 U.S.C. § 9703(g)(4)(B). At the end of each fiscal year, after reserving the Fund's authorized retained capital of no more than \$50 million, one-half of the remaining funds are appropriated as the Super Surplus — available to the Secretary of the Treasury for any federal law enforcement activity.

Expenses of the Secretary's Enforcement Fund (SEF) totaled approximately \$13 million in FY 1996, an increase of \$8 million over FY 1995. As with the Super Surplus, the SEF is another one of the Fund's permanent spending authorities. The SEF is authorized under 31 U.S.C. § 9703(b)(5) and is derived from asset sharing revenue received from the Department of Justice or the U.S. Postal Service. Such revenue represents Treasury's share of forfeitures that resulted from joint investigations with these agencies. The SEF is available without fiscal year limitation for any Treasury law enforcement purpose.

The increase in expenditures in these two categories is simply the consequence of greater funds availability in the revenue areas that support these two special authorities.

• *Federal Law Enforcement Conveyance*

Expenses in this category totaled \$9 million in FY 1996, a decrease in the FY 1995 balance of

approximately \$7 million. The Fund's discretionary authorities allows for equipping law enforcement vehicles, as well as for communications equipment, protective equipment, and certain types of laboratory equipment. The decreased spending level in this category is directly attributable to reductions in the Fund's annual appropriation in the past several years.

Assets

A summary of the assets of the Fund as of September 30, 1996, is presented (in millions) in the following table. **Undistributed funds and fund balances with Treasury and cash** totaled approximately \$76 million on September 30, 1996. This balance fluctuates based on the timing of deposits of forfeited currency into the Fund and distributions of forfeited currency shared with local, state and foreign law enforcement agencies. On September 30, 1996, the Fund had **investments** in Treasury securities of \$145 million and **accrued interest** on investments of \$590,000. The balance for **accounts receivable** totaled approximately \$590,000 on September 30, 1996, and is principally associated with funds forfeited but still in the U.S. Customs suspense account. The value of forfeited property (net of mortgages and liens) on September 30, 1996, was approximately \$33 million, an increase of over \$3 million from FY 1995. Finally, the total for **seized currency** on September 30, 1996, was \$238 million, an increase of \$61 million from FY 1995.

| END OF YEAR ASSETS OF THE FUND (\$ millions) | | |
|--|--------------|--------------|
| | 1996 | 1995 |
| Undistributed funds and fund balances with Treasury and cash | \$ 76 | \$ 220 |
| Investments | 145 | 35 |
| Accrued interest | 1 | 1 |
| Receivables | 1 | 4 |
| Forfeited property (net of liens payable) | 33 | 30 |
| Seized currency & other investments (*) | 238 | 177 |
| Total | \$494 | \$467 |

* Under the Statement of Federal Financial Standards (SFFAS) Number 3, effective September 30, 1994 and thereafter, seized currency is reported as a custodial asset upon seizure. The amount cited here represents currency held in the Fund's suspense account, or on hand at field office locations.

Liabilities and Net Position

A summary of the liabilities and net position of the Fund as of September 30, 1996, as compared with September 30, 1995, is shown (in millions) in the following table. The large decrease in **distributions payable** is principally associated with \$39 million in victim restitution payments arising from *United States v. Ken International* in FY 1995. Revenue from forfeited property held for sale is deferred until the property is sold. When compared to FY 1995, more forfeited property was held for sale on September 30, 1996, which accounts for the increase in **deferred revenue** of \$2 million. **Accounts payable** totaled \$51 million on September 30, 1996, an increase over FY 1995 of \$17 million.

In addition to liabilities of \$349 million recognized by the Fund on September 30, 1996, \$40 million was reserved as the **unobligated balance** to be carried forward to begin 1997 operations and \$67 million was reserved for **unliquidated obligations** of FY 1996. Further, the Fund recorded a decrease in distributions to the Office of National Drug Control Policy's (ONDCP) **Special Forfeiture Fund**. FY 1996 ended with the **cumulative results of fund operations** totaling \$54 million of which \$16 million is to be distributed to ONDCP.

| END OF YEAR FUND LIABILITIES AND NET POSITION (\$ millions) | | |
|---|--------------|--------------|
| | 1996 | 1995 |
| Liabilities: | | |
| Distributions payable | \$ 29 | \$ 69 |
| Deferred revenue from forfeiture assets | 31 | 29 |
| Seized currency | 238 | 177 |
| Accounts payable | 51 | 34 |
| Net Position: | | |
| Unobligated balance | 40 | 50 |
| Unliquidated obligations | 67 | 57 |
| Distributions to ONDCP's Special Forfeiture Fund | (16) | (22) |
| Cumulative results of operations | 54 | 73 |
| Total | \$494 | \$467 |

Summary of Financial Management Improvements

During FY 1996, Fund management continued to improve in operational processes and financial management operations. Recognizing the close connection between field operations and proper financial management, EOAF began reviewing and updating the policy guidelines disseminated by the office. Additionally, EOAF conducted a number of training seminars throughout FY 1996 to ensure that the field staff of the four Treasury law enforcement bureaus are fully aware of the Fund's policies and the proper practices associated with the asset seizure and forfeiture process.

• Performance Indicators

Performance indicators are a tool for ensuring that a program's operations are functioning as intended and that the mission is being achieved. In FY 1995, the Fund began tracking several performance measures through a manual data collection and calculation process. This effort continued during FY 1996 and, as a result, the Fund's auditors were able to review and validate the information. Accordingly, this area was not cited by the auditors as a Reportable Condition in FY 1996. Additionally, the Fund has identified several more areas where it would be appropriate to gather data and assess performance. Steps are currently being undertaken to ensure that the appropriate data elements and reports are incorporated into our automated systems so that the manual collection of data will no longer be necessary.

• FY 1996 Audit

The Fund's independent auditors have given the FY 1996 financial statements an unqualified opinion. This is the second consecutive year that the Fund has received an unqualified opinion, and gives the Fund's management reassurance that the financial management efforts undertaken in the past several years have been fruitful. The number of material weaknesses and reportable conditions cited by the auditors in the

accompanying *Independent Auditor's Report on Internal Control* have been reduced.

• Inventory Tracking Systems

The remaining material weaknesses and reportable conditions pertain principally to deficiencies contained in financial accounting and property inventory systems maintained by the Customs Service. We have previously reported that these weaknesses would be corrected with the inception of the Seized Asset and Case Tracking System (SEACATS). SEACATS was intended to serve as the financial system of record for the Fund and as a single repository for all inventory and case information related to seized and forfeited property, fines, penalties or liquidated damages of the Customs Service. The development of this system was intended to replace several, non-integrated tracking systems operated by the Customs Service and would rectify the remaining material weaknesses identified in the Treasury Forfeiture Fund's annual financial audits. With the assistance and participation of Fund management, SEACATS was approved under Treasury Directive 32-02, which requires that the development of revenue and financial management systems be sanctioned by the Assistant Secretary for Management.

In November 1996, Customs implemented SEACATS. However, there have been a considerable number of start-up problems, including system conversion problems. Consequently, the difficulties encountered by SEACATS could ultimately affect the ability of the Fund to record and track revenues, expenses and changes in the seized and forfeited inventory during fiscal year 1997. Assisting the Customs Service with resolution of these problems has been among the highest priorities for management of the Fund. Lastly, Fund management has initiated changes to maintain accounting records on an accrual basis, and to ensure that the Fund's general ledger records all balances and transactions reflected in the financial statements. This will correct the Fund's

two material weaknesses identified in the FY
1996 audit.

SECTION II
FINANCIAL STATEMENTS

Gardiner, Kamy & Associates, P.C.

Management Consultants and Certified Public Accountants

1717 K Street, N.W., Suite 601 Washington, D.C. 20036

Phone: 202 857-1777

Fax: 202 857-1778

Independent Auditor's Report on Financial Statements

The Inspector General
United States Department of the Treasury
Washington, D.C.:

We have audited the accompanying statements of financial position of the Department of the Treasury Forfeiture Fund (the Fund) as of September 30, 1996 and 1995, and the related statements of operations and changes in net position for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards: *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

These financial statements were prepared in conformity with the hierarchy of accounting policies described in Note 2 to the financial statements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of the Treasury Forfeiture Fund as of September 30, 1996 and 1995, and the results of its operations and changes in net position for the years then ended, on the basis of accounting described in note 2.

The Department of the Treasury was granted a waiver by the OMB from preparing the statement of cash flows and the statement of budgetary resources and actual expenses, beginning with fiscal year 1995. Accordingly, the Fund did not include a statement of cash flows or a statement of budgetary resources and actual expenses in its fiscal year 1996 Annual Report.

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In accordance with *Government Auditing Standards*, we have also issued a report dated January 17, 1997, on our consideration of the Fund's internal control structure and a report dated January 17, 1997, on its compliance with laws and regulations.

Our audits were conducted for the purpose of forming an opinion on the financial statements referred to in the first paragraph of this report as a whole. The information presented in management's Overview of the Department of the Treasury Forfeiture Fund and the Supplemental Financial and Management Information sections is not a required part of the financial statements but is supplementary information required by OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, or the *Treasury Forfeiture Fund Act of 1992*. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

This report is intended for the information and use of the U.S. Congress, the management of the Fund, and the U.S. Department of the Treasury. However, this report is a matter of public record and its distribution is not limited.

Gardiner Kanya & Associates, P. C.

January 17, 1997

**Department of the Treasury Forfeiture Fund
Statements of Financial Position
September 30, 1996 and 1995
(Dollars in thousands)**

Assets

| | <u>1996</u> | <u>1995</u> |
|--|------------------|------------------|
| Entity Assets: | | |
| Intragovernmental | | |
| Fund balance with Treasury and cash (note 3) | \$ 75,982 | \$220,417 |
| Investments (note 4) | 145,379 | 34,646 |
| Interest receivable | 590 | 566 |
| Accounts receivable | <u>448</u> | <u>2,086</u> |
| Total intragovernmental | <u>222,399</u> | <u>257,715</u> |
| Governmental | | |
| Accounts receivable | 142 | 1,766 |
| Prepaid expenses | <u>200</u> | <u>487</u> |
| Forfeited property, net (note 5): | | |
| Held for sale, net | 30,653 | 27,417 |
| To be shared with federal, state or local, or foreign governments | <u>2,749</u> | <u>2,228</u> |
| Total forfeited property, net | <u>33,402</u> | <u>29,645</u> |
| Total governmental | <u>33,744</u> | <u>31,898</u> |
| Total entity assets | <u>256,143</u> | <u>289,613</u> |
| Non-Entity Assets: | | |
| Seized currency (note 6): | | |
| Fund balance with Treasury and cash | 72,505 | 91,307 |
| Investments (note 4) | <u>165,519</u> | <u>85,814</u> |
| Total seized currency | <u>238,024</u> | <u>177,121</u> |
| Total non-entity assets | <u>238,024</u> | <u>177,121</u> |
| Total Assets | <u>\$494,167</u> | <u>\$466,734</u> |

The accompanying notes are an integral part of these financial statements.

Department of the Treasury Forfeiture Fund
Statements of Financial Position
September 30, 1996 and 1995
(Dollars in thousands)

Liabilities and Net Position

| | <u>1996</u> | <u>1995</u> |
|---|------------------|------------------|
| Liabilities: | | |
| Liabilities covered by budgetary resources: | | |
| Intragovernmental liabilities: | | |
| Distributions payable: | | |
| ONDCP Special Forfeiture Fund | \$ 16,388 | \$ 21,922 |
| Other federal agencies | 3,062 | 2,107 |
| Accounts payable | <u>46,365</u> | <u>28,218</u> |
| Total intragovernmental | <u>65,815</u> | <u>52,247</u> |
| Governmental liabilities: | | |
| Distributions payable: | | |
| State and local agencies | 7,910 | 6,628 |
| and foreign governments | 1,697 | 38,276 |
| Victim restitution | 5,011 | 5,853 |
| Accounts payable | <u>31,038</u> | <u>28,692</u> |
| Deferred revenue from forfeited assets | <u>45,656</u> | <u>79,449</u> |
| Total governmental | <u>111,471</u> | <u>131,696</u> |
| Total liabilities covered by budgetary resources | <u>111,471</u> | <u>131,696</u> |
| Liabilities not covered by budgetary resources: | | |
| Governmental: | | |
| Commitments and contingencies (note 13) | -- | -- |
| Seized currency (note 6) | <u>238,024</u> | <u>177,121</u> |
| Total governmental | <u>238,024</u> | <u>177,121</u> |
| Total liabilities not covered by budgetary resources | <u>238,024</u> | <u>177,121</u> |
| Total Liabilities | <u>349,495</u> | <u>308,817</u> |
| Net Position (note 7): | | |
| Unobligated balance | 40,000 | 50,000 |
| Unliquidated obligations | 66,713 | 57,169 |
| Cumulative results of operations | 54,347 | 72,670 |
| Distributions to ONDCP's Special Forfeiture Fund | <u>(16,388)</u> | <u>(21,922)</u> |
| Total Net Position | <u>144,672</u> | <u>157,917</u> |
| Total Liabilities and Net Position | <u>\$494,167</u> | <u>\$466,734</u> |

The accompanying notes are an integral part of these financial statements.

**Department of the Treasury Forfeiture Fund
Statements of Operations and Changes in Net Position
For the years ended September 30, 1996 and 1995
(Dollars in thousands)**

| | <u>1996</u> | <u>1995</u> |
|--|------------------|-----------------|
| Revenues and financing sources: | | |
| Federal: | | |
| Investment interest income | \$ 9,021 | \$ 6,894 |
| Proceeds from participating with other federal agencies | 8,920 | 8,137 |
| Public: | | |
| Undistributed forfeited currency and monetary instruments | 73,889 | 81,892 |
| Distributed forfeited assets (note 8) | 57,518 | 112,253 |
| Sales of forfeited property, net of mortgages and claims of \$4,062 and \$4,789, respectively | 20,918 | 26,452 |
| Payments received in lieu of forfeiture, net of refunds of \$6,677 and \$4,423, respectively | 2,880 | 6,649 |
| Reimbursed costs | 1,773 | 2,807 |
| Other revenues and financing sources | <u>1,253</u> | <u>6,418</u> |
| Total revenues and financing sources | <u>176,172</u> | <u>251,502</u> |
| Allocation of revenues: | | |
| Equitable sharing: | | |
| State and local agencies | 47,683 | 58,100 |
| Foreign countries | 111 | 7,319 |
| Federal agencies | 6,774 | 8,393 |
| Victim restitution (note 10) | <u>2,950</u> | <u>38,441</u> |
| Total allocations of revenue | <u>57,518</u> | <u>112,253</u> |
| Net revenues and financing sources | <u>118,654</u> | <u>139,249</u> |
| Program expenses - Non-discretionary: | | |
| Seizure investigative costs and asset management | 35,804 | 44,402 |
| Seized property national contract services | 26,248 | 27,938 |
| Other asset related contract services | 2,711 | 1,309 |
| Awards to informer (moiety payment) | 1,985 | 2,519 |
| Other | 10,809 | 6,822 |
| Super Surplus (note 11) | 13,515 | 399 |
| Secretary's Enforcement Fund (note 12) | <u>12,902</u> | <u>4,505</u> |
| Total non-discretionary expenses | <u>\$103,974</u> | <u>\$87,894</u> |

(continued)

The accompanying notes are an integral part of these financial statements.

Department of the Treasury Forfeiture Fund
Statements of Operations and Changes in Net Position
For the years ended September 30, 1996 and 1995
(Dollars in thousands)
(Continued)

| | <u>1996</u> | <u>1995</u> |
|---|------------------|------------------|
| Program expenses - Discretionary: | | |
| Awards for information or assistance | \$ 355 | \$ 186 |
| Purchases of evidence and information | 1,770 | 2,349 |
| Federal law enforcement conveyance | 8,617 | 16,182 |
| Other | 601 | 4,129 |
| Total discretionary expenses | <u>11,343</u> | <u>22,846</u> |
| Total program expenses | <u>\$115,317</u> | <u>\$110,740</u> |
| Excess of net revenues and financing sources over total program expenses | 3,337 | 28,509 |
| Distribution to ONDCP's Special Forfeiture Fund | (16,388) | (21,922) |
| Recission of apportionment (note 7) | (194) | -- |
| Net Position, beginning of year | <u>157,917</u> | <u>151,330</u> |
| Net Position, end of year (note 7) | <u>\$144,672</u> | <u>\$157,917</u> |

The accompanying notes are an integral part of these financial statements.

(1) Reporting Entity

The Department of the Treasury Forfeiture Fund (Treasury Forfeiture Fund or the Fund) was established by the Treasury Forfeiture Fund Act of 1992, Public Law 102-393 (the TFF Act), and is codified at 31 USC 9703. The Fund was created to consolidate all Treasury law enforcement bureaus under a single forfeiture fund program administered by the Department of the Treasury. Treasury law enforcement bureaus fully participating in the Fund are the U.S. Customs Service (Customs); the Internal Revenue Service (IRS); the United States Secret Service (Secret Service); the Bureau of Alcohol, Tobacco and Firearms (ATF); the Financial Crimes Enforcement Network (FinCEN); and the Federal Law Enforcement Training Center (FLETC). FinCEN and FLETC contribute no revenue to the Fund and receive relatively few distributions from the Fund. The U.S. Coast Guard, part of the Department of Transportation, also participates in the Fund. However, all Coast Guard seizures are treated as Customs' seizures because the Coast Guard lacks seizure authority.

Prior to the establishment of the Fund, ATF, IRS and Secret Service participated in the Assets Forfeiture Fund of the Department of Justice. Customs had its own forfeiture fund into which deposits of all Customs and Coast Guard forfeitures were made. The Fund basically transformed the Customs Forfeiture Fund into a Departmental fund serving the needs of all Treasury law enforcement bureaus. FinCEN and FLETC did not previously participate in any forfeiture fund. Prior to fiscal year 1994, only Customs and Coast Guard participated in the Fund.

The Fund is a special fund that is accounted for under Treasury symbol numbers 20X5693 and 20X5697. The Fund is managed by the Executive Office for Asset Forfeiture (EOAF).

Under a Memorandum of Understanding (MOU) with the Department of the Treasury, Customs acts as the executive agent for certain Fund operations. Pursuant to that executive agency role, the Customs Accounting Services Division (ASD) is responsible for accounting and financial reporting for the Fund; including timely and accurate reporting and compliance with Treasury, the Comptroller General and the Office of Management and Budget (OMB) regulations and reporting requirements.

The principal goals of the Treasury forfeiture program are to: (1) punish and deter criminal activity by depriving criminals of property used in or acquired through illegal activities; (2) be cognizant of the due process rights of affected persons; (3) enhance cooperation among foreign, federal, state, and local law enforcement agencies through the equitable sharing of assets forfeited; and (4) produce revenues to enhance the forfeiture program and strengthen law enforcement.

(2) Summary of Significant Accounting Policies

Basis of Accounting and Presentation

The accompanying financial statements have been prepared to report the financial position and results of operations of the Fund. Until a sufficiently comprehensive set of accounting standards is agreed to and published by the Joint Financial Management Improvement Program (JFMIP) principals, which will constitute generally accepted accounting principles for the federal government, the following hierarchy shall constitute an "other comprehensive basis of accounting" used for preparing these financial statements:

- Individual standards developed by the Federal Accounting Standards Advisory Board and agreed to and published by the JFMIP principals.

NOTES TO FINANCIAL STATEMENTS

- Form and content requirements included in OMB Bulletin No. 94-01 and subsequent issuances.
- Accounting standards contained in agency accounting policy, procedures manuals and/or related guidelines, so long as they are prevalent practices.
- Accounting principles published by authoritative standard setting bodies and other authoritative sources: (1) in the absence of other guidance in the first three parts of this hierarchy; and (2) if the use of such accounting standards improve the meaningfulness of these financial statements.

Financial Statements Presented

To appropriately present the results of its principal activities (i.e., custodial/fiduciary responsibilities) and the funding of such, the Fund has presented a statement of operations and changes in net position with the detailed changes in net position presented in note 7. The Department of the Treasury was granted a waiver by the Office of Management and Budget from preparing the statement of cash flows and the statement of budgetary resources and actual expenses. As such, these statements are not included in the annual report of the Fund.

The form and content of the statement of financial position, as suggested by OMB, has been adjusted to present non-entity assets (and offsetting liabilities) for revenue collected or to be collected but not yet distributed to the various entities expected to receive these funds.

Allowable Fund Expenses

The majority of the revenue recorded by the Fund is utilized for operating expenses or distributed to state and local law enforcement agencies, other federal agencies, other foreign governments and the Office of National Drug Control Policy (ONDCP) Special

Forfeiture Fund in accordance with the various laws and regulations governing the operations and activities of the Fund. These activities reflect the

custodial/fiduciary responsibilities that the Fund has been authorized by law to enforce.

Under the TFF Act, the Fund is authorized to pay certain discretionary and non-discretionary expenses.

Non-discretionary expenses include all proper expenses of the seizure (including investigative costs and purchases of evidence and information leading to seizure, holding cost, security costs, etc.), awards of compensation to informers, satisfaction of liens against the forfeited property, and claims of parties in interest to forfeited property. Expenses incurred by state and local law enforcement agencies in joint law enforcement operations with a Treasury law enforcement organization are also recognized as non-discretionary expenses.

Discretionary expenses include purchases of evidence and information related to smuggling of controlled substances; equipment to enable vessels, vehicles or aircraft to assist in law enforcement activities; reimbursement of private persons for expenses incurred while cooperating with a Treasury law enforcement organization in investigations; and publication of the availability of awards.

Discretionary expenses are subject to an annual, definite Congressional appropriation from deposits made to the Fund. Under the Act, non-discretionary expenses are subject to a permanent indefinite Congressional appropriation and financed through the revenue generated from forfeiture activities without limitation.

The Fund's expenses are generally paid on a reimbursement basis. Reimbursable expenses are incurred by the respective bureaus participating in the Fund against their appropriation and then submitted to the Fund for reimbursement. The bureaus are reimbursed through Inter-Agency

NOTES TO FINANCIAL STATEMENTS

Transfer (SF-1081) or Online Payments and Collections (OPAC). Certain expenses such as equitable sharing payments, are paid directly from the Fund.

Further, the Fund is a component unit of the Department of the Treasury and as such, employees of Treasury perform certain operational and administrative tasks related to the Fund. Payroll costs of employees directly involved in the security and maintenance of forfeited property are recorded as expenses in the financial statements of the Fund (included in the line item "seizure investigative costs and asset management" in the statement of operations and changes in net position).

Revenue and Expense Recognition

Revenue from the forfeiture of property is deferred until the property is sold or transferred to a state, local or federal agency or foreign government. Revenue is not recorded if the forfeited property is ultimately destroyed or cannot be legally sold.

Revenue from currency is recognized upon forfeiture. Payments in lieu of forfeiture (mitigated seizures) are recognized as revenue when the payment is received. Revenue received from participating with certain other federal agencies is recognized when the payment is received. Similar to the distributions of forfeited property or currency made to federal, state or local agencies or foreign countries who provide direct or indirect assistance in related seizures, the fund receives proceeds from certain other federal agencies. Operating costs are recorded as expenses when goods are received or services are performed.

As provided for in the TFF Act, the Fund has invested seized and forfeited currency. Treasury's Financial Management Service invests the funds in obligations of, or guaranteed by, the United States government. Interest is reported to the Fund and recorded monthly in the general ledger.

Transactions with Office of National Drug Control Policy

At fiscal year end, certain excess unobligated balances, on a budgetary basis, remaining in the Fund are to be transferred to the Office of National Drug Control Policy (ONDCP) Special Forfeiture Fund. The Omnibus Crime Control Act of 1994 requires the transfer of one half of all excess unobligated balances, up to \$100 million, to the ONDCP Special Forfeiture Fund. The remaining excess unobligated balances are retained in the Fund. Liabilities of approximately \$16.4 million and \$21.9 million to the ONDCP Special Forfeiture Fund for fiscal years 1996 and 1995, respectively, have been recognized in the accompanying statement of financial position.

Assets Distributed

Forfeited property, currency or proceeds from the sales of forfeited property may be shared with federal, state and local law enforcement agencies or foreign governments which provided direct or indirect assistance in the related seizure. In addition, the Fund may transfer forfeited property to other federal agencies which would benefit from the use of the item. A new class of asset distribution was established for victim restitution in 1995. These distributions include property and cash returned to victims of fraud and other illegal activity. Upon approval by EOAF management to share or transfer the assets, both revenue from distributed forfeited assets and distributions (allocations or revenue) are recognized for the net realizable value of the asset to be shared or transferred, thereby resulting in no gain or loss recognized. Liabilities are recognized when EOAF approves payments.

Reclassification

During fiscal year 1996, the Fund's management reclassified the operating expense categories in the statement of operations and changes in net position

NOTES TO FINANCIAL STATEMENTS

to align with the expense categories used in preparing the budget for the Fund. Although the total amount of non-discretionary and discretionary expenses did not change, the individual expense line items were changed. Accordingly, the accompanying financial statements of the Fund for 1995 have been restated to be comparable to 1996's presentation.

Entity Assets

Entity assets are used to conduct the operations and activities of the Fund. Entity assets consist of cash or other assets which could be converted into cash to meet the Fund's current or future operational needs. Such other assets include investments, receivables, and forfeited property which is held for sale or to be distributed.

- **Fund Balance with Treasury and Cash --** Fund balance with Treasury and cash represents monies, including forfeited cash not deposited.
- **Investments --** This includes cash in the Treasury Forfeiture Fund and seized currency held in the Customs suspense account.
- **Receivables --** Intragovernmental receivables principally represent monies due from Customs and the Justice Assets Forfeiture Fund. The values reported for governmental receivables are primarily funds owed from EG&G Dynatrend, the seized and forfeited property contractor.
- **Prepaid Expenses --** In some instances, mortgages and other claims are paid before final closing of sale of related property, as required by court order. Such amounts paid are eventually obtained from the sale of the property. The values reported here are associated with these special transactions.

- **Forfeited Property --** Forfeited property is recorded at estimated fair value at the time of seizure. However, based on historical sales experiences for the year, properties are adjusted to reflect the current fair market value at the end of the fiscal year. Direct and indirect holding costs are not capitalized for individual forfeited assets. Forfeited currency is included in fund balance with Treasury and cash in the accompanying statement of financial position.

Further, mortgages and claims on forfeited assets are recognized as a valuation allowance and a reduction of deferred revenue from forfeited asset when the asset is forfeited. The allowance includes mortgages and claims on forfeited property held for sale and a minimal amount of claims on forfeited property previously sold. Mortgages and claims expenses are recognized when the related asset is sold and is reflected as a reduction of sales of forfeited property.

OMB issued Statement of Federal Financial Accounting Standards Number 3, *Accounting for Inventory and Related Property* (SFFAS No. 3). SFFAS No. 3 requires seized monetary instruments (cash and cash equivalents) to be recognized as an asset in the financial statements and a liability be established in an amount equal to the seized asset value. SFFAS No. 3 also specifies that a valuation allowance be established against forfeited property for liens or claims from a third party.

SFFAS No. 3 requires certain additional disclosures in the notes to the financial statements, including an analysis of changes in seized property and an analysis of changes in forfeited property, for both carrying value and quantities from that on hand at the beginning of the year to that on

NOTES TO FINANCIAL STATEMENTS

hand at the end of the year. These analyses are disclosed in notes 5 and 6.

In fiscal year 1995, the Department of the Treasury issued guidance defining currency for the purposes of applying SFFAS No. 3. This definition excluded marketable securities, foreign currency and other non-cash equivalents from the definition of currency. The change in accounting principle results from the reclassification of other financial instruments from cash which does not produce revenue until it is disposed. Prior to fiscal year 1995, these types of assets were treated as currency and revenue was recognized immediately upon forfeiture.

Non-entity Assets

"Non-entity assets" consist of seized currency and investments of seized currency. Because the non-entity assets are not considered as financing sources (revenue) available to offset operating expenses, a corresponding liability is recorded and presented as governmental liabilities under "liabilities not covered by budgetary resources" in the statement of financial position to reflect the custodial/fiduciary nature of these activities.

- **Seized Currency** -- is defined as cash or financial instruments that are readily convertible to cash on a dollar for dollar basis. Seized property (including currency and monetary instruments) is recorded at its market value at the time of seizure. The value is determined by the seizing entity and is usually based on market analysis such as a third party appraisal, standard property value publications or bank statement.

Liabilities Covered by Budgetary Resources

Liabilities covered by budgetary resources represent liabilities incurred which will be covered by

available budgetary resources. The components of such liabilities for the Fund are as follows:

- **Distributions Payable** -- Distributions payable to federal sources is principally related to surplus revenue that, by law, must be transferred to the ONDCP. (See "Transactions with Office of National Drug Control Policy"). Distributions payable to non-federal sources is associated with equitable sharing payments to state and local governments, and payments to be made by the Fund to victims of fraud.
- **Accounts Payable** -- Amounts reported in this category are mainly accrued expenses authorized by the TFF Act (See "Allowable Fund Expenses") for which reimbursement was pending at year end.
- **Deferred Revenue from Forfeited Assets** -- At year end, forfeited assets were held by the Fund which had not yet been converted into cash through sale and deposited. The amount reported here represents the value of these assets, net of mortgages and claims.

Liabilities Not Covered by Budgetary Resources

These amounts represent liabilities of the Fund which are not covered by available budgetary resources. Such liabilities consist of commitments and contingencies, which is disclosed in note 13, and seized currency. As explained in the above non-entity assets section, seized currency presented here is a corresponding liability recorded to reflect the custodial/fiduciary natures of the non-entity assets.

The presentation of non-entity assets and the corresponding liabilities in a separate, self-balancing set of accounts ensures that the net position of the Fund presents only those resources which will be consumed in current or future operating cycles,

NOTES TO FINANCIAL STATEMENTS

while the non-entity categories contain resources relating to the Fund's custodial/fiduciary activities.

Net Position

The components of net position are classified as follows:

- **Unobligated Balance** -- Under the Act, the Secretary of the Treasury is authorized to retain in the Fund up to \$50 million of the unobligated balance, on a budgetary basis of the Fund or, if the Secretary determines a greater amount is necessary for asset specific expenses, an amount equal to but not more than 10 percent of the total obligations from the Fund in the preceding fiscal year. As provided for under the TFF Act, effective September 30, 1996, EOAF reduced the unobligated balance to \$40 million.
- **Unliquidated Obligations** -- This category represents the amount of undelivered purchase orders, contracts and equitable sharing requests which have been obligated with current budget resources. An expense and liability are recognized and the corresponding obligations are reduced as goods are received or services are performed. For equitable sharing, the expense and liability are recognized and the corresponding obligations are reduced when final EOAF approval for payment is given.
- **Cumulative Results of Operations** -- This category represents the net difference, since the inception of the activity, between: (1) expenses and losses and distributions; and (2) financing sources including used appropriations, revenues and gains.
- **Distributions to ONDCP's Special Forfeiture Fund** -- This category represents the balance to be transferred to ONDCP.

(See "Transactions with the Office of National Drug Control Policy").

(3) Entity - Fund Balance with Treasury and Cash

Fund balance with Treasury and cash as of September 30, 1996, and 1995, consists of the following (dollars in thousands):

| | <u>1996</u> | <u>1995</u> |
|-------------|------------------|------------------|
| Obligated | \$ 118,089 | \$ 91,240 |
| Unobligated | <u>(42,107)</u> | <u>129,177</u> |
| | <u>\$ 75,982</u> | <u>\$220,417</u> |

The negative unobligated fund balance with Treasury and cash is offset by investments. Forfeited cash held as evidence included in fund balances with Treasury and cash amounted to approximately \$9.0 million and \$12.6 million at September 30, 1996, and 1995, respectively.

(4) Investments

All investments are short-term (31 days or less) non-marketable par value Federal debt securities issued by the Bureau of Public Debt and purchased through the Department of the Treasury's Financial Management Service. Investments are always purchased at a discount and are reported at acquisition cost, net of discount. The discount is amortized into interest income over the term of the investment. The investments are always held to maturity. They are made from cash in the Treasury Forfeiture Fund and from seized currency held in the Customs Suspense Account. Interest earned on investments of seized currency is recognized as revenue of the Fund. The following schedule presents the investments on hand as of September 30, 1996, and 1995 (dollars in thousands):

NOTES TO FINANCIAL STATEMENTS

| <u>Description</u> | <u>Par</u> | <u>Discount</u> | <u>Net</u> |
|----------------------------|------------------|------------------|------------------|
| <u>September 30, 1996:</u> | | | |
| Treasury Forfeiture Fund - | | | |
| 31 days 4.86% U.S. | | | |
| Treasury Bills | \$145,990 | \$(611) | \$145,379 |
| U.S. Customs Suspense | | | |
| Account - | | | |
| 31 day 4.86% U.S. | | | |
| Treasury Bills | <u>166,215</u> | <u>(696)</u> | <u>165,519</u> |
| Total | <u>\$312,205</u> | <u>\$(1,307)</u> | <u>\$310,898</u> |

| | | | |
|----------------------------|------------------|----------------|------------------|
| <u>September 30, 1995:</u> | | | |
| Treasury Forfeiture Fund - | | | |
| 24 days 5.34% U.S. | | | |
| Treasury Bills | \$34,770 | \$(124) | \$34,646 |
| U.S. Customs Suspense | | | |
| Account - | | | |
| 27 day 5.35% U.S. | | | |
| Treasury Bills | <u>86,160</u> | <u>(346)</u> | <u>85,814</u> |
| Total | <u>\$120,930</u> | <u>\$(470)</u> | <u>\$120,460</u> |

Interest receivable at September 30, 1996, and 1995, was \$590,000 and \$566,000, respectively.

(5) Analysis of Changes in Forfeited Property and Currency

The following summarizes the components of forfeited property (net), as of September 30, 1996 and 1995 (dollars in thousands):

| | <u>1996</u> | <u>1995</u> |
|--|-----------------|-----------------|
| Held for Sale | \$32,747 | \$30,187 |
| To be shared with federal, state or local, or foreign government | <u>2,749</u> | <u>2,228</u> |
| Total forfeited property | 35,496 | 32,415 |
| Less: Allowance for mortgages and claims | <u>(2,094)</u> | <u>(2,770)</u> |
| Total forfeited property, net | <u>\$33,402</u> | <u>\$29,645</u> |

Forfeited property held for sale, net of allowance for mortgages and claims is \$30,653, and is presented in the statement of financial position.

NOTES TO FINANCIAL STATEMENTS

(5) Analysis of Changes in Forfeited Property and Currency (Continued)

The following schedule presents the changes in the forfeited property balance from October 1, 1995, to September 30, 1996. The detail of this schedule by bureau, is presented in the notes to the financial statement of each bureau. Dollar value in thousands

| | 10/1/95 Financial Statement Balance | | Fair Value Adjustment | | 10/01/95 Carrying Value | | Forfeitures | | Deposits/Sales | | Deposits/Transfers | |
|---|-------------------------------------|--------|-----------------------|--------|-------------------------|--------|-------------|--------|----------------|--------|--------------------|--------|
| | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number |
| Currency | \$12,635 | -- | \$-- | -- | \$12,635 | -- | \$112,086 | -- | \$116,464 | -- | \$-- | -- |
| Other Monetary Instruments | 9,923 | -- | -- | -- | 9,923 | -- | 3,977 | -- | 5,406 | -- | -- | -- |
| Real Property | 15,675 | 116 | 2,350 | -- | 18,025 | 116 | 20,787 | 158 | 18,092 | 134 | 324 | 5 |
| General Property | 2,782 | 3,987 | 5,518 | -- | 8,300 | 3,987 | 32,015 | 7,562 | 22,653 | 2,997 | 2,447 | 1,864 |
| Vessels | 877 | 46 | 565 | -- | 1,442 | 46 | 1,863 | 79 | 2,303 | 76 | 343 | 9 |
| Aircraft | 918 | 8 | 2 | -- | 920 | 8 | 3,906 | 22 | 1,184 | 15 | 590 | 6 |
| Vehicles | 2,240 | 511 | 607 | -- | 2,847 | 511 | 12,494 | 4,294 | 7,188 | 4,064 | 3,669 | 226 |
| Total Other Monetary Instruments and Property | 32,415 | 4,668 | 9,042 | -- | 41,457 | 4,668 | 75,042 | 12,115 | 56,826 | 7,286 | 7,373 | 2,110 |
| Grand Total | \$45,050 | 4,668 | \$9,042 | -- | \$54,092 | 4,668 | \$187,128 | 12,115 | \$173,290 | 7,286 | \$7,373 | 2,110 |

| | Victim Restitution | | Destroyed | | Other Adjustments | | Value Change | | Fair Value Adjustment | | 9/30/96 Financial Statement Balance | |
|---|--------------------|--------|-----------|--------|-------------------|--------|--------------|--------|-----------------------|--------|-------------------------------------|--------|
| | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number |
| Currency | \$ 32 | -- | -- | -- | \$ 824 | -- | -- | -- | \$ -- | -- | \$ 9,049 | -- |
| Other Monetary Instruments | 816 | -- | -- | -- | 370 | -- | -- | -- | -- | -- | 8,048 | -- |
| Real Property | 788 | 5 | -- | -- | 596 | 8 | (194) | -- | (2,953) | -- | 17,057 | 138 |
| General Property | 21 | 21 | -- | 3,418 | 3,279 | 95 | (2,388) | -- | (12,559) | -- | 3,526 | 3,344 |
| Vessels | -- | -- | -- | 8 | (52) | (1) | (86) | -- | (191) | -- | 330 | 31 |
| Aircraft | -- | -- | -- | -- | (58) | (1) | -- | -- | 239 | -- | 3,233 | 8 |
| Vehicles | 70 | 4 | -- | 20 | (31) | (9) | (207) | -- | (874) | -- | 3,302 | 482 |
| Total Other Monetary Instruments and Property | 1,695 | 30 | -- | 3,446 | 4,104 | 92 | (2,875) | -- | (16,338) | -- | 35,496 | 4,003 |
| Grand Total | \$1,727 | 30 | \$-- | 3,446 | \$4,978 | 92 | (2,875) | -- | (\$16,338) | -- | \$41,545 | 4,003 |

The fair value adjustments above are necessary to convert forfeited property from unadjusted carrying value (market value at the time of seizure) to an estimate of the fair value at the time of forfeiture, which is the amount recorded in the financial statements. Due to the varied mix of specific types of assets within each asset category, the number of items presented in the 10/01/95 balance represent quantities calculated using many different units of measure. Due to the use of different units of measure within each asset category, the usefulness of this quantity disclosure is questionable. In 1996 in order to present a more meaningful quantity, the number presented for each class of property represents the number of seizure line items recorded regardless of the unit of measure or unit quantity.

Other adjustments above primarily represent minor reclassifications or adjustments to beginning balances. Value changes represent the changes in the appraised values of forfeited property during the year.

During the year, it was determined that contraband, such as narcotics, do not impact the financial position of the Fund.

Accordingly, the following numbers (no dollar value was attributable to contraband) of illegal drugs, previously separately disclosed, and other contraband, previously included in General Property, were removed from the above beginning balances:

| Number of Line Items | General Property | Illegal Drugs |
|----------------------|------------------|---------------|
| 9/30/95 Balance | 5,611 | 1,099 |
| Reclassification | (1,624) | (1,099) |
| 10/1/95 Balance | 3,987 | 0 |

NOTES TO FINANCIAL STATEMENTS

(6) Analysis of Changes in Seized Property and Currency

Seized property and currency result primarily for enforcement activities. Such property is not legally owned by the Fund until judicially or administratively forfeited. Because of the fungible nature of currency and the high level of control necessary over it, seized currency is reported as a custodial asset upon seizure. Seized property other than currency is reported as an asset upon forfeiture. The detail of this schedule by bureau, is presented in the notes to the financial statements of each bureau.

The following schedule presents the changes in the seized property balances from October 1, 1995 to September 30, 1996. (Dollar value in thousands):

| | 10/1/95 Financial Statement Balance | | Seizures | | Remissions | | Forfeitures | | Other Adjustments | | Value Change | | 9/30/96 Financial Statement Balance | |
|---|-------------------------------------|--------|-----------|--------|------------|--------|-------------|--------|-------------------|----------|--------------|--------|-------------------------------------|--------|
| | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number | Value | Number |
| Total Seized Currency | \$177,121 | -- | \$214,773 | -- | \$43,722 | -- | \$112,086 | -- | \$1,447 | -- | \$491 | -- | \$218,024 | -- |
| Other Monetary Instruments | 16,718 | -- | 10,725 | -- | 657 | -- | 3,977 | -- | (2,569) | -- | 198 | -- | 20,438 | -- |
| Real Property | 50,583 | 309 | 44,517 | 326 | 8,154 | 58 | 20,787 | 158 | (19,420) | (88) | 3,843 | -- | 50,582 | 331 |
| General Property | 146,160 | 17,976 | 208,291 | 34,767 | 89,842 | 11,830 | 32,015 | 7,562 | (37,698) | (9,478) | (14,922) | -- | 179,974 | 23,873 |
| Vessels | 3,688 | 116 | 7,161 | 267 | 2,979 | 63 | 1,863 | 79 | (1,935) | (101) | (45) | -- | 4,077 | 140 |
| Aircraft | 5,559 | 34 | 7,505 | 35 | 6,606 | 17 | 3,906 | 22 | (952) | (6) | (92) | -- | 1,508 | 24 |
| Vehicles | 21,433 | 2,957 | 107,491 | 12,643 | 49,669 | 3,897 | 12,494 | 4,294 | (46,173) | (3,707) | (1,056) | -- | 19,332 | 3,702 |
| Total Other Monetary Instruments and Property | \$244,141 | 21,392 | \$385,690 | 48,038 | \$157,857 | 15,865 | \$75,042 | 12,115 | \$(108,947) | (13,380) | \$(12,074) | -- | \$275,911 | 28,070 |
| Grand Total | \$421,262 | 21,392 | \$600,463 | 48,038 | \$201,579 | 15,865 | \$187,128 | 12,115 | \$(107,500) | (13,380) | \$(11,583) | -- | \$513,935 | 28,070 |

Included in other adjustments above are approximately \$98,305,000 of property that was seized directly or with assistance from other federal agencies during the fiscal year and transferred to other agencies. Value changes represent the changes in appraised values of seized property during the year.

Due to the varied mix of specific types of assets within each asset category, the number of items presented in the 1001/95 balance represent quantities calculated using many different units of measure. Due to the use of different units of measure within each asset category, the usefulness of this quantity disclosure is questionable. In 1996 in order to present a more meaningful quantity, the number presented for each class of property represents the number of seizure line items recorded regardless of the unit of measure or unit quantity.

During the year, it was determined that contraband, such as narcotics, do not impact the financial position of the Fund. Accordingly, the following numbers (no dollar value was attributable to contraband) of illegal drugs, previously separately disclosed, and other contraband previously included in General property, were removed from the beginning balances:

| General | | Illegal Drugs | |
|----------------------|---------|---------------|---------|
| Number of Line Items | | | |
| 9/30/95 Balance | 19,466 | | 6,376 |
| Reclassification | (1,490) | | (6,376) |
| 10/1/95 Balance | 17,976 | | -- |

NOTES TO FINANCIAL STATEMENTS

(7) Net Position

The following summarizes the changes in net position for the years ended September 30, 1996, and 1995 (dollars in thousands):

| | <u>Unobligated Balance</u> | <u>Unliquidated Obligations</u> | <u>Cumulative Results of Operations</u> | <u>Total Net Position</u> |
|---|--------------------------------|-------------------------------------|---|-----------------------------------|
| Balances, September 30, 1994 | \$50,000 | \$52,513 | \$48,817 | \$151,330 |
| Excess of net revenues and financing sources over total program expenses | -- | -- | 28,509 | 28,509 |
| Net change in obligations of current resources | -- | 4,656 | (4,656) | -- |
| Balances, September 30, 1995, before distribution to ONDCP's Special Forfeiture Fund | \$50,000 | \$57,169 | \$72,670 | \$179,839 |
| Distribution to ONDCP's Special Forfeiture Fund | -- | -- | (21,922) | (21,922) |
| Balances, September 30, 1995, net of distribution to ONDCP's Special Forfeiture Fund | \$50,000 | \$57,169 | \$50,748 | \$157,917 |
| Excess of net revenues and financing sources over total program expenses | -- | -- | 3,337 | 3,337 |
| Net change in obligations of current resources | -- | 9,544 | (9,544) | -- |
| Reduction of unobligated balance | (10,000) | -- | 10,000 | -- |
| Recission of Apportionment | -- | -- | (194) | (194) |
| Balances, September 30, 1996, before distribution to ONDCP's Special Forfeiture Fund | \$40,000 | \$66,713 | \$54,347 | \$161,060 |
| Distribution to ONDCP's Special Forfeiture Fund | -- | -- | (16,388) | (16,388) |
| Balances, September 30, 1996, net of distribution to ONDCP's Special Forfeiture Fund | \$40,000 | \$66,713 | \$37,959 | \$144,672 |

Recission of Apportionment -- During Fiscal Year 1996, Public Law 104-134 adjusted previously approved OMB apportionments for amounts not subject to appropriation. Rescissions were taken on a pro rata basis from funds available to every federal agency, department and office in the Executive Branch. Accordingly, the Fund's portion of the recission was \$194,000.

(continued)

NOTES TO FINANCIAL STATEMENTS

(7) Net Position (continued)

The following summarizes the components of unliquidated obligations as of September 30, 1996, and 1995 (dollars in thousands):

| | <u>1996</u> | <u>1995</u> |
|-------------------|-----------------|-----------------|
| Discretionary | \$ 6,577 | \$10,001 |
| Equitable Sharing | 25,544 | 21,199 |
| Non-discretionary | <u>34,592</u> | <u>25,969</u> |
| Total | <u>\$66,713</u> | <u>\$57,169</u> |

(8) Distributed Forfeited Assets

The following summarizes the component of distributed forfeited assets for the years ended September 30, 1996, and 1995 (dollars in thousands):

| | <u>1996</u> | <u>1995</u> |
|--|-----------------|------------------|
| Currency | \$46,132 | \$ 64,078 |
| Property | 6,757 | 9,084 |
| Proceeds from sales of forfeited property | <u>4,629</u> | <u>39,091</u> |
| Total | <u>\$57,518</u> | <u>\$112,253</u> |

(9) Related Party Transactions

The Fund reimbursed agencies for the purchase of certain capital assets. These assets are reported by the participating agencies. During the fiscal years ended September 30, 1996 and 1995, \$8,617,000 and \$16,182,000, respectively, of capital assets were reimbursed by the Fund and are reported as discretionary expenses in the accompanying financial statements.

(10) Mizuno Fraud and Money Laundering Case

The Mizuno case arose out of criminal activities of a Japanese firm headed by Ken Mizuno (Ken International Inc.) a Japanese citizen. Mizuno purchased U.S. properties with illegal funds obtained

from a conspiracy to oversell memberships in a nonexistent Japanese golf course. The case involved \$800 million in fraudulent memberships, of which \$260 million was concealed, disguised, and laundered in the U.S. Through numerous complex financial transactions, large purchases of automobiles, jewelry, a DC-9 jet, and various real properties in Nevada, California, and Hawaii, were made. Approximately \$100 million of the \$260 million was traced to the purchases of these assets.

The Japanese court system and the U.S. Attorney entered into an agreement in 1992 to dispose of designated assets belonging to the Mizuno firm that were located by Customs officials in the U.S. Under this agreement, certain proceeds from the sale of the Mizuno assets and forfeiture of currency were to be returned to Japan to pay victims of the fraud. The Treasury Forfeiture Fund would get ten percent of the net proceeds after costs.

EG&G Dynatrend, through their contract with Customs, disposed of the property through auction. The following summarizes the activity for fiscal years 1996 and 1995 (in millions):

| | <u>1996</u> | <u>1995</u> |
|---|-------------|-------------|
| Sales proceeds | \$ 2 | \$54 |
| Currency forfeiture proceeds | - | 2 |
| Other revenues | - | 3 |
| Payments due to victims of the fraud | 3 | 38 |
| Total expenses (including payments to victims) | 2 | 53 |
| Retained by the Fund and the Fund's share | - | 6 |

(11) Super Surplus

31 USC 9703 (g)(4)(B) allows for the expenditure, without fiscal year limitation, of funds amounting to one half of the excess of unobligated fund balances after the reservation of \$40 million for law enforcement activities of any Federal Agency. Under the TFF Act, the Fund is allowed to retain \$40 million effective September 30, 1996.

NOTES TO FINANCIAL STATEMENTS

Accordingly, EOAF reduced the unobligated fund balance from \$50 million (prior fiscal year balances) to \$40 million.

(12) Secretary's Enforcement Fund

31 USC 9703 (b)(5) is another category of permanent indefinite authority. These funds are available to the Secretary, without further action by Congress and without fiscal year limitation, for federal law enforcement purposes of Treasury law enforcement organizations. The source of Section 9703(b)(5) fund is equitable sharing payments received from the Department of Justice and the U.S. Postal Service (USPS) representing Treasury's share of forfeiture proceeds from Justice and USPS cases.

(13) Commitments and Contingencies

As of year end, there are equitable sharing requests in various stages of approval. Because final approval has not been obtained as of September 30, they are not recorded as liabilities of the Fund. However, the Fund identified equitable sharing requests in the amount of approximately \$19,439,000, and \$23,731,000 which were approved or in the final stages of approval subsequent to September 30, 1996, and 1995, respectively. The forfeited currency revenue was recognized in one fiscal year; however, the distribution will not be recognized in the financial statements until the following fiscal year. In addition to the amount estimated above, there are additional amounts which may ultimately be shared which are not identified at this time.

In recent decisions, the United States Court of Appeals for the Ninth Circuit ruled that it is unconstitutional to forfeit currency based upon a violation of a federal currency reporting statute. Accordingly, the court has ruled that in returning currency, the government must return the benefit that is received from holding the currency. The interest to be returned will be payable out of the

income of the Fund, and, at present, represents a possible claim of potential significance. However, at present it is not possible to determine the likelihood that such claims will arise. Similarly, it is not possible to determine the value of such potential claims against the Fund.

Judgement and settlement of \$25,000 or greater, resulting from litigation and claims against the Fund are satisfied from various claims and judgement funds maintained by the Department of the Treasury.

(14) Subsequent Events

In fiscal year 1995, the Assistant Secretary for Management (Treasury) approved the development of the Seized Asset and Case Tracking System (SEACATS). The development of this system was intended to replace several non-integrated tracking systems operated by Customs. SEACATS was also intended to serve as the financial system of record for the Fund and as the single repository for all inventory and case information related to seized and forfeited property, fines, penalties or liquidated damages of Customs. In November 1996, Customs implemented SEACATS. However, there have been a considerable number of start-up problems, including system conversion problems. Consequently, the difficulties encountered by SEACATS could ultimately affect the ability of the Fund to record and track revenues, expenses and changes in the seized and forfeited inventory during fiscal year 1997.

(15) Prior Period Adjustment -- Fiscal Year 1995

Certain adjustments were made during fiscal year 1995 to restate the October 1, 1994, balances of seized and forfeited property and currency. Those adjustments were for corrections or errors, adjustments to the property classifications, and conversions from quantities reported in recorded units of measure to number of seizure case records. Also, sales revenue recorded initially during fiscal

NOTES TO FINANCIAL STATEMENTS

(15) Prior Period Adjustment -- Fiscal Year 1995 (continued)

year 1995 was determined to be earned during fiscal year 1994. Adjustments were also made to reduce previously recorded liabilities for mortgages and claims on forfeited property which were subsequently determined to be invalid.

SECTION III
INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE
AND INTERNAL CONTROL STRUCTURE

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Independent Auditor's Report on Compliance

The Inspector General
United States Department of the Treasury
Washington, D.C.:

We have audited the financial statements of the Department of the Treasury Forfeiture Fund (the Fund) as of September 30, 1996, and for the year then ended, and have issued our report thereon dated January 17, 1997.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the Fund is the responsibility of the management of the Fund. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatements, we performed tests of the Fund's compliance with certain provisions of laws and regulations that may directly affect the financial statements, including the following:

- Budget and Accounting Procedures Act of 1950, as amended
- Chief Financial Officers Act of 1990
- Federal Manager's Financial Integrity Act of 1982 (FMFIA)
- Anti-Deficiency Act, Prompt Payment Act
- 31 USC 9703, Treasury Forfeiture Fund Act of 1992
- 19 USC 1300 Series
- 19 USC 1500 Series
- 19 USC 1600 Series
- 18 USC 981, 21 USC 881
- Customs and Trade Act, Trade and Traffic Act
- Comprehensive Crime Control Act
- Section 90205 of the Violent Crime Control and Law Enforcement Act of 1994
- Section 112 of the Treasury/Postal Appropriations Bill

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As part of our audit, we also obtained an understanding of the process by which the Fund identifies and evaluates weaknesses required to be reported under the FMFIA and related Treasury implementing procedures as it relates to the Fund. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such laws and regulations. Accordingly, we do not express such an opinion.

The results of our tests disclosed the following instance of noncompliance that is required to be reported herein under *Government Auditing Standards*.

The Budget and Accounting Procedures Act of 1950 as amended, Section 3512, *Executive Agency's Accounting System* requires federal agencies to establish an internal control structure which ensures the safeguarding of assets and the proper recording of revenues and expenditures. As described in our Report on Internal Controls dated January 17, 1997, the Fund's internal control structure has certain material weaknesses which result in noncompliance with this Act. Most of the material weaknesses require significant computer system improvements to correct. Until the system enhancements can be implemented, management has developed year-end manual procedures to compensate for many of the system weaknesses.

In accordance with *Government Auditing Standards*, we have also issued reports dated January 17, 1997 on our audit of the Fund's financial statements and on our consideration of the Fund's internal control structure.

This report is intended for the information and use of the U.S. Congress, the management of the Fund, and the U.S. Department of the Treasury. However, this report is a matter of public record and its distribution is not limited.

Gardiner Kanya & Associates, P.C.
January 17, 1997

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Independent Auditor's Report on Internal Control Structure

The Inspector General
United States Department of the Treasury
Washington, D.C.:

We have audited the financial statements of the Department of the Treasury Forfeiture Fund (the Fund) as of September 30, 1996, and for the year then ended, and have issued our report thereon dated January 17, 1997.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Fund is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- transactions including those related to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the financial statements and any other laws and regulations that the OMB, Fund management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated;
- funds, property, and other assets are safeguarded against loss from unauthorized use or disposition;
- transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over the assets; and

- data that support reported performance indicators are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Because of inherent limitation in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Fund as of and for the year ended September 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of significant internal control structure policies and procedures, determined whether they have been placed in operation, assessed control risk and performed tests of the Fund's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Our consideration included obtaining an understanding of the significant internal control structure policies and procedures and assessing the level of control risk relevant to all significant cycles, classes of transactions, or account balances.

With respect to the performance measure control objective described above, we obtained an understanding of relevant internal control structure policies and procedures designed to achieve this control objective and assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure over financial reporting that, in our judgement, could adversely affect the Fund's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited, or material to a performance indicator or aggregation of related performance indicators, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined below. However, we noted two matters involving the internal control structure and

its operation that we consider to be material weaknesses as defined below. These conditions were considered in determining the nature, timing and extent of the procedures to be performed in our audit of the financial statements of the Fund as of and for the year ended September 30, 1996.

The identified material weaknesses and reportable conditions, as defined above, are summarized below with further explanation in Exhibits I and II of this report.

Material Weaknesses

- **Accounting records are primarily maintained on a cash basis** - The Fund's accounting records are primarily maintained on the cash basis of accounting, rather than the accrual basis. Accordingly, most transactions are reflected in the accounting system when the cash is received or disbursed rather than when the transactions occur. Financial information and transactions from each bureau are not received timely to accurately record the Fund's activities during the year. Hence, year-end manual procedures were developed in order to produce accrual basis financial statements that could be substantiated through an audit.
- **General ledger** - The Fund's general ledger does not record all balances and transactions that are reflected in the financial statements. Financial information needed from each bureau to accurately record the Fund's activities are not sent timely. Rather, procedures were developed to identify and capture information manually from other bureaus' systems in order to compile the financial statements.

The above material weaknesses were identified in the prior year's Independent Auditor's Report on Internal Control Structure and are of continuing significance.

Reportable Conditions

- **Inventory property tracking systems** - The four Treasury law enforcement bureaus used four different inventory tracking systems to prepare the required analysis of changes in forfeited and seized property schedules. The four systems collect and account for seized and forfeited assets differently and used slightly different data definitions. As a result, manual manipulation and reconciliation are required to produce the analysis of change in forfeited and seized property schedules.
- **Forfeited property valuation** - Forfeited property is not recorded in the subsidiary system during the year at its fair value at the time of forfeiture. An adjustment is made to the financial statements as of September 30, 1996 and 1995, to record forfeited property at an estimate of fair value.

The above reportable conditions were identified in the prior year's Independent Auditor's Report on Internal Control Structure and are of continuing significance.

Although in preparing the financial statements, the Fund's management uses year-end manual procedures to compensate for the above identified conditions and weaknesses, these conditions and weaknesses existed throughout the year and therefore information obtained from the accounting system during the year may not be reliable and management of the Fund should not place reliance on the information as the sole basis on which to base decisions.

Because these conditions and weaknesses impact many functions and lines of authority between the Treasury bureaus, we recommend the Fund's management, together with the other Treasury bureaus, develop a joint plan to implement the recommendations included in Exhibits I and II.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of the Fund in a separate letter dated January 17, 1997.

In accordance with *Government Auditing Standards*, we have also issued reports dated January 17, 1997 on our audit of the Fund's financial statements and its compliance with laws and regulations.

This report is intended for the information and use of the U.S. Congress, the management of the Fund, and the U.S. Department of the Treasury. However, this report is a matter of public record and its distribution is not limited.

Gardiner Kampa & Associates, P.C.

January 17, 1997

EXHIBIT I
MATERIAL WEAKNESSES

ACCOUNTING RECORDS ARE PRIMARILY MAINTAINED ON A CASH BASIS

CONDITION

The Treasury Forfeiture Fund's (the Fund) general ledger as well as Customs, Secret Service, IRS and ATF's supporting systems are maintained primarily on a cash basis. In addition, these supporting computer systems maintained by each enforcement bureau do not interface with one another or with the Fund's general ledger to ensure that all transactions are accurately and timely recorded. To produce accrual basis financial statements that can be substantiated through an audit, year end manual procedures for each enforcement bureau were developed. The Fund's management provided each bureau representative with year end close out procedures to identify the amounts which should be accrued in the financial statements at year end.

Accounts Payable and Accrued Liabilities - The Fund does not follow accrual accounting whereby a liability and an expense is recognized when the underlying goods have been received or the services have been performed. Furthermore, during the fiscal year, reimbursement requests were not submitted regularly and on a timely basis.

Mortgage and Claims payable - The issue of how to determine a lien liability and when to reduce it has been addressed by EOAF in the updated directive number 14, "Expeditionary Payment of Liens, Mortgages and Taxes by the Department of the Treasury", effective October 1995. However, the updated directive does not provide clear instructions as to when the liability is to be recorded. Therefore, implementation of the instructions, while resolving other issues will not ensure that a liability is recorded for claims and mortgages throughout the year. In fact, the directive requires that upon EOAF's approval of payment, the appropriate accounting strip data be affixed to the paperwork authorizing the obligation and

disbursement of funds which is then to be forwarded to the Accounting Services Division (ASD) for processing. Also, the directive requires ASD to disburse the approved payments within 14 calendar days from the date of EOAF's approval of payment. These requirements do not provide for a complete accrual of all liens and mortgages that would provide reliable information throughout the year, because ASD cannot record the liability unless EOAF's approval with the accompanying accounting strip is received allowing recordation of a liability only for claims and mortgages that have been approved for payment.

Forfeited Currency - Currently, a time lag exists between when the Field Officers are notified of the forfeiture and when ASD, is notified of the forfeiture and therefore records revenue in the general ledger.

Distributions Payable - The Fund, under certain laws and regulations, has the authority to share forfeited property and currency with federal, state, and local agencies or foreign countries who participate either directly or indirectly in a related seizure. In addition, the Fund may transfer forfeited property to other federal agencies with appropriate approval. Currently the Fund does not record the transfer of property to other federal agencies during the fiscal year. Instead, the Fund makes an adjustment to record this information on the financial statements as part of the year end manual procedures.

Accounts Receivable - Customs Service maintains a contract with EG&G Dynatrend (EG&G) whereby EG&G stores property seized by any agency participating in the Fund, conducts auction sales of forfeited property, and collects storage costs reimbursed by violators. Cash collections made by EG&G on behalf of the Fund are deposited into various bank accounts in the name of EG&G and, within one week, are accumulated and transferred to the U.S. Treasury account at the Federal Reserve Bank of New York. The money collected by

EG&G represents a significant portion of the revenues earned by the Fund. However, the ASD only records revenue upon receipt of a validated deposit slip, which is approximately one week later.

CRITERIA

The Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, requires federal agencies to maintain accounts of the agency on the accrual basis. If the difference between the results of cash and accrual basis of accounting are insignificant, the cash basis of accounting may be followed.

The accrual basis of accounting contributes significantly to effective financial control over resources and costs of operations and is essential to the development of meaningful cost information. The accrual basis of accounting involves identifying and recording costs and revenues in the period in which the revenue is earned or the cost is incurred, rather than in the period revenue is collected or the cost is disbursed. This position is further supported by the Office of Management and Budget (OMB) Bulletin 94-01, *Form and Content of Agency Financial Statements*, which recommends the use of accrual basis of accounting by federal agencies.

CAUSE

In order for ASD to accurately record the Fund's activities on an accrual basis of accounting, financial transactions received from each bureau must be current and timely. Currently, the financial statement information received from the bureaus for accounts payable and accrued liabilities, mortgages and claims payable, and forfeited currency is not current. For example, ASD is not notified timely of the forfeiture of currency because: (1) the Field Offices are not monitoring and updating the system timely to reflect the change in the currency status; and (2) a standardized procedure for documenting the forfeiture date in the system has not been implemented. ASD is unable to identify that the

forfeiture has occurred prior to year end unless the system is updated or proper notification is given, because the forfeiture date is entered into the system by the field and the supporting documentation is maintained by the field.

EFFECT

The Fund's maintenance of the general ledger on a cash basis and the untimely recordation of transactions distorts the information reported in the financial statements on a monthly basis and results in the unavailability of accrual-basis financial information on which to rely for management's daily decision making procedures and evaluating the achievement of the Fund's objectives.

RECOMMENDATION

Although the necessary adjustments are made each September 30 to convert the cash basis financial data to the accrual basis, in order to comply with the requirements of SFFAS No. 1 and to improve financial information on which daily decisions are based, we recommend that the following specified procedures be implemented to properly account for transactions on the accrual basis of accounting throughout the year.

Accounts Payable and Accrued Liabilities - Customs, Secret Service, IRS and ATF should submit requests for reimbursement monthly to provide more timely results of operations for the Fund and thereby allow for more timely analysis of the financial position of the Fund. The reimbursement requests submitted by each law enforcement bureaus, but not yet paid by the Fund should be accrued as liabilities at each month end. Also, any direct payment requests which have been received but not paid at month end should be accrued as liabilities.

Mortgages and Claims Payable - We recommend that agencies record lien and mortgage information in their tracking systems. We also recommend that

the updated lien and mortgage information obtained from the national seized property contractor be used in the agencies' tracking systems.

Forfeited Currency - ASD performed a reconciliation of forfeited currency between the revenue recorded in Automated Commercial System (ACS) and the forfeited currency balance reported in the "Analysis of Changes in Forfeited Property" schedule required by the Statement of Federal Financial Accounting Standards No. 3 (SFFAS No. 3), *Accounting for Inventory and Related Property*. However, if the system is not timely updated, this reconciliation cannot provide the information necessary to capture the recognition of revenue for currency that was forfeited prior to year end.

In accordance with SFFAS No. 3, we recommend that forfeited currency be recognized as revenue at the time of forfeiture. The Seized Currency Tracking System (SCTS) is designed to account for Customs seized currency from the point of seizure (at which time it is recorded in a Customs' Fund) until the seized currency is either returned to the violator or forfeited. The F-13 report, produced from the SCTS, includes information for all currency seizures presently maintained in security vaults, bank suspense accounts, and safe deposit boxes at Customs locations and banks throughout the country. If the status of seizures are timely updated in SCTS by the Field Offices and the system is modified to record the forfeiture date, a forfeited currency receivable could be recorded by ASD based on the F-13 report.

However, in November 1996, Customs implemented a new tracking system, Seized Assets and Case Tracking System (SEACATS), that eliminates SCTS. SEACATS is supposed to perform all the functions previously performed by SCTS and will also interface with the Fund's general ledger. We recommend that: (1) Customs remind the field that the forfeiture date should be entered into SEACATS immediately after forfeiture, and (2) check SEACATS to ensure that it has been designed

properly to recognize revenue upon input of the forfeiture date.

While it may be less efficient, an alternative method to implement these recommendations is to require, at each month end, each district coordinator to submit a signed letter to the appropriate individual at the ASD indicating all seizures forfeited during the current month. A journal entry could then be recorded in the general ledger to recognize the forfeited currency as revenue.

Distributions Payable - We recommend that the Fund establish and implement policies and procedures to ensure the recordation of property distributed to federal, state, and local agencies or foreign countries during the fiscal year. The procedures may require that each law enforcement bureau submit, on a monthly basis, a list of all property distributed to federal, state, and local agencies or foreign countries for accrual in the general ledger.

Accounts Receivable - Due to the significance of the revenues collected by EG&G and the average two week lapse between receipt of funds by EG&G and the recordation of revenue by the ASD, we recommend that EG&G provide the Fund with details of cash held as of month-end indicating the composition of revenue (that is sales, reimbursed storage costs, etc.). Based on this information, we recommend that the ASD accrue revenues not collected.

Until the necessary system changes can be implemented, the manual year-end procedures will continue to be necessary to prepare subsequent year financial statements. Therefore, we recommend that the law enforcement bureaus be reminded of the importance of properly following the year-end procedures. We also recommend that procedures be again reviewed with the law enforcement bureaus to identify any possible misunderstandings or refinements to the procedures.

GENERAL LEDGER

CONDITION

The Asset Information Management System (AIMS), which is the general ledger system maintained by Customs, processes, groups and summaries transactions into account balances for all Custom funds and the Fund. The general ledger is currently not used to track all balances and transactions that comprise the Fund, such as accounts receivable, liens and mortgages payable, forfeited property and deferred revenue, and seized currency and its offsetting liability due to the lack of interface between the systems. Rather, information is identified and captured manually, at the end of the fiscal year, from other systems in order to properly compile financial statements.

CRITERIA

The Budget and Accounting Procedures Act of 1950, Section 3512, *Executive Agency's Accounting System* requires federal agencies to establish an internal control structure which ensures the safeguarding of assets and the proper recording of revenues and expenditures. It is further reinforced by the Federal Manager's Financial Integrity Act of 1982 (FMFIA) which requires that internal accounting and administrative controls be established to provide reasonable assurance that revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets. Finally, the Federal Accounting Standards Advisory Board (FASAB) has recommended certain standards, which have been issued by the OMB, requiring the use of the accrual basis of accounting (SFFAS No. 1) and accounting and reporting requirements for inventory and related property (SFFAS No. 3).

CAUSE

The Fund's general ledger is maintained on the cash basis. Accordingly, accrual basis accounts are not maintained during the year. In addition, the inventory subsidiary systems maintained by each of the Treasury law enforcement bureaus do not interface with the Fund's general ledger. Accordingly, inventory related transactions that are non-cash generated are not recorded in the Fund's general ledger.

EFFECT

The combined effect of the use of cash-basis accounting and the lack of interface among the relevant subsidiary systems and the general ledger precludes the capturing of all transactions related to the Fund on a regular (monthly) basis. Therefore, complete financial statements cannot be produced using the general ledger balances. Seized and forfeited property, related liabilities, and various other accrual accounts are not captured in the general ledger during the year. As a result, financial statements produced during the year do not correctly present the results of operation and net position of the Fund.

RECOMMENDATION

We recommend that all accrual basis accounts, seized currency and its offsetting liability, and forfeited property and the related revenue, be recorded in the Fund's general ledger in a timely manner. We recommend that existing procedures, be followed requiring each law enforcement bureaus' staff to forward the forfeiture information as authorized, to the appropriate personnel for updating the bureaus' inventory tracking system and, if held by the contractor, to EG&G, to update SEACATS to reflect changes in property status.

Alternatively, the Fund should develop and implement an integrated system which will capture all transactions in the general ledger, including accounts receivable, liens and mortgages payable,

forfeited property, deferred revenue, and seized
currency and its offsetting liability.

EXHIBIT II
REPORTABLE CONDITIONS

INVENTORY PROPERTY TRACKING SYSTEMS

CONDITION

Customs, IRS, Secret Service, and ATF maintain seized and forfeited property, the value of which is included in the Fund's financial statements. In the previous fiscal year, each bureau prepared an analysis of changes in forfeited and seized property, including the dollar amounts and quantities of property. However, no reliance was placed on the quantities presented because uniform measurements were not consistently used. In the current fiscal year, each bureau prepared an analysis of changes in forfeited and seized property, which included the dollar amounts of property and numbers of seizure case records.

The four Treasury law enforcement bureaus use four different inventory tracking systems to prepare the required analysis of changes in forfeited and seized property schedules. The four systems collect and account for seized and forfeited assets differently and use slightly different data definitions. As a result, manual manipulation and reconciliation are required to prepare the analysis in forfeited and seized property schedules. Additionally, since these inventory tracking systems do not tie to the Fund's system of record, it is necessary to perform substantive reconciliations between the Fund's records and the bureaus' records to give assurance that all transactions are being properly realized.

CRITERIA

SFFAS No. 3 requires disclosure of an analysis of changes in forfeited and seized property. The standard requires presentation of both dollar amounts and quantity changes. Therefore, each of the law enforcement bureaus' inventory property tracking systems should provide all data necessary to produce the analysis of changes in forfeited and seized property, with minimal manual intervention and reconciliation, and to provide management with meaningful information.

CAUSE

Customs - The Customs' tracking system, Customs Property Tracking System (CPTS), maintains no historical data. The system overwrites data when changes are made and leaves no audit trail of when, how or why the changes were made. Specifically, any CPTS user can make changes to the system data to disguise a loss or theft of seized property, without a record of who made the change. Additionally, the system does not periodically generate a log of changes made, for supervisory review. Unauthorized changes would not likely be detected during seized property inventories since Custom's inventory instructions require only that quantity differences between CPTS and on-hand amounts be investigated.

ATF - In order to produce the SFFAS No. 3 exhibits, ATF printed a variety of standard reports and manually manipulated them to meet the reporting requirements. ATF's system, Consolidated Asset Tracking System (CATS), does not automatically perform the required reconciliation between seized currency and deposits to the Customs suspense account, or the reconciliation between forfeited currency and deposits to the Fund. ATF manually reconciled this information based on printed reports generated from the CATS system.

Also, difficulties were encountered in obtaining accurate reports of forfeited items. ATF staff were often aware that an item had been forfeited because they were in possession of a Final Order of Forfeiture. However, the CATS system did not recognize this item as forfeited and ATF staff were not allowed to enter a forfeiture date into the CATS system if the asset had been forfeited judicially. Consequently, manual adjustments were required in order to prepare the SFFAS No. 3 exhibits.

Secret Service - The Secret Service's tracking system known as Asset Tracking System (ATS), does not provide historical data on cases which have had subsequent activity. For example, if the Secret Service staff were to produce a schedule on October 31 requesting information as of September 30, but an event occurred during the period of September 30

to October 31, the system would produce a schedule which would include all activities through October 31. Manual adjustments and reconciliations would have to be performed to reflect only activity as of September 30. In essence, ATS produces reports as of the request date. As a result, to produce the SFFAS No. 3 exhibits, the Secret Service staff compared two or more schedules and made significant manual adjustments to complete the analysis of changes in forfeited and seized property SFFAS No. 3 exhibits.

EFFECT

The difficulties encountered in preparing the changes in forfeited and seized property analysis by the agencies referred to above indicate that the Fund lacks the ability to properly, fully and accurately account for seized and forfeited property.

The number of non-integrated systems makes reconciliation extremely difficult and seriously diminishes the quality of the data available for financial reporting.

The current policies and procedures were developed piecemeal and independently of any one systems initiative, and, as a result, the systems do not effectively support the policies and procedures.

Because the current systems were developed prior to the recognized need for consistent, timely and accurate financial management data and strict financial management controls, little or no system functions (e.g., beginning and ending balances, audit trails, etc.) exist to support these areas.

RECOMMENDATION

We understand that a major systems development effort which focuses on the design, development and implementation of a new inventory system has been approved and is underway for Customs. This system, as purported by the Fund's management, will provide a cradle-to-grave system for tracking all property from case initiation to final financial resolution and will meet all SFFAS No. 3 requirements for seized and forfeited property.

Implementation of the system by the Fund's management will be used to help produce the audited financial statements starting in fiscal year 1997. This system will be made available to the other enforcement bureaus. Prior to final implementation during the development life cycle, we recommend that each bureau produce the SFFAS No. 3 analysis requirements for seized and forfeited property in order to evaluate and update any shortfalls in the new system. We also recommend post conversion audits to ensure that the system works as purported. We recommend that the Fund eventually have only one inventory system with consistent data definitions. This will allow the law enforcement bureaus to recognize and correct any problems encountered in a more timely manner as well as alerting the staff to issues that might need to be considered in the development of the new system.

In fiscal year 1995, the Assistant Secretary for Management (Treasury) approved the development of the Seized Asset and Case Tracking System (SEACATS). The development of this system was intended to replace several non-integrated tracking systems operated by the Customs. SEACATS was also intended to serve as the financial system of record for the Fund and as the single repository for all inventory and case information related to seized and forfeited property, fines, penalties or liquidated damages of Customs. In November 1996, Customs implemented SEACATS. However, there have been a considerable number of start-up problems, including systems conversion problems. Consequently, the difficulties encountered by SEACATS could ultimately affect the ability of the Fund to record and track revenues, expenses and changes in the seized and forfeiture inventory during fiscal year 1997.

FORFEITED PROPERTY VALUATION

CONDITION

Forfeited property is not recorded in the subsidiary system during the year at its fair value at the time of forfeiture. Rather, the value of forfeited property is currently recorded in the law enforcement

bureaus' inventory tracking systems at appraised value (fair market value), determined at the seizure date, by the seizing agent, import specialist or independent appraiser.

To develop year end value of forfeited property for inclusion in the Fund's 1995 and 1996 financial statements, management performed a historical analysis by property category of sales values compared to the initial appraised amounts. These ratios were applied to the ending forfeited property value to determine the financial statement value of forfeited property.

CRITERIA

Statement of Federal Financial Accounting Standards (SFFAS) No. 3 requires forfeited property to be stated at fair market value at the time of forfeiture, in the bureaus' general ledger (inventory tracking systems).

CAUSE

The Fund does not perform an appraisal to determine fair market value of property at the date of forfeiture.

EFFECT

Carrying forfeited property at fair values as of seizure date, in particular, for financial reporting purposes can be misleading because the values are often overstated and therefore does not present an accurate picture of the net realizable value to the Fund.

RECOMMENDATION

We recommend that the Fund's management evaluate the accuracy of fair market values assigned to forfeited property. Accordingly, the fair market value should be determined by performing an appraisal at the date of forfeiture. We also recommend that the Fund's management continue reviewing the methodology used to arrive at fair market value to refine its accuracy and ease in

preparation. As the process is refined, it will become easier to prepare the monthly analysis to properly value and record month-end forfeited property balances.

SECTION IV
SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Equitable Sharing Summarized by State and U.S. Territories
For the year ended September 30, 1996
(Dollars in thousands)
(Unaudited)

| <u>State/U.S. Territories</u> | <u>Currency Value</u> | <u>Property Value</u> |
|-------------------------------|------------------------|-----------------------|
| Alabama | \$ 87 | \$ -- |
| Alaska | 56 | -- |
| Arizona | 1,138 | 262 |
| Arkansas | -- | 1 |
| California | 5,685 | 69 |
| Colorado | 131 | 2 |
| Connecticut | 58 | -- |
| D.C. Washington | -- | 60 |
| Delaware | 46 | -- |
| Florida | 8,764 | 315 |
| Georgia | 264 | 19 |
| Guam | 13 | -- |
| Hawaii | 15 | -- |
| Idaho | 11 | -- |
| Illinois | 1,541 | 13 |
| Indiana | -- | -- |
| Iowa | 160 | -- |
| Kansas | 10 | 2 |
| Kentucky | 6 | 1 |
| Louisiana | 5 | -- |
| Maryland | 45 | 17 |
| Massachusetts | 325 | 17 |
| Michigan | 152 | -- |
| Minnesota | 10 | -- |
| Mississippi | 101 | 11 |
| Missouri | 418 | 1 |
| Montana | 28 | 5 |
| Nebraska | -- | -- |
| Nevada | -- | -- |
| New Jersey | 2,430 | 96 |
| New Hampshire | -- | -- |
| New Mexico | 357 | 36 |
| New York | 12,339 | 29 |
| North Carolina | 552 | 69 |
| North Dakota | -- | 4 |
| Ohio | 345 | 6 |
| Oklahoma | 135 | -- |
| Oregon | 41 | -- |
| Pennsylvania | 572 | -- |
| Puerto Rico | -- | -- |
| Rhode Island | 2 | -- |
| South Carolina | 98 | 1 |
| South Dakota | -- | -- |
| Tennessee | 57 | -- |
| Texas | 10,988 | 27 |
| Utah | 24 | -- |
| Vermont | -- | -- |
| Virgin Islands | -- | -- |
| Virginia | 329 | 17 |
| Washington | 103 | 5 |
| West Virginia | 123 | 9 |
| Wisconsin | 38 | 10 |
| Wyoming | -- | -- |
| Total | <u>\$47,602</u> | <u>\$1,104</u> |

Summarized above are the currency and property values of assets forfeited and shared with state and local agencies and U.S. territories participating in the seizure. This supplemental schedule is not a required part of the financial statements of the Department of the Treasury Forfeiture Fund. Information in this schedule represents assets physically transferred during the year and therefore does not agree with total assets shared with state and local agencies in the financial statements. In addition, the above numbers do not include the adjustment to present property distributed at net realizable value.

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Uncontested Seizures of Currency and Monetary instruments Valued Over
\$100,000, Taking More Than 120 Days from Seizure to Deposit in Fund
For the year ended September 30, 1996
(Dollars in thousands)
(Unaudited)

| <u>State/U.S. Territory</u> | <u>Total Number of Cases</u> | <u>Forfeited Being Held as Evidence</u> | <u>Uncontested Cash</u> |
|-------------------------------|----------------------------------|---|-----------------------------|
| United States Customs Service | | | |
| Florida | 10 | \$155 | \$6,680 |
| New York | 11 | 200 | 4,332 |
| Puerto Rico | 8 | 121 | 1,915 |
| California | 6 | -- | 1,852 |
| Texas | 2 | -- | 985 |
| Illinois | <u>1</u> | <u>--</u> | <u>138</u> |
| Total | <u>38</u> | <u>\$476</u> | <u>\$15,902</u> |
| Internal Revenue Service | | | |
| Missouri | 3 | -- | 612 |
| North Carolina | <u>1</u> | <u>--</u> | <u>150</u> |
| Total | <u>4</u> | <u>--</u> | <u>762</u> |
| Grand Total | <u>42</u> | <u>\$476</u> | <u>\$16,664</u> |

31 U.S.C. 9703(f)(2)(E) requires the Secretary of Treasury to report annually to Congress uncontested seizures of currency or proceeds of monetary instruments over \$100,000, which were not deposited in the Department of the Treasury Forfeiture Fund within 120 days of the seizure date.

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Information Required by 31 U.S.C. 9703(f)
For the year ended September 30, 1996
(Unaudited)

The Treasury Forfeiture Fund Act of 1992, 31 U.S.C.9703(f), requires the Secretary of the Treasury to transmit to Congress, not later than February 1, of each year, certain information. The following summarizes the required information.

(1) A report on:

(A) The estimated total value of property forfeited with respect to which funds were not deposited in the Department of the Treasury Forfeiture Fund during the preceding fiscal year under any law enforced or administered by the Department of the Treasury law enforcement organizations or the United States Coast Guard, in the case of fiscal years beginning after 1993.

At September 30, 1996, the Fund had forfeited currency of \$9,048,000 held as evidence. These amounts are reported as undistributed funds with Treasury and cash in the audited financial statements.

As reported in the audited financial statements, at September 30, 1996, the Fund had forfeited property held for sale of \$32,747,000. The proceeds will be deposited in the Fund when the property is sold.

Upon seizure, currency, and other monetary instruments not needed for evidence in judicial proceedings are deposited in a Customs suspense account. Upon forfeiture, it is transferred to the Treasury Forfeiture Fund. At September 30, 1996, there was \$379,000 of forfeited currency and other monetary instruments that had not yet been transferred to the Fund. This is reported as a part of - "Intragovernmental accounts receivables" in the audited financial statements.

(B) The estimated total value of all such property transferred to any state or local law enforcement agency.

The estimated total value of all property transferred to any state or local law enforcement agency is summarized by state and U.S. territories. Total currency transferred was \$47,602,000 and total property transferred was \$1,104,000 at appraised value.

(2) A Report on:

(A) The balance of the Fund at the beginning of the preceding fiscal year.

The total net position of the Treasury Forfeiture Fund on September 30, 1995, which became the beginning balance for the Fund on October 1, 1995, as reported in the audited financial statements is \$157,917,000.

(B) Liens and mortgages paid and the amount of money shared with federal, state, local and foreign law enforcement agencies during the preceding fiscal year.

Mortgages and claims expense as reported in the audited financial statements were \$4,062,000. The amount actually paid on a cash basis was not materially different.

The amount of forfeited currency and property shared with federal, state, local and foreign law enforcement agencies as reported in the audited financial statements was as follows:

| | |
|--------------------------|--------------|
| State and local agencies | \$47,683,000 |
| Foreign countries | \$111,000 |
| Other federal agencies | \$6,774,000 |

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Analysis of Revenues, Expenses, and Distributions
For the year ended September 30, 1996
(Dollars in thousands)
(Unaudited)

Revenues and expenses and distributions by asset category:

| | <u>Revenues</u> | <u>Expenses and Distribution</u> |
|---|------------------|--------------------------------------|
| Vehicles | \$ 8,699 | \$ 17,130 |
| Vessels | 2,416 | 21,826 |
| Aircraft | 2,416 | 7,031 |
| General Property | 7,732 | 69,275 |
| Real Property | 27,062 | 2,713 |
| Currency and monetary instruments | <u>138,586</u> | <u>49,211</u> |
| | 186,911 | 167,186 |
| Less: | | |
| Mortgages and claims | (4,062) | (4,062) |
| Refunds | (6,677) | (6,677) |
| Add: | | |
| Allocation of revenue to ONDCP Special Forfeiture Fund | -- | 16,388 |
| Excess of net revenues and financing sources over total program expenses | <u>--</u> | <u>3,337</u> |
| | <u>\$176,172</u> | <u>\$176,172</u> |

Revenues and expenses and distributions by type of disposition:

| | <u>Revenues</u> | <u>Expenses and Distribution</u> |
|---|------------------|--------------------------------------|
| Sales of property and forfeited currency and monetary instruments | \$127,620 | \$ 31,739 |
| Reimbursed storage costs | 1,773 | 17,214 |
| Assets shared with state and local agencies | 47,683 | 47,683 |
| Assets shared with other federal agencies | 6,774 | 6,774 |
| Assets shared with foreign countries | 111 | 111 |
| Victim Restitution | 2,950 | 2,950 |
| Destructions | -- | 19,826 |
| Pending disposition | <u>--</u> | <u>40,889</u> |
| | 186,911 | 167,186 |
| Less: | | |
| Mortgages and claims | (4,062) | (4,062) |
| Refunds | (6,677) | (6,677) |
| Add: | | |
| Allocation of revenue to ONDCP Special Forfeiture Fund | -- | 16,388 |
| Excess of net revenues and financing sources over total program expenses | <u>--</u> | <u>3,337</u> |
| | <u>\$176,172</u> | <u>\$176,172</u> |

This supplemental schedule "Analysis of Revenues, Expenses and Distributions" is required under the Treasury Forfeiture Fund Act of 1992. The allocations in the schedule were determined from information obtained from a U.S. Customs Service information system. This system maintains revenue and expenses by each seizure for property held at the contractor. The percentages of revenue and expenses from this system were applied to revenue and expenses and distributions as reflected in the statement of operations and changes in net position. Because the Fund does not have a cost accounting system, the method used does not provide reliable information in the analysis of revenue and expenses and distributions by type of disposition. The information is presented to comply with the requirements of the Treasury Forfeiture Fund Act of 1992.

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Information Required by 31 U.S.C. 9703(f)
For the year ended September 30, 1996
(Unaudited)

(C) The net amount realized from the operations of the Fund during the preceding fiscal year, the amount of seized cash being held as evidence, and the amount of money that has been carried over into the current fiscal year.

The net amount realized from the operations of the Fund as shown in the audited financial statements is \$3,337,000.

The amount of seized currency not on deposit in the Fund's suspense account at September 30, 1996, was \$20,171,000. This amount includes some funds in process of being deposited at year end; cash seized in August or September 1996, that is pending determination of its evidentiary value from the U.S. Attorney; and the currency seized for forfeiture being held as evidence.

On a budgetary basis, unobligated balances as originally reported on the Office of Management and Budget Reports, SF-133, "Report on Budget Execution," was approximately \$72,775,000 for fiscal year 1996. As provided by the Omnibus Crime Control Act of 1995, \$40 million and one half of the excess unobligated balances of \$16,388,000 in fiscal year 1996, are retained in the Fund.

(D) Any defendant's property, not forfeited at the end of the proceeding fiscal year, if the equity in such property is valued at \$1 million or more.

The total approximate value of such property for the Treasury Forfeiture Fund, at estimated values determined by Agency and contractor officials, and the number of seizures is as follows:

| | | |
|-----------------|---------------|-------------|
| Customs Service | \$159,761,000 | 52 seizures |
| IRS | \$66,831,000 | 22 seizures |
| Secret Service | \$1,037,000 | 1 seizure |

(E) The total dollar value of uncontested seizures of monetary instruments having a value of over \$100,000 which, or the proceeds of which, have not been deposited into the Fund within 120 days after the seizure, as of the end of the preceding fiscal year.

The total dollar value of such seizures is \$16,664,000. A separate schedule is presented on page 58.

(F) The balance of the Fund at the end of the preceding fiscal year.

The total net position of the Fund at September 30, 1996, as reported in the audited financial statements is \$144,672,000.

(G) The net amount, if any, of the excess unobligated amounts remaining in the Fund at the end of the preceding fiscal year and available to the Secretary for federal law enforcement related purposes.

In fiscal year 1996, \$40 million was allowed to be retained in the Fund. One half of the excess unobligated amounts were to be transferred to the ONDCP Special Forfeiture Fund. In addition, on a budgetary basis, the Fund was allowed to retain the remaining \$16,388,000 of the excess unobligated amounts.

(H) A complete set of audited financial statements prepared in a manner consistent with the requirements of the Chief Financial Officers Act of 1990.

The audited financial statements, including the Independent Auditor's Report, is found in Section II.

DEPARTMENT OF THE TREASURY FORFEITURE FUND
Information Required by 31 U.S.C. 9703(f)
For the year ended September 30, 1996
(Unaudited)

(I) An analysis of income and expense showing revenue received or lost (i) by property category (such as general property, vehicles, vessels, aircraft, cash, and real property); and (ii) by type of disposition (such as sale, remission, cancellation, placement into official use, sharing with state and local agencies, and destruction).

A separate schedule is presented on page 59.