



AUDIT OF THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' USE OF INCOME- GENERATING, UNDERCOVER OPERATIONS

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AUDIT OF THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' USE OF INCOME-GENERATING, UNDERCOVER OPERATIONS

EXECUTIVE SUMMARY

The Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) is responsible for the investigation and prevention of federal offenses involving the unlawful use, manufacture, and possession of firearms and explosives, acts of arson and bombings, and illegal trafficking of alcohol and tobacco products. In conducting its undercover operations, ATF may participate in transactions that are normally prohibited by federal law. In most of these illicit transactions, ATF uses appropriated funds to make any purchases and deposits any proceeds into the Department of the Treasury's General Fund.

However, in 2004, ATF was granted the same authority previously provided to the Federal Bureau of Investigation (FBI) and the Drug Enforcement Administration (DEA) to use proceeds generated from these undercover operations to offset necessary and reasonable operational expenses related to the same operations. ATF refers to this authority as "churning authority," and to cases that use such authority as "churning investigations." To date, the ATF has used this authority only to investigate tobacco diversion, which involves efforts to evade state, local, or federal tobacco taxes.

The Office of the Inspector General (OIG) conducted this audit to determine whether ATF: (1) properly authorized income-generating undercover operations (churning investigations); and (2) provided adequate management and oversight of its churning investigations.¹ Our audit included a review of 20 of the 36 churning investigations conducted by ATF between February 2006 and June 2011 that generated total reported revenues of nearly \$162 million.

We found a serious lack of oversight by ATF at both the headquarters and field office levels during the period of time covered by the audit. ATF's guidance regarding churning investigations lacked breadth and specificity, and managers at ATF headquarters as well as managers and Special Agents

¹ During this audit, we identified certain issues requiring further investigation. We referred those matters to the OIG's Investigations Division, and put our audit on hold pending such investigation. Subsequently, we were able to complete our audit and issue this report.

at ATF field offices often disregarded it. We found that ATF proceeded with churning investigations without proper approval, misused the proceeds from churning investigations, and failed to account properly for cigarettes and assets purchased during churning investigations.

With respect to approval of churning investigations, we found that none of the 35 requests for churning authority approval submitted to ATF Headquarters and the Department between February 2006 and June 2011 had been reviewed by ATF's Undercover Review Committee prior to submission to the Department, as was required by ATF policy. Indeed, we were told that ATF's Undercover Review Committee did not meet between February 2005 and January 2012. Additionally, we found that 33 of 35 requests did not include critical information in the request as required by ATF policy.

We also identified one churning investigation that was never authorized by ATF Headquarters or the Department. The unauthorized churning investigation sold approximately \$15 million of cigarettes in an 18-month period. We further found that this investigation did not operate within ATF's framework for managing churning investigations, and that it exceeded ATF's statutory authority to conduct such investigations. Additionally, we found that the confidential informant was allowed to keep more than \$4.9 million of the \$5.2 million of gross profit generated from sales of tobacco to criminal targets. According to ATF, the confidential informant was allowed to keep that amount to cover his business expenses. However, ATF did not ensure the reasonableness of the expenses claimed, nor did ATF require the informant to provide adequate documentation to support or justify those expenses and we found that the more than \$4.9 million covered more than just the business expenses related to ATF activity, including 100 percent of the confidential informant's total business operating overhead and more than \$2.3 million in profit.

With respect to ATF's use of churning funds, our audit found that ATF policies then in place, did not clearly establish the permissible uses of churning proceeds, resulting in agents and supervisors making their own determination about which expenditures to approve and leading to inconsistencies in purchases made with churning proceeds. We also found a material lack of oversight and controls to ensure that cash, cigarettes, equipment, and other assets used in churning investigations were accurately tracked, properly safeguarded, and protected from misuse. We identified expenditures that appeared improper, unnecessary, and unreasonable, or made in support of other unrelated ATF investigations. Some of the expenses included:

- \$193,000 to lease warehouse space owned by a confidential informant where the terms of the lease were not documented and the utilities were paid based on estimates one year in advance,
- \$226,394 to rent between 3 and 12 vehicles on a monthly basis for more than a year where no documentation existed in the case file to justify the expense as reasonable and operationally necessary, and
- \$30,000 (60 percent of the retail price) to lease a 2011 Chevrolet Tahoe for 1 year.

In addition, due to inadequate documentation of cigarette inventories, when we reviewed records from 20 of the 36 churning investigations, we were unable to reconcile the disposition of 2.1 million of the more than 9.9 million cartons of cigarettes purchased for those 20 investigations. The retail value of those 2.1 million cartons of cigarettes (or 420 million cigarettes) was more than \$127 million.²

In our report, we make 1 recommendation to the Deputy Attorney General and 16 recommendations to ATF to assist them in ensuring that churning investigations are properly authorized and managed by the Department, ATF Headquarters, and ATF field offices. During the course of our audit, we met with ATF officials several times to discuss our concerns with the churning program. ATF officials told us that ATF had begun to take corrective actions to address many of the deficiencies we identified, including

² After learning of our findings, ATF's Deputy Director ordered ATF forensic auditors to conduct a separate reconciliation of the disposition of cigarettes from two of the largest cases in the OIG's 20 case sample, as those two cases included the substantial majority of the 2.1 million cartons of cigarettes we could not reconcile.

The ATF told us that it reviewed every single Report of Investigation (ROI) from these two cases to see if it referenced the disposition of cigarettes, even if the ROI was not referenced in the case management log. The ATF stated that during this review, it found a limited number of unexplained deposits associated with the two investigations and assumed that those deposits were related to the sale of cigarettes and then estimated the number of cigarettes that were likely sold given the amount of the deposit. Using these methods, the ATF review arrived at a significantly smaller amount of unreconciled cigarettes than our audit. The ATF review did find similar problems as the OIG has described in this report, including "a clear lack of internal controls, oversight, training and policy to guide ATF agents in these cases which resulted in a lack of uniformity in procedures, required documentation, inventory controls, and accountability."

ATF describes its review in more detail in its response to this audit, which is attached as Appendix II. However, for the reasons we outline in our response which is attached as Appendix III, we do not believe the results of ATF's review are comparable to the OIG review.

an internal review of existing policies and procedures related to churning investigations. As a result, ATF has revised its policies and procedures for administering churning investigations to enhance the safeguards for authorizing and managing churning investigations. Due to the sensitivity of these investigations and the high risk that proceeds from otherwise illegal business transactions may be misused, it is critically important that ATF and the Department have adequate controls to ensure that churning investigations are properly authorized and appropriately managed.

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AUDIT OF THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' USE OF INCOME-GENERATING, UNDERCOVER OPERATIONS³

INTRODUCTION

The Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) is responsible for the investigation and prevention of federal offenses involving the unlawful use, manufacture, and possession of firearms and explosives, acts of arson and bombings, and illegal trafficking of alcohol and tobacco products. ATF uses undercover operations to detect and investigate crimes for which it has primary jurisdiction. To conduct these undercover operations, ATF at times engages in business transactions that might normally be prohibited by federal law. In most cases, as required by law, ATF deposits any proceeds from these illicit transactions into the Department of the Treasury's General Fund.

However, in 2004, the existing law was amended to grant ATF the same authority previously provided to the Federal Bureau of Investigation (FBI) and the Drug Enforcement Administration (DEA) to use the proceeds of its undercover operations to support its investigative work. Specifically, ATF was authorized, in the context of undercover investigative operations that are necessary for the detection and prosecution of crimes against the United States, or for the collection of foreign intelligence or counterintelligence, to use appropriated funds to lease or purchase real property, establish and operate a proprietary business on a commercial basis, and deposit funds and proceeds generated during the operation in a financial institution, and also to use the proceeds of the operation to offset necessary and reasonable expenses incurred in that operation.⁴ This authority, which ATF refers to as "churning authority," may be exercised only if the proposed activity is certified by the Director of ATF and the Attorney General as necessary to the

³ During this audit, we identified certain issues requiring further investigation. We referred those matters to the OIG's Investigations Division, and put our audit on hold pending such investigation. Subsequently, we were able to complete our audit and issue this report.

⁴ See 28 U.S.C. § 533 note (explaining that Public Law 108-447, div. B, title I, § 116 extended to ATF the same authority previously granted to the Federal Bureau of Investigation and Drug Enforcement Administration in Public Law 102-395 § 102(b) and in effect pursuant to Public Law 104-132 § 815(d)).

conduct of the undercover operation.⁵ ATF, the FBI, and DEA are the only Department of Justice (Department) components with churning authority.

After receiving this authority, ATF made a determination that it would only be used in connection with complex, long-term undercover tobacco diversion and alcohol diversion investigations. To date, however, ATF has only used this authority to investigate tobacco diversion, which involves efforts to evade state, local, or federal tobacco taxes.⁶

The most common tobacco diversion scheme involves diverting tobacco from a state or locality with low tobacco taxes to a state or locality with high tobacco taxes and taking advantage of the disparity among the states' excise tax rates. Other tobacco diversion include selling counterfeit tobacco products, selling tobacco products illegally over the internet, and selling tobacco products without tax stamps or with counterfeit tax stamps. According to ATF, counterfeit tobacco products are primarily manufactured in China and Eastern Europe and packaged to look like brands well recognized in the U.S., smuggled into the United States, and then sold through both illegal and legitimate retail outlets. Counterfeit products use trade names and packaging similar to legally manufactured products, and as a result, legitimate outlets may not realize the products they are selling are counterfeit products. ATF officials also stated that some Native American tribes and reservations are using the internet to sell cigarettes without paying the requisite federal and state excise taxes.

According to ATF, state governments lose over \$5 billion annually in tax revenue as a result of tobacco diversion. ATF also told us that while tobacco diversion is primarily a financial crime, these schemes have been used to finance terrorist activities and criminal organizations.

⁵ Pursuant to 28 U.S.C. § 510, the Attorney General may also delegate certifying authority to specified individuals as appropriate.

⁶ The Contraband Cigarette Trafficking Act (CCTA), enacted in 1978, gave ATF primary jurisdiction over the interstate trafficking of cigarettes. The purpose of the CCTA was to prevent any person from profiting by transporting and selling contraband cigarettes in interstate commerce. Among other provisions, the CCTA generally prohibits any person from shipping, transporting, receiving, selling, possessing, distributing, or purchasing more than 10,000 cigarettes that bear no evidence of state tax payment in the state in which cigarettes are found, if that state requires an indication of such payment of taxes to be placed on the cigarette packaging or other container. See 18 U.S.C. § 2341 (defining contraband cigarettes) and 18 U.S.C. § 2342 (prohibiting the trafficking of contraband cigarettes). North Carolina, North Dakota, and South Carolina do not require tax stamps on cigarettes and other tobacco products.

Between February 2006 and June 2011, ATF approved 35 investigations using this churning authority to investigate tobacco diversion. In general, in these undercover investigations ATF purchased cigarettes from manufacturers, and agents or informants then sold them to criminal targets at or below wholesale cost. The targets allegedly would transport the contraband cigarettes to a high-tax state, where they would be sold without collecting the proper state and local taxes.

Within ATF, the Alcohol and Tobacco Diversion Division (ATDD) has had primary responsibility for overseeing and managing ATF's churning investigations. ATF restructured its operations in October 2011, and the ATDD became the Alcohol and Tobacco Diversion Branch, within the Alcohol, Tobacco, and Fire Enforcement Division, while retaining the same staff, duties, and responsibilities.

As described further in the Findings and Recommendations section of this report, ATF may only use proceeds generated from these undercover operations with the case-specific approval of the Chief of the Criminal Division's Organized Crime and Racketeering Section.

To administer its churning authority, ATF has issued two memoranda outlining its procedures for individual cases to request and manage churning authority.

In June 2005, ATF's Assistant Director of Field Operations issued a Churning Policy Memorandum (2005 Memorandum). This four-page memorandum outlined ATF's policies and procedures for the use of churning authority. The 2005 Memorandum was never incorporated into ATF's Orders as a formal policy, but it remained in effect until April 2011.

In April 2011, during our fieldwork for this audit, ATF issued a new churning memorandum (2011 Memorandum) that superseded the 2005 Memorandum. The 2011 Memorandum is more comprehensive than the 2005 Memorandum and includes more stringent controls over churning funds, with restrictions on the procurement and exchange of tobacco between churning investigations, and varying levels of approval for use of the funds based on dollar amounts requested. Similar to the 2005 Churning

Memorandum, the 2011 Churning Memorandum was considered interim policy and was not incorporated into ATF's Orders.⁷

Prior Inspections and Reviews

Office of the Inspector General Report

In a September 2009 report, the OIG examined ATF's implementation of its Alcohol and Tobacco Diversion Program as a deterrent to illegal sales and smuggling of tobacco products.⁸ The OIG found that ATF lacked a strong national program for diversion enforcement, resulting in an ad hoc enforcement approach. Additionally, the review found that ATF lacked a clear understanding of the scope of diversion activity across its field divisions, and that Headquarters did not fully support the field divisions' diversion investigations. The OIG therefore recommended that ATF take appropriate steps to assess the scope of the diversion problem in each field division and across the country in developing its enforcement strategy and resource allocation plan; consider re-instituting the assignment of Program Coordinator responsibilities to a Special Agent in each field division for alcohol and tobacco diversion issues; and establish within the Alcohol and Tobacco Diversion Division a formal point-of-contact position for the field divisions. The OIG closed all three recommendations by November 2010 after ATF demonstrated that it had implemented the OIG's suggested improvements.

ATF's Office of Professional Responsibility and Security Operations Review

In March 2011, after we began our audit, ATF's Office of Professional Responsibility and Security Operations completed a review of all 33 ATF investigations that were granted churning authority from 2005 to February 25, 2011, to determine if ATF-authorized churning investigations complied with ATF's Churning Policy dated June 24, 2005, and to assess the

⁷ In April 2013, after our field work was complete, ATF issued a new Alcohol and Tobacco Enforcement Programs Order. According to ATF, this order, ATF Order 3380.1, was issued as a result of ATF's internal process review and included changes implemented in response to the preliminary findings we shared with ATF at a mid-audit briefing. Order 3380.1, replaced the 2011 Memorandum, the previous Tobacco Enforcement Program order and several other memoranda, and is ATF's current policy guidance for all alcohol and tobacco investigations, including churning investigations.

⁸ U.S. Department of Justice Office of the Inspector General, *The Bureau of Alcohol, Tobacco, Firearms and Explosives' Efforts to Prevent the Diversion of Tobacco*, Evaluations and Inspections Report I-2009-005 (September 2009).

internal controls associated with that policy.⁹ The report's findings included the following:

- not all undercover bank accounts included a double signature,
- monetary transactions were not always documented in the case management log,
- documentation of expenditures did not always identify the person who made the expenditure or what was purchased,
- the beginning tobacco inventory for some churning investigations could not be determined because initial purchases of cigarettes were obtained through Major Case Funding or agent cashier funds,
- no perpetual inventory of tobacco was maintained,
- records were not maintained to account for the destruction or discarding of damaged inventory,
- funds received were not always deposited into the undercover bank accounts in a timely manner,
- a complete accounting for all assets purchased with churning account funds was not available, and
- several assets purchased with churning funds could be viewed as supplementing ATF's annual appropriation.

Audit Approach

The objectives of this audit were to determine whether ATF:
(1) properly authorizes its income-generating, undercover operations;
(2) provides adequate management and oversight of its income-generating, undercover investigations (churning investigations) at the headquarters and field division levels.

To accomplish these objectives, we interviewed ATF officials, including the Assistant Director of Field Operations and the Chiefs of the Special Operations Division, Resource Management Section, and Criminal

⁹ U.S. Department of Justice Bureau of Alcohol, Tobacco, Firearms and Explosives Office of Professional Review and Security Operations – Inspection Division, *Report of Churning Account Review* (March 16, 2011).

Intelligence Division. We interviewed the entire staff of the Alcohol and Tobacco Diversion Division (ATDD), as well as Special Agents, Group Supervisors, Assistant Special Agents in Charge (ASAC), and Special Agents in Charge (SAC). We also interviewed staff within the Department's Criminal Division, including the Chief of the Organized Crime and Racketeering Section, and the Policy Legal Counsel to the Chief of the Asset Forfeiture Section.

In addition, we reviewed all 35 of ATF's requests for churning authority submitted between February 2006 and June 2011. We also performed audit work analyzing the field division oversight of churning investigations at eight ATF field divisions: (1) Atlanta, Georgia; (2) Baltimore, Maryland; (3) Charlotte, North Carolina; (4) Detroit, Michigan; (5) Kansas City, Missouri; (6) Newark, New Jersey; (7) Philadelphia, Pennsylvania; and (8) Washington, D.C. At these 8 field divisions and some of their associated field offices, we reviewed and analyzed case files from 20 of the 35 investigations granted churning authority between March 2006 and January 2011. In addition, we identified and reviewed one case file for an investigation that had not been granted churning authority but nevertheless operated as a churning case.

Our audit resulted in two findings. Finding I presents weaknesses in ATF's process for approving income-generating, undercover operations. Finding II identifies deficiencies in oversight and management at the headquarters level and within ATF's field divisions. Further information on the audit objectives, scope, and methodology is contained in Appendix I.

FINDINGS AND RECOMMENDATIONS

I. AUTHORIZATIONS FOR CHURNING INVESTIGATIONS

Our audit identified a total of 36 ATF churning investigations during our audit period. Thirty-five of the 36 investigations were initiated with requests for churning authority that were approved by ATF and the Department. However, we found that none of these 35 requests were reviewed and approved by ATF's Undercover Review Committee, as required by ATF policy. In addition, 33 of these 35 investigations did not comply with other ATF requirements governing requests for and approval of churning authority.

We found that one of the 36 churning investigations was conducted despite the failure to submit a request for churning authority to either ATF or the Department. In this investigation, we found that the confidential informant was allowed to keep more than \$4.9 million of the \$5.2 million of gross profit generated from sales of tobacco to criminal targets. According to ATF, the confidential informant was allowed to keep that amount to cover his business expenses. However, ATF did not ensure the reasonableness of the expenses claimed nor did ATF require the informant to provide adequate documentation to support or justify those expenses, and we found that the more than \$4.9 million covered more than just the business expenses related to ATF activity, including 100 percent of the confidential informant's total business operating overhead and more than \$2.3 million in profit.

We also found that ATF's policies and procedures lacked specific criteria to determine which cases should be granted such churning authority. We found that the lack of review by the ATF's Undercover Review Committee, as well as the absence of criteria for approving requests for churning authority, resulted in inconsistencies in the nature and types of tobacco investigations approved for churning authority.

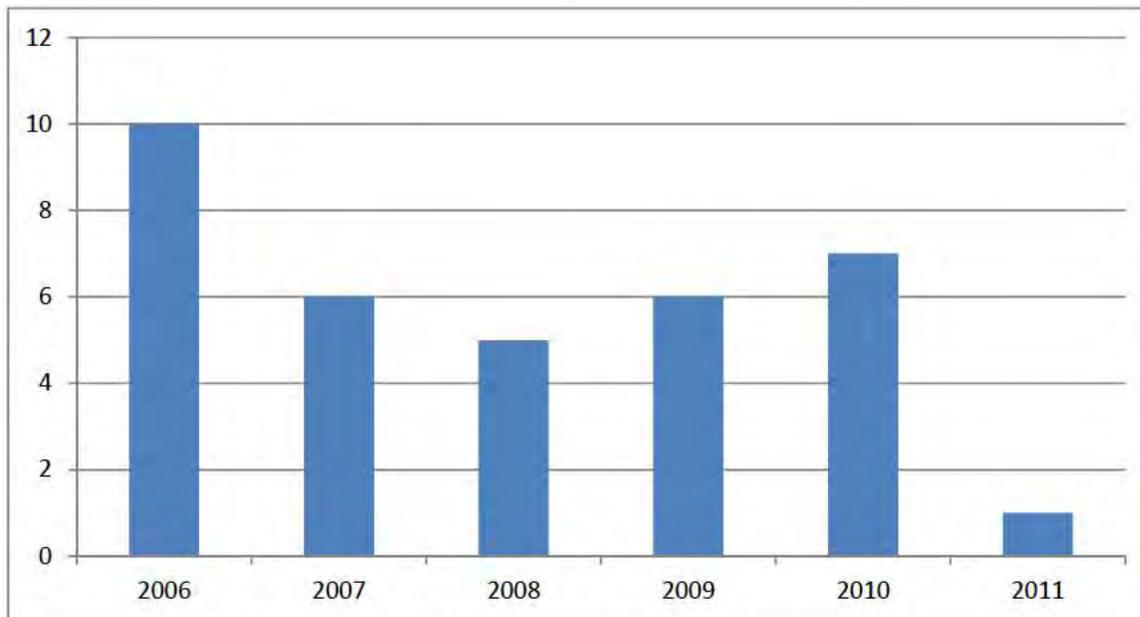
Authorization Requests

The Department has not issued any policies or guidance describing how the FBI, DEA, or ATF should implement the ability to use income generated from undercover investigations, so each of the three agencies administers this authority according to its own policies and directives, subject to the Department's case-by-case approval. At the time of our audit, ATF's policy for reviewing and approving requests for churning authority was contained in a 2005 Churning Memorandum (2005 Memorandum).¹⁰ This memorandum advised ATF agents and supervisors that the use of churning authority was intended primarily for complex, long-term undercover investigations. The memorandum also noted that churning investigations are considered sensitive, as described in ATF Order 3250.1A, Informant Use and Undercover Operations (Order 3250.1A), and therefore, churning investigations must comply with the provisions regarding sensitive operations contained in Order 3250.1A.¹¹

¹⁰ ATF issued an interim churning policy in April 2011. However, no requests for churning authority were submitted between April 2011 and the end of our audit's fieldwork in December 2011. As a result, our analysis is entirely based on compliance with the 2005 Churning Memorandum.

¹¹ ATF Order 3250.1A does not define sensitive circumstances. However, ATF Order 3250.1B identifies the following types of investigations and tactics as categorically sensitive: storefront operations; outlaw motorcycle or other recognized organized groups/gangs with regional, national and/or international status; participation in otherwise illegal activity by undercover agents; and possible criminal conduct by any elected or appointed official.

Exhibit 1
ATF Churning Requests by Calendar Year
February 2006 through June 2011



Source: OIG analysis of ATF data

Authorization Process

According to the 2005 Memorandum, requests for churning authority required approval from the appropriate ATF Deputy Assistant Director for Field Operations, the ATF Undercover Review Committee, and a Deputy Assistant Attorney General (DAAG) in the Department's Criminal Division. According to Order 3250.1A, applications for approval to conduct undercover operations involving "sensitive circumstances" were required to be reviewed by the Chief of the Special Operations Division.¹² Upon the Chief's favorable review, the application was to be reviewed by ATF's Undercover Review Committee, which was to examine the application to determine whether adequate measures had been taken to minimize the incidence of "sensitive circumstances" involved in the proposed undercover operation and to "reduce the risks of harm and intrusion that are created by such circumstances."¹³ After its review, the Undercover Review Committee was

¹² The Special Operations Division is responsible for multiple programs that support ATF agents in the field, including undercover operations security, specialized deployments, and technical operations.

¹³ The Undercover Review Committee is chaired by the appropriate Deputy Assistant Director of Field Operations and includes the Chief of the Special Operations Division, the Chief of the appropriate operational division, a representative from the Office of Chief Counsel, and a representative from the Department of Justice's Criminal Division.

required to submit the application to the ATF Assistant Director (or his or her designee) with a recommendation to approve or disapprove the request. If the Undercover Review Committee approved the request, it was directed to include a brief written statement describing why the investigation merits approval in light of the sensitive circumstances.

Review of the Authorization Request Process

We found that, between February 2006 and June 2011, 35 requests for authorization had been submitted by ATF Special Agents and approved by ATF's Deputy Assistant Director for Field Operations and the Chief of the Criminal Division's Organized Crime and Racketeering Section (OCRS), but that none of the requests had received all of the intermediate approvals required by ATF guidance. Specifically, while we determined that all of the authorization requests were approved by the respective SACs, the Chief of the ATDD, and the Deputy Assistant Director before being submitted to the Chief of OCRS for final approval, we found no evidence that the authorization requests were reviewed by the Chief of the Special Operations Division or the Undercover Review Committee. Further, most ATF officials we interviewed told us that they did not know that ATF had an Undercover Review Committee, and ATF's Chief Counsel told us that ATF's Undercover Review Committee did not meet between February 2005 and January 2012.

While the 2005 Memorandum references approval by a Criminal Division DAAG, the Attorney General has designated the Chief of the Criminal Division's Organized Crime and Racketeering Section (OCRS) as the authorizing official for all of the Department's income-generating undercover operations, including ATF. According to the Chief of OCRS, he and an ATF Program Officer met to discuss the details of each request, and he signed the request at the end of the discussion. The Chief stated there was no Department policy guidance for reviewing and approving churning requests – or similar requests from the FBI and the DEA – and that he relied on his years of experience participating in the FBI's Undercover Review Committee and reviewing similar requests from the FBI to evaluate churning requests from ATF. When evaluating a request, he said he considers factors such as the prosecutorial merit of the investigation, whether the targets identified are a part of the same criminal conspiracy, and the degree to which the investigation relies on a confidential informant. He added that the statute for churning authority is quite vague and that there is no case law to refer to because the statute has never been tested.

Content of Requests for Churning Authority

We examined all 35 requests for authorization to determine whether each contained the required information outlined in the 2005 Memorandum. According to the 2005 Memorandum, the request was required to include: (1) the background of the investigation; (2) a thorough identification of the suspect; (3) the current status of the investigation; and (4) the proposed investigative activity and technique that will be used to produce the proceeds from the operation.

In addition, the 2005 Memorandum required churning authorization requests to adhere to the requirements outlined in Order 3250.1A, paragraph 95(c), which requires that applications for approval of investigations involving sensitive circumstances include: (1) arrest records of criminal targets, (2) a statement of the time period of the investigation, (3) a description of any inducement techniques employed to ensure that innocent parties will be protected against entrapment, (4) a statement of proposed expenses, (5) a statement of "circumstances expected to occur" and description of why the operation merits approval, and (6) a letter from a U.S. Attorney documenting the U.S. Attorney's approval of the investigative tactic employed as well as an agreement to prosecute any meritorious case that develops.¹⁴

We determined that 33 of the 35 requests did not contain all of the information required by the 2005 Memorandum. Specifically, 19 requests did not disclose the arrest records of criminal targets, 25 did not propose the time period of the investigation, and 2 did not provide an inducement description. None of the 33 requests included a letter from the U.S. Attorney documenting approval and agreement to prosecute the case.

Additionally, 9 of the 35 requests for churning authority did not explicitly or thoroughly identify suspects to be investigated. For example, approval was granted for two investigations that targeted geographic areas as opposed to individual suspects, and for an investigation targeting "criminal networks" in the field office's territory rather than specific individuals or organizations.

According to agents we interviewed, some of these requests were intentionally broad so that the agent would have the flexibility to pursue suspects that had not yet been identified at the time of the request. For

¹⁴ ATF Order 3250.1A, Informant Use and Undercover Operations, defines inducement as an element of entrapment. Entrapment occurs when the government originates the idea of a crime and then induces another person to engage in conduct constituting such a crime when the other person is not disposed to do so.

example, one request we reviewed identified potential tobacco trafficking schemes as the target of the investigation rather than particular suspects. The Special Agent who submitted the request explained that he intentionally did not identify any suspects in his request because his goal was to include every possible contingency, allowing him to pursue a broad scope of potential investigations. Both ATF and the Department approved this request.

In addition, although not explicitly described in policy guidance, several ATF officials, as well as the Chief of OCRS, told us that the suspects identified in requests for churning authority must be part of the same criminal conspiracy. Nevertheless, in at least six requests we reviewed, churning authority was granted to investigations that identified multiple suspects that were not part of the same criminal network or conspiracy.

We also found that neither ATF nor the Department – which is also responsible for reviewing and approving similar requests from the FBI and the DEA – had issued any formal criteria against which churning requests should be evaluated. Our review of the 2005 Memorandum identified no guidance about what criteria should be considered when evaluating requests, and ATF and Department officials, including the Chief of OCRS who is responsible for approving these requests on behalf of the Department, confirmed that no other such guidance exists.

In our judgment, the controls for approving churning investigations in the 2005 Memorandum were inadequate. For example, the lack of specificity in the targets that were intended to be investigated allowed for several different investigations to be operated under the umbrella of a single investigation. By allowing multiple unrelated investigations to operate under one churning authorization, ATF undermined its ability to appropriately monitor the progress of its churning investigations, which are inherently sensitive due to the potential for fraud and abuse. This practice also increased the risk that churning proceeds could be used for purposes that exceed the statutory authorization, which limits the use of churning funds to offsetting necessary and reasonable expenses incurred in the same undercover operation. In addition, the lack of formal criteria against which churning requests were to be evaluated similarly undermined ATF's oversight of churning operations by creating the risk of inconsistent or inappropriate approvals.

In April 2011, ATF updated its policy guidance to include more stringent controls for churning investigations, including requiring a new churning authorization and new investigation number whenever criminal targets that were not part of the initial conspiracy are added to the scope of

the investigation. However, the guidance did not establish criteria for ATF officials to use to determine which cases should initially be granted churning authority. It also removed the requirement for investigations to be reviewed by an ATF Undercover Review Committee, as required by ATF Order 3250.1A, Informant Use and Undercover Operations, paragraph 95(c).¹⁵

Unauthorized Churning Investigation and Improper Co-Mingling of Proceeds

During the course of our audit, we also identified one tobacco investigation, separate from the 35 approved investigations discussed above, that had operated without proper churning authority and had its proceeds deposited into another churning operation's accounts. The name of this operation was the target of the investigation, so we will refer to this investigation as "Operation Alpha".

Over an 18 month period beginning in 2009, Operation Alpha used an ATF confidential informant to sell at least \$14.9 million worth of cigarettes (more than 900,000 cartons, or 180 million cigarettes) to the targets of an investigation into tax avoidance.¹⁶ The cigarettes were ordered by an ATF case agent through ATF Headquarters, and then shipped to and paid for by the confidential informant, who was a tobacco distributor. The confidential informant then sold the cigarettes to the targets of Operation Alpha and provided the net profits from these sales to ATF. The net profits were deposited by ATF into the undercover bank account of an unrelated churning investigation that had been authorized, which we will refer to as "Operation Beta."¹⁷ Operation Alpha and Operation Beta were entirely separate investigations with separate case numbers and separate targets. However, Operation Beta was conducted by a Special Agent in another ATF field division who had been responsible for signing up the ATF confidential informant used in Operation Alpha.

¹⁵ ATF's Order 3380.1, issued in April 2013, once again includes a requirement that all churning investigations be approved by an ATF Undercover Review Committee.

¹⁶ A carton of cigarettes contains 10 packages of cigarettes, and each package contains 20 cigarettes.

¹⁷ Net profits are the remainder of revenue less the cost of goods sold and indirect costs.

The depositing of proceeds from Operation Alpha into the accounts of Operation Beta violated the statutory requirement that churning funds should only be used to fund the same investigation.¹⁸ Additionally, according to ATF policy, each investigation is required to have its own churning authority in order to deposit the proceeds from illicit transactions into an account other than the Treasury's general fund. While ATF and the Department had granted churning authority to Operation Beta, no such authority had been requested or approved for Operation Alpha.¹⁹ Operation Alpha thus failed to comply with the limits and safeguards of the statutory authority governing churning investigations, and it operated outside ATF's normal framework for managing churning investigations.

This failure to follow legal requirements and internal procedures contributed to the significant irregularities we uncovered during our review of Operation Alpha. For example, we were unable to verify how many cigarettes were sold during Operation Alpha because neither the Report of Investigation (ROI) nor ATF's management log included either the total amount of tobacco sold by the confidential informant during each undercover transaction or the dollar amounts associated with each of the related transactions. Based on the documentation provided by the case agent for Operation Alpha, we also were unable to verify that all of the sales were appropriately supervised by ATF personnel.

Moreover, the records provided by the confidential informant to ATF indicated that ATF did not properly account for the confidential informant's reported business expenses during Operation Alpha. According to ATF, the confidential informant was allowed to keep more than \$4.9 million to cover his business expenses. However, we found that the more than \$4.9 million covered more than just the business expenses related to ATF activity, including 100 percent of the confidential informant's total business operating overhead. In addition, the confidential informant attributed about \$2.37 million to "commissions" for the sales that he made.

In an interview with the OIG, the confidential informant stated that the "commissions" were not actually expenses, but profit that he retained. When we reviewed the information that the confidential informant submitted to ATF, it showed that the total proceeds from the sale of cigarettes by the

¹⁸ See Public Law 102-395 § 102(b)(1)(D), which was applied to ATF in Public Law 108-447, div. B, title I, § 116 as described at 28 U.S.C. § 533 note.

¹⁹ According to the case agent of Operation Alpha, he never applied for or opened an undercover bank account for the case because the Chief of ATDD had orally authorized him to use the Operation Beta's bank account. In statements to the OIG, the Chief of ATDD denied authorizing Operation Alpha's use of Operation Beta's bank account.

informant was \$14.9 million, that the cost of goods sold was \$9.7 million, and that the informant's reported business expenses (including his commissions) were nearly \$5 million. As a result, the net profit to ATF was only \$245,822, as shown in Exhibit 2.

**Exhibit 2 - Operation Alpha Proceeds, Expenses, and Profits
As Reported by Confidential Informant,
May 2009 Through November 2010**

Proceeds	\$14,908,218
Cost of Goods	\$ 9,703,448
Gross Profit	\$ 5,204,770
Expenses	\$ 2,586,688
Commissions	\$ 2,372,260
Net Profit to ATF	\$ 245,822

Source: OIG Analysis

While the confidential informant was allowed to keep more than \$4.9 million of the total \$5.2 million of gross profit from the sales of tobacco to criminal targets in Operation Alpha, neither the case agent for Operation Alpha nor the case agent for Operation Beta was able to provide us with documentation showing that ATF had entered into an agreement to reimburse the confidential informant for these expenses. As a result, ATF did not ensure the reasonableness of the expenses claimed nor did ATF require the informant to provide adequate documentation to support or justify those expenses. These irregularities create the risk that ATF may have allowed the confidential informant to retain proceeds of illicit transactions to which he was not entitled.

ATF also failed to account properly for the cigarettes it purchased during Operation Alpha. We found that ATF did not maintain records showing how many cigarettes were sold or how much revenue was generated by the sale of contraband cigarettes during Operation Alpha. ATF did, however, maintain records on how many cigarettes it purchased from wholesalers to support Operation Alpha. According to these records, between May 2009 and November 2010, the case agent for Operation Alpha ordered a total of 674,820 cartons of tobacco at a cost of \$8 million. Yet, based on our analysis of the records provided by the confidential informant, during the same period the informant reported that he sold a total of 904,638 cartons of cigarettes at a cost of \$9,703,448. We were unable to reconcile the difference of 229,818 cartons and \$1.7 million between the two sets of records. Further, according to records of orders maintained at ATF Headquarters, between December 2010 and February 2011, the case agent for Operation Alpha ordered an additional 140,160 cartons of cigarettes at a

cost of approximately \$1.7 million, yet ATF was unable to account for how those cigarettes were used.

Conclusion

Our review of the 35 ATF investigations that received churning authority found that ATF did not adhere to its policies for authorizing churning investigations. Specifically, although the 2005 Memorandum required that churning investigation authorizations be reviewed by ATF's Undercover Review Committee before being submitted to the Department for final approval, we found no evidence that ATF's Undercover Review Committee reviewed any of the 35 churning requests.

The 2005 Memorandum also required churning authorization requests to include specific information about the investigation, such as a thorough identification of the suspect and a letter from the U.S. Attorney documenting the U.S. Attorney's approval of the investigative tactic employed as well as an agreement to prosecute any meritorious case that develops. However, we found that 33 of the 35 requests did not contain all of the required information, including 9 requests that did not explicitly or thoroughly identify suspects to be investigated.

Additionally, we found one investigation, Operation Alpha, that operated without requesting or receiving prior approval from either ATF or the Department. We also found that Operation Alpha failed to follow the statutory requirement that churning funds should only be used to fund the same investigation. Additionally, we found that this operation had significant irregularities, including the failure to account properly for substantial amounts of cigarettes and money. In light of Operation Alpha, we have concerns with ATF's ability to comply with the provisions of 28 U.S.C. § 533 that grant it the authority to conduct churning investigations.

While ATF updated its policy guidance in April 2011 to include more stringent controls over the authorization of churning investigations, the 2011 guidance, like the 2005 Memorandum, did not establish criteria for ATF officials to use to determine which cases should initially be granted churning authority. In addition, we are concerned that the 2011 guidance did not include requirements for investigations to be reviewed by an ATF Undercover Review Committee, as required by ATF Order 3250.1A, Informant Use and Undercover Operations, paragraph 95(c) or a letter from a U.S. Attorney documenting the U.S. Attorney's approval of the investigative tactic employed.

Recommendations

We recommend that the Deputy Attorney General:

1. Consider implementing Department-wide requirements for authorizing churning requests to ensure that such requests are handled consistently across Department components and that best practices are employed by all Department components.

We recommend that ATF:

2. Consider amending the 2011 Churning Memorandum to add the requirement of consulting with the relevant U.S. Attorney before employing the investigative tactic.
3. Establish procedures to ensure that requests for churning authority are approved according to existing ATF policies, including review by ATF's Undercover Review Committee.
4. Implement effective policies and procedures to ensure targets of income-generating undercover investigations are specifically identified prior to granting the investigation churning authority.
5. Develop and implement criteria to be used by ATF officials responsible for authorizing churning investigations to determine whether a churning request should be approved.
6. Develop and implement effective policies and procedures to ensure unauthorized churning investigations do not occur. These policies and procedures could include periodic reviews of all investigations where income is generated to ensure such income is not used unless appropriately authorized.

II. HEADQUARTERS AND FIELD DIVISION OVERSIGHT AND MANAGEMENT

We found that ATF lacked comprehensive guidelines, policies, and procedures needed for its Headquarters and field divisions to effectively oversee and manage ATF's churning investigations. ATF did not have policies in place to establish how funds developed through churning cases could be utilized, leading to significant inconsistencies in the way churning investigations were managed. In the absence of clear guidelines, ATF Special Agents and supervisors in Headquarters and in the field made their own determinations about whether given expenditures were allowed.

We also found that ATF did not have mechanisms in place to adequately track tobacco that was bought, sold, traded, given away, and destroyed by its churning operations. As a result, when we reviewed 20 of the 36 churning investigations, we were unable to independently reconcile the disposition of 2.1 million of the more than 9.9 million cartons of cigarettes purchased for those 20 investigations. The retail value of those 2.1 million cartons of cigarettes (or 420 million cigarettes) was more than \$127 million. In our judgment, ATF's lack of controls over a potential black market commodity that is highly vulnerable to fraud is very troubling, and raises the concern that ATF may not have fully complied with 28 U.S.C. § 533, as amended, by not ensuring case revenues and purchases were appropriately utilized.

Additionally, we found that the investigations we reviewed did not effectively track non-tobacco purchases, such as GPS devices, cell phones, tablet computers, surveillance equipment, and other electronic devices. Other significant weaknesses we identified included potential compromises of operational security, lack of proper authorization for expenses, delays in depositing proceeds, and failures to document investigative activities.

ATF Headquarters Oversight and Management of Churning Investigations

At the time of our audit, the ATDD was responsible for the management of ATF's tobacco diversion program, including program guidance, tobacco procurement, intelligence support, field office support, and coordination with other law enforcement agencies. However, in October 2011, ATF restructured its field operations and the ATDD became the Alcohol and Tobacco Diversion Branch within the Alcohol, Tobacco, and Fire Enforcement Division. The Alcohol and Tobacco Diversion Branch has the same roles and responsibilities the ATDD had. This report describes ATF's operations and organization as they existed during the time of our audit. We interviewed the entire staff at the ATDD in order to determine what program guidance, policies, and procedures had been established to manage and oversee churning investigations.

During our audit period, the Chief of the ATDD was responsible for oversight, planning, and coordination of the division's programs, supported by a Project Officer, three Program Managers, and eight program support staff.²⁰ The Project Officer's responsibilities included monitoring, coordination, and support of ATF field enforcement activities. The Program Managers' responsibilities included serving as policy developers as well as monitoring program progress. The roles and responsibilities of the ATDD program support personnel varied and included intelligence analysis, tobacco procurement, training, financial reporting, and industry operations.

Despite the ATDD staff's broad responsibilities, based on our interviews we determined that, in practice, the ATDD provided limited support to the churning investigations being conducted by the field divisions and field offices. Specifically, we found that the ATDD staff lacked training and expertise to assist tobacco investigations in the field. For example, none of the Special Agents assigned to the ATDD (Chief, Project Officer, and Program Managers) had ever conducted a tobacco diversion investigation.

In addition, the ATDD staff experienced a high rate of turnover during the audit period and Special Agents with whom we spoke told us the turnover contributed to the division's inability to adequately support churning investigations in the field. We found that from February 2011 to March 2012, the ATDD experienced turnover in the Chief, Project Officer,

²⁰ The Chief of the ATDD departed the position in March 2011 to take a management position in an ATF field office. An Acting Chief filled the position until October 2011, at which time the ATDD was reorganized as the Alcohol and Tobacco Diversion Branch within the Alcohol, Tobacco and Fire Enforcement Division. A permanent chief was assigned to the Alcohol and Tobacco Diversion Branch in May 2013.

and Program Manager positions, resulting in a turnover rate of approximately 38 percent. Moreover, at no point during this same period did the ATDD have a permanent Chief. Although some level of staff turnover is to be expected, we believe frequent changes in the Special Agents assigned to ATDD and the delay in filling the Chief position likely contributed to the lack of adequate oversight and management.

Also as a result of this turnover, Special Agents in the field involved in churning investigations told us that they often relied on each other's personal experience rather than the ATDD for official guidance and support. Many Special Agents we interviewed said that the ATDD generally lacked awareness of the investigative activities in the field, and that they therefore rarely communicated with the ATDD about the details of their cases. However, several of the Special Agents we interviewed noted that one ATDD Program Analyst was extremely knowledgeable and helpful.

Churning Policy Guidance

In July 2005, about 7 months after ATF received churning authority, ATF's Assistant Director for Field Operations issued interim policy in the 2005 Memorandum that outlined ATF's policies and procedures for the use of its new churning authority. The 2005 Memorandum established, among other things, the following requirements:

- undercover bank accounts for churning investigations must have double signature authority to deposit and withdraw funds,
- each monetary transaction for a churning investigation must be documented in the management log in N-Force,²¹
- churned funds cannot be co-mingled with any other monies in one undercover bank account, and
- a first-line supervisor must reconcile the account at the end of each month and forward the report to ATF Headquarters.

However, we found that the 2005 Memorandum did not contain detailed operating procedures, was not supplemented by other guidance specific to churning investigations, and was never incorporated into ATF's Orders as a formal policy, resulting in inconsistent oversight and management of ATF's churning investigations.

²¹ N-Force is ATF's official case file of record for documenting investigative activity and information, creating reports, tracking investigative leads, and linking data.

Specifically, our review of the memorandum found that it provided very little guidance about what types of expenditures could or could not be made with churning funds. The only specifics about allowable expenditures were made within the context of a hypothetical tobacco investigation where the memorandum stated, "The expenses would include, among other things, the purchase of additional cigarettes to further the investigation, the payment of transport services, or the storage of the cigarettes." Because the 2005 Memorandum only addressed these three expenditures specifically, Special Agents told us that, prior to submitting a request to use churning funds, they often consulted with each other, their supervisors, or the Chief of ATDD, for guidance on whether a purchase could be made using churning funds. The formal approval process is discussed in greater detail below.

Our findings were consistent with statements made to us by many Special Agents, supervisors, and ATDD staff, who described the 2005 Memorandum as vague and lacking specifics about policies and procedures for the use of churning funds. Several ATF officials also told us that in the absence of clear guidelines, some ATF Special Agents and supervisors made their own determinations about the allowability of particular expenditures instead of seeking input from the ATDD, and one field division developed its own informal policies and procedures that were communicated to the Special Agents within that office. We also found that ATDD and the field offices occasionally came to different conclusions about specific expenses. For example, one field office spent \$8,990 to purchase a forklift to move tobacco on and off trucks, but once the purchase had been made, ATF Headquarters informed the field office that the expenditure was unallowable and that the field office should have leased the forklift instead.

In addition, we found that ATF did not amend other policies relevant to churning investigations in 2005 to reflect the fact that it had received churning authority. For example, ATF Order 3250.1A, Informant Use and Undercover Operations, required that all proceeds from investigative activities be returned to the General Fund of the Treasury, even though ATF's churning authority specifically allowed ATF to deposit churning funds into a bank account.²² Similarly, and as discussed in greater detail below, ATF also did not update Order 3400.1B, Property Taken Into Bureau Custody, to address how agents should receive, process, and store churning proceeds.

²² In November 2011, after we had completed our audit fieldwork, ATF Order 3250.1A, Informant Use and Undercover Operations was superseded by ATF Order 3250.1B, Undercover Operations, and ATF Order 3252.1, Confidential Informant Usage. ATF Order 3250.1B includes guidance specific to churning investigations.

In April 2011, during our fieldwork for this audit, ATF issued an updated memorandum (2011 Memorandum) that superseded the 2005 Memorandum. The 2011 Memorandum is more comprehensive than its four-page predecessor and includes 14 categories of policies and procedures, as well as more detailed guidance on the permissible uses of churning funds. It also includes more stringent controls over churning funds, including varying levels of approval for use of the funds based on the dollar amounts requested, places restrictions on the procurement of tobacco and exchange of tobacco between churning investigations, and includes guidance regarding how to dispose of property acquired with churning funds once an investigation has ended, including the requirement that all assets must be turned over to the General Services Administration.

However, our review of the 2011 Memorandum identified several shortcomings. For example, while the 2011 Memorandum includes an inventory requirement, it does not require that any tobacco that was purchased and on-hand prior to the receipt of churning authority be included in the starting inventory. The amount of tobacco ordered for an investigation before it receives churning authority can be significant: one case we reviewed received \$1.5 million in cigarettes before it became a churning investigation. By not having inventory controls before and after an investigation obtains churning authority, ATF undermines its ability to adequately monitor and track the tobacco bought and used in its investigations.

Additionally, although the 2011 policy guidance includes restrictions on the procurement of tobacco, this restriction only applies to tobacco purchased through ATF Headquarters, not to tobacco purchased by other means, such as directly from distributors.

As was the case with the 2005 Memorandum, the 2011 Memorandum was considered interim policy and was not incorporated into ATF's Orders.

In May 2013, ATF provided us with its new policy guidance governing churning investigations, ATF Order 3380.1, issued in April 2013. This Order was issued as a result of ATF's internal process review and included changes implemented in response to the preliminary findings we shared with ATF at a mid-audit briefing.

Inadequate Ongoing Monitoring of Churning Investigations

As discussed in Finding I above, after an investigation has received ATF internal approval for churning authority, it must obtain approval from the Department. According to the Chief of OCRS, while the final approval

rests with the Department, the Department does not continue to monitor or oversee churning investigations once it authorizes them.

In comparison, the Chief of OCRS told us that the Department participates in ongoing oversight activities for FBI churning investigations. Specifically, we found that the FBI convenes an undercover review committee made up of both Department and FBI officials to manage churning cases. The committee meets every 6 months to review significant FBI undercover investigations. The Chief of OCRS told us that he believed there should be a similar process for ATF's churning investigations.²³

Instead, ATF Headquarters is solely responsible for the oversight of churning investigations. Their two primary tools for doing so during our audit period were Reports of Investigation (ROI) and the N-Force case management log. As described below, we found deficiencies in the ATF's use of both of these tools.

ROIs are ATF's primary tool for reporting investigative matters. ROIs are to provide timely, detailed investigative activity on cases including, but not limited to, interviews, undercover contacts, the collection of evidence and records, and the sale or trade of undercover merchandise, and are stored in N-Force. ROIs are intended to provide accurate documentation of case investigative history and to allow for management review of cases.

The 2005 Memorandum required that an ROI be created in N-Force for each investigative activity where churned funds were used, including instances where churned funds were used to purchase items for subsequent sale to a target of investigation. We found a wide disparity in the level of detail included in the ROIs for the 20 churning operations we reviewed. We also found that churning case ROIs were not always prepared as required by the 2005 Memorandum, including instances where the purchases and sales of tobacco products were not recorded in an ROI. The failure to prepare detailed ROIs in accordance with the 2005 Memorandum contributed to the OIG's inability to independently reconcile all of the tobacco bought, sold, traded, given away, and destroyed in the 20 ATF churning investigations we reviewed.

The N-Force case management log is to be used by Special Agents to track administrative actions during a case to document discussions, meetings, and contact with others about the investigation, and to update the

²³ According to Department officials, beginning in December 2012, ATF's Undercover Review Committee includes US Attorney participation.

case with other information that is not appropriate for an ROI.²⁴ Case management logs are also intended to allow for management review of expenses and proceeds. As such, the 2005 Memorandum directed Special Agents to document each expense and all proceeds in the case management log. These requirements were changed in the 2011 Memorandum, which only requires that proceeds, not expenses, be documented in the case management log.

Our review found none of the 20 churning investigations we reviewed – all of which were governed for at least some period of time by the 2005 Memorandum – had documented expenses in the case management log.

In addition, although we found that Special Agents generally documented the proceeds in the case management log as required by both the 2005 and the 2011 Memoranda, we also found that the level of detail about those expenses that we were able to access, using the case management log, varied significantly. For some investigations we reviewed, the case management log entries documenting proceeds included a reference to the corresponding ROI. The referenced ROI listed the specific activity related to the deposit such as the quantity, brand, and price of the cigarettes sold. In contrast, several investigations we reviewed documented only the total amount deposited in the case management log. As a result, we were unable to independently match all of the deposits recorded in the case management log to a corresponding ROI. Although neither the 2005 nor the 2011 Memoranda require references to corresponding ROIs in the case management log, the lack of references contributed to our inability to independently reconcile the amount of tobacco bought, sold, traded, given away, and destroyed in all of the investigations we reviewed.

In July 2011, ATF established the Monitored Case Program to ensure close coordination between ATF Headquarters and field offices for its most sensitive investigations, including all churning investigations.²⁵ For such investigations, the Monitored Case Program requires, among other things:

- field divisions to prepare a briefing paper for Deputy Assistant Director review and approval at the time the investigation becomes a monitored case;

²⁴ ATF Order 3111.1, *Use of N-Force*.

²⁵ In addition to churning investigations, the Monitored Case Program applies to investigations that have a documented international crime nexus, a widespread critical impact on public safety, or that involve long-term undercover operations.

- the relevant SAC to brief the Deputy Assistant Director each month on the status of the investigation; and
- the relevant SAC to telephone the Deputy Assistant Director when a significant activity or advancement in the investigation occurs, when the case changes its strategy significantly, or when there is an unanticipated change to the scope of the investigation.

Because ATF's Monitored Case Program took effect near the end of our audit fieldwork, we did not review its implementation. However, we examined the policy, and based on our review of the briefing requirements, we believe the required form for briefing Headquarters does not include information vital to monitoring a churning investigation, such as the amount of churning funds expended to date, or the amount of tobacco procured or sold to date. As a result, the information ATF Headquarters officials receive about churning investigations still may not provide them the information necessary to adequately oversee churning investigation activities.

Field Division Management of Churning Investigations

In addition to examining ATF Headquarters' role in initiating and supervising churning investigations, we also reviewed the management of churning investigations at the field division level. We examined the policies as implemented at the Special Agent level, particularly controls over proceeds from churning investigations and the use of churning case-related funds, as well as inventory controls over items purchased using churning funds, such as cigarettes, equipment, and vehicles.

We found that, even with the addition of the 2011 Memorandum that updated some aspects of churning case management, the policies for the use of churning funds and related items were inadequate and not comprehensive.²⁶ Specifically, we found that ATF had not adequately ensured that Special Agents: (1) deposit proceeds obtained during a churning investigation in a timely manner, (2) receive authorization to use churning funds prior to making expenditures with those funds, and (3) provide a detailed description of the requested use of churning funds. Regarding the inventories of tobacco products and the use of other equipment during investigations, we found that Special Agents were not required to have and maintain a complete inventory of all tobacco products

²⁶ ATF Order 3380.1, issued in April 2013, replaced the 2011 Memorandum, the previous Tobacco Enforcement Program order, and several other memoranda and is ATF's current policy guidance for all alcohol and tobacco investigations, including churning investigations.

obtained during an investigation and that other equipment, such as vehicles and surveillance equipment, was not inventoried and tracked. During our field work we also identified several practices that we believe could compromise the security of churning investigations we reviewed.

Controls Over Proceeds from Churning Investigations

Prior to April 2011, when ATF issued the 2011 Memorandum, it had not implemented policies and procedures for how agents should receive, process, and store churning proceeds. The primary policies and procedures for how money was to be received into ATF custody were contained in ATF Order 3400.1B, Property Taken Into Bureau Custody. The Order required that cash taken into ATF custody be converted to a cashier's check or money order and transferred to a suspense account within 5 days of its receipt.²⁷ However, ATF Order 3400.1B did not account for the exemption granted to ATF in 28 U.S.C. § 533, which established ATF's authority to use churning funds and permitted ATF to deposit monetary proceeds from an investigation into an undercover bank account and use them in furtherance of the investigation. When ATF issued the 2011 Memorandum, ATF had 25 open churning bank accounts with a total of \$46.8 million on deposit.

Prior to that time, ATF's Office of Professional Responsibility and Security Operations conducted an internal audit of ATF's churning accounts and noted that ATF lacked sufficient internal controls for safeguarding assets. Specifically, the ATF's February 2011 audit determined that churning proceeds were not always deposited into bank accounts in a timely fashion, and it noted one instance in which an issue with a banking institution led a Special Agent to store funds in an evidence vault safe for more than 1 year.

Our review consisted of 20 investigations that deposited about \$162 million into churning investigation accounts, including proceeds from the sale of tobacco, earned interest, and non-investigative deposits.

For each investigation, we documented and verified all of the deposits of cash into undercover bank accounts from the proceeds of the sale of tobacco products. As discussed previously, the 2005 Memorandum required that all investigative activity be documented in a ROI, so we reviewed all relevant ROI's to document the date of each undercover transaction and to determine whether the activity reported in the ROI matched what was

²⁷ A suspense account is a combined receipt and expenditure account established to temporarily hold funds that are later refunded or paid into another government fund when an administrative or final determination as to the proper disposition is made.

reported in the Monthly Reconciliations. We identified 1,559 deposits that were made with the proceeds of investigative activity.

Our review uncovered several issues related to deposits. For example, ATF did not have a timeliness requirement for depositing the proceeds of churning investigations. Many Special Agents told us that proceeds were deposited within 5 days of the investigative activity; however, we found that 327 of 1,559 (21 percent) deposits totaling \$27,426,277 occurred between 6 and 98 days after the investigative activity. For example, we found that one investigation did not deposit over \$688,000 in cash into the undercover bank account for 31 days. In another instance, that same investigation did not deposit over \$739,000 into the undercover bank account for 51 days. ATF officials did not provide an explanation for the delay in depositing the funds. We also found that another field office routinely withheld proceeds from its undercover bank account and kept the cash in a safe to be used as a "petty cash box." Although we could not determine the amount of proceeds this field office kept in a safe, we reviewed a May 2011 entry in the investigative management log indicating that Special Agents removed \$27,500 in cash from a safe and deposited it into the churning bank account.²⁸

We also found that for 206 (13 percent) deposits, totaling \$32.8 million, we could not determine the amount of time that elapsed between ATF receiving the proceeds and the deposit of the proceeds because the date on which ATF received the proceeds was not recorded in an ROI or elsewhere in the case file. An ROI was required for every transaction in which a special agent received money from a criminal target, yet we found that the case files of the 20 churning investigations we reviewed did not contain an ROI documenting the date of each of these 206 transactions.²⁹

We find the material lack of controls over the timely deposit of undercover proceeds during the audit period to be alarming. Untimely deposits of cash into bank accounts increase the risk of embezzlement, theft, misuse, and mishandling of funds. We believe ATF must act aggressively to ensure that controls for the handling of churning proceeds,

²⁸ Our findings were consistent with the March 2011 report of the ATF Office of Professional Responsibility and Security Operations, which found that funds received in churning investigations were not always deposited into the undercover bank accounts in a timely manner.

²⁹ In some cases, it appears that an ROI was not required, and therefore not prepared, because the tobacco was sold to another ATF investigation. Our findings regarding the sale of tobacco from one ATF investigation to another are discussed on page 31.

including its current policies for depositing churning proceeds into an undercover bank account, are adequate and scrupulously followed.

Approval to Spend Churning Funds

According to the 2005 Memorandum, the forms and procedures for using churned funds were similar to those for using agent cashier funds.³⁰ As with agent cashier funds, the SAC of each field division had the authority to initially approve or decline a request to use churned funds. Before churning funds could be expended, a Special Agent had to complete a *Request for Expenditure* form detailing exactly what the funds would be used for. These requests were then to be approved by a submitting Special Agent's first-line supervisor prior to expenditure. Once the funds had been expended, Special Agents were required to complete a *Report of Expenditures* form, documenting the use of the churned funds and to include receipts documenting the expenditure. The first-line supervisor then reviewed and approved the *Report of Expenditures* to ensure that the expenditure was in accordance with the request.

In the 20 investigations we reviewed, we could not determine whether first-line supervisory approval always occurred prior to the expense being incurred. However, we found that, in 16 of the investigations, Special Agents routinely expended funds prior to submitting the *Request for Expenditure* form for approval. We received a variety of explanations for why this may have occurred. For example, in reviewing the expenses that occurred without approval, we found instances of recurring expenses, such as cell phone bills, rent, and utilities, and were told by ATF officials that some field offices did not require prior approval for such recurring expenses. We were also told that Special Agents obtained verbal approval prior to the expenses being incurred. In one field office, we found that request forms for expenditures were submitted at the end of each month, and that requests included the total expenditures made for that month. The Resident Agent in Charge of that field office told us that his prior verbal approval was needed for all expenditures. In another field office, we were told by a Special Agent that prior approval was not required for every transaction; rather such approval was only needed for expenditures over a specific threshold. However, the Special Agent was not able to explain what that threshold was. In all 20 investigations, the proper forms were ultimately approved by the appropriate officials.

³⁰ ATF policies and procedures for agent cashier funds are contained in ATF Order 3251.1. Agent cashier funds are appropriated funds allocated for use in investigations to purchase evidence, provide subsistence for confidential informants, and other expenditures in connection with the procurement of evidence pursuant to the enforcement of laws and regulations within ATF's statutory jurisdiction.

In discussing our concerns related to this issue, many Special Agents and supervisors we interviewed explained that while Special Agents always received some sort of verbal or electronic approval, it was not always practical to obtain the required written approval prior to expending funds. According to these officials, some Special Agents did not operate out of the same office as the division SAC and ASAC, and because some requests had to be mailed for approval, the approval process could take several days. Special Agents also stated that the requirement to obtain written approvals prior to making expenditures could impede some investigations due to the fast pace required for some investigative activities.

Many ATF supervisors and Special Agents also told us that the approval process for churning expenditures was wasteful and inefficient and suggested that it be revised. SACs and ASACs we spoke to believed that the requirement that they sign all churning expenditures, regardless of the amount, was not a prudent use of their time. They suggested that ATF develop a dollar threshold under which lower supervisory level approval would be sufficient. Further, ATF officials suggested that recurring expenditures, such as rent and utilities, should be approved only once, and told us that ATF uses a similar process for recurring expenses that are paid for with agent cashier funds.

We believe that an efficient, risk-based process for documenting the approval of churning expenditures is essential to ensure that the expenditures are reasonable and necessary to the specific investigation. Such a process also acts as a control against fraud and abuse. However, we also believe that ATF's current process for approving churning expenditures could be streamlined without significantly increasing such risks. In addition to the suggestions from ATF officials cited above, we believe that the use of an electronic form could significantly decrease the amount of time the process takes.

Churning Fund Expenditures

As previously discussed, we found that the guidance regarding the nature and types of allowable churning fund expenditures contained in the 2005 Memorandum provided inadequate guidance about what types of expenditures were allowable with churning funds. As a result of this deficiency, we were not able to examine the specifics of each transaction to determine whether the transaction was allowable and fully supported. We therefore reviewed churning case expenditures to determine whether ATF had instituted adequate controls over the use of churning funds.

Our review focused on expenses incurred from the time an investigation was granted churning authority through June 2011. During that period, Special Agents for the 20 investigations we reviewed spent more than \$117 million on various expenses, including tobacco, equipment, travel, and vehicle rental. Approximately 92 percent of the \$117 million expended was for tobacco. Nevertheless, our review identified several examples of expenditures that, in our judgment, were wasteful. In addition, we identified expenditures which, to the extent they furthered ATF's operations generally, appeared inconsistent with the statutory requirement that churning funds should only be used to offset necessary and reasonable expenses incurred in the same undercover operation that generated them.³¹

Below we describe churning fund expenditures in eight categories of expenses, as well as additional churning fund expenditures we reviewed that raised concerns about ATF's management of those funds. Exhibit 3 categorizes the expenditures by type of expense.

Exhibit 3 Churning Funds Expenditures by Category

Category	Total Expenditure By Category	Percentage of Overall Expenditure
Tobacco	\$ 107,992,062	92%
Investigative Payments	\$ 2,906,903	2%
Fees and Other Miscellaneous	\$ 1,766,693	2%
Travel	\$ 1,669,365	1%
Utilities and Rent	\$ 818,379	1%
Vehicles	\$ 777,817	1%
Transcription Services	\$ 685,208	1%
Equipment, Accessories, and Supplies	\$ 368,291	0%
Unknown Expenses	\$ 166,019	0%
Grand Total ³²	\$ 117,150,737	100%

Source: OIG analysis

³¹ See Public Law 102-395 § 102(b)(1)(D), which was applied to ATF in Public Law 108-447, div. B, title I, § 116 as described at 28 U.S.C. § 533 note; see also Government Accountability Office, Office of the General Counsel, Principles of Federal Appropriations Law, Third Edition, Volume 2, Page 6-162 and 6-163 (2004). ("As a general proposition, an agency may not augment its appropriations from outside sources without specific statutory authority.")

³² The grand total is \$117,150,738. The difference is due to rounding.

Tobacco

For all tobacco-related expenditures, we documented the date, quantity, and purchase amount of each transaction. The types of expenditures in this category included cigarettes, tax stamps, counterfeit tobacco, and other tobacco products, such as snuff, cigars, and bulk tobacco. For these purchases, we attempted to match each purchase with an invoice to verify that the quantity and cost on the invoice matched ATF records. In the absence of invoices, we relied on documentation in the investigative file, including the management log, requests for expenditures, and records of expenditures.

During our review period, the 20 churning investigations made 848 tobacco-related purchases. We found that ATF did not maintain a copy of the required invoice for 182 (21 percent) of the 848 purchases. In 34 of the 182 instances in which there was no invoice, the case file or the management log did not contain any documentation that allowed us to determine the quantity or value of the tobacco purchased. As a result, we could not verify the amount of tobacco purchased or the cost of the individual purchases made. However, based on the documentation that was provided to the audit team, we determined that the 20 churning investigations spent a total of almost \$108 million to purchase tobacco-related products, including more than 9.9 million cartons of cigarettes from distributors, manufacturers, wholesalers, and other ATF investigations.

In addition to examining the accounting of funds used to purchase tobacco-related products, we also examined the inventories of tobacco products on hand for the 20 investigations. We found that in 11 of the 20 investigations, Special Agents purchased and traded tobacco with other ATF churning and non-churning investigations, as well as other investigations outside of ATF. This use of both funds and on-hand inventories violates ATF's policy that funds only be used to further the specific investigation for which churning authority was granted. Because records were not always maintained showing the quantity and brand of tobacco products in these transactions, and because of other factors described below, we were unable to conclusively determine how much tobacco was obtained, sold, traded, given away, and destroyed in each of the investigations we reviewed.

Investigative Payments

Investigative payments include those payments made to criminal targets or confidential informants for subsistence, travel, or other investigative activities completed in the furtherance of an investigation. Investigative payments also include payments for money laundering or the

procurement of an otherwise illegal product from a target other than tobacco, such as illegally trafficked firearms or illegal drugs.

For the 20 churning investigations we reviewed, we determined that \$2,906,903 was spent on investigative payments. More than \$1 million of these expenditures was for the purchase of evidence, including tobacco products and counterfeit tax stamps. These expenditures also included money laundering activities. We found that \$117,073 was spent on subsistence and travel expenses for confidential informants, including examples where ATF reimbursed confidential informants for insufficiently documented expenses or substantial expenses without documenting the connection between the expense and the investigation. Specifically, ATF reimbursed an informant \$8,779 for travel as part of a joint ATF operation with another federal agency. The only documentation for the expenses was an invoice from the informant's company for air freight service and handling fees. There were no receipts for airfare, hotel, or other travel expenses. In another instance, the request for expenditure stated that funds were used for travel-related expenses for a confidential informant, but \$5,841 of the \$7,528 paid to the informant was for telephone bills that averaged over \$1,400 a month. Further, there was no explanation describing the operational need for the significant monthly telephone costs.

Fees and Other Miscellaneous

For the miscellaneous category, we found that the majority of charges were for wire transfer fees, typically associated with payment to tobacco manufacturers. This category also included automated teller machine fees, parking fees, parking tickets, credit card finance charges, and all expenditures that do not conform to the other categories discussed in this section. A total of \$1.77 million in fees and miscellaneous expenses were incurred.

Travel

We identified \$1,669,365 in travel-related expenditures paid for with churning funds within the 20 investigations we reviewed. Travel expenditures included lodging, per diem, transportation, petty cash for travel and transportation, and any travel-related expenditure not otherwise classified elsewhere. Travel expenditures included travel by ATF employees, Task Force Officers, and other federal, state, and local agency personnel.

During our review, we identified many instances where little or no information regarding the purpose of travel was included in the documentation. As a result, we were not always able to determine whether

the travel was in support of the specific investigation or for other purposes. Some of these expenditures raised the concern that churning funds were used to support administrative travel or travel of non-ATF personnel that more appropriately should have been paid for out of ATF appropriations or the appropriations of other agencies. For example, we found occasions where churning funds were used to pay travel expenses for the following:

- ATF administrative employees, including Intelligence Analysts, Intelligence Research Specialists, and Industry Operations Investigators;
- ATF agents traveling from various field offices to Washington, D.C., to provide investigative updates; and
- Non-ATF employees, including officials from United States Attorney's Offices, U.S. Immigration and Customs Enforcement, and the Internal Revenue Service.

We found many other shortcomings in ATF's travel-related documentation. The files we reviewed did not always contain sufficient documentation to show that approval had been granted prior to travel, as required by ATF travel policies. In multiple instances, travel requests were submitted after travel occurred and numerous travel-related expenditures lacked supporting documentation, making it difficult for ATF to ensure that churning funds were not wasted or used for prohibited purposes, and that its employees remain accountable for their use of those funds.

Utilities and Rent

We found that \$818,379 was spent on rent for warehouse space and utilities for the 20 churning investigations we reviewed. The utilities paid for included charges for telephone, cell phone, electricity, and gas for heating. We also found that two investigations spent more than \$193,000 in churning funds to lease warehouse space owned by an ATF confidential informant. Because the informant was cooperating with ATF and had an ongoing relationship with ATF, these transactions are problematic and create the potential for an actual or apparent conflict of interest. In addition, the two investigations both paid for rent and utilities one year in advance, so the utility charges were based on estimates, not actual costs. Because the rent payments both investigations made were related-party transactions and the terms of the lease were not documented, we could not determine whether the lease amounts were fair market value.

Vehicles

We defined vehicle expenses as those related to the rental or lease of vehicles that were not associated with temporary duty travel. This category also included vehicle-related expenses such as gasoline, repairs, and maintenance.

The 20 churning investigations in our review spent a total of \$777,817 on vehicle-related expenses. Many of the expenditures in this category were for the rental of trucks or vans to transport tobacco to or from undercover transactions. However, we also found several expenditures that appeared to be wasteful or an abuse of ATF's churning authority.³³ The following four examples highlight our concerns:

- Although the churning investigations we reviewed typically had one or two agents assigned to them, we found that some investigations routinely rented multiple vehicles for extended periods of time. One investigation we reviewed paid more than \$30,000 to rent 12 vehicles for up to 1 month. The lead ATF Special Agent for the case said the vehicles were for Task Force Officers but could not explain the operational need for the expenditure or the number of Task Force Officers that used the vehicles, so we could not determine whether this expenditure was reasonable and prudent. The same investigation spent \$226,394 to rent between 3 and 12 vehicles on a monthly basis for more than a year. There was no documentation in the case file to document the operational need for the vehicles or indicate that they were being used solely to support the churning investigation that rented the vehicles, so we could not determine whether this expenditure was reasonable and prudent.
- According to ATF agents we interviewed, the ATDD would not permit churning investigations to purchase vehicles, but it would permit the leasing of vehicles. In one instance, a Special Agent leased a 2011 Chevrolet Tahoe for 1 year at a cost of \$30,000, which represents approximately 60 percent of the list price of the vehicle. We believe that if the vehicle was needed and met case-specific investigative requirements, obtaining the use of such a vehicle, either through purchase or a lease with more reasonable terms, would have been a better use of funds. In addition, we found no documentation to

³³ Government Auditing Standards define abuse, in part, as "behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances." See Government Accountability Office, Government Auditing Standards, December 2011.

demonstrate that the vehicle was being used solely for the churning investigation that leased it.

- Churning funds were often used for maintenance and repairs of vehicles, yet we found a lack of documentation demonstrating that the vehicles being repaired were being used solely by the churning investigations, or that the vehicles were an integral part of the churning investigation. For example, within a 16-day period, one investigation spent more than \$6,500 in churning funds to repair a Mercedes Benz. In a little over a month, another investigation spent \$11,883 on vehicle repairs and maintenance. The same investigation also spent about \$4,700 in a month's time to repair a BMW and \$1,200 to repair a motorcycle. In each of these examples, ATF did not document that these vehicles were used exclusively for the churning investigation that paid for the repairs or that a cost benefit analysis was performed to ensure that the expenditures were prudent.
- Three investigations paid a confidential informant, a tobacco distributor, \$70,443 to rent vehicles owned by the informant. Unlike commercial rental car agreements, ATF also bore the cost of maintenance and repairs to these vehicles, which were paid for with churning funds. The informant was not in the business of renting vehicles and there was no contract or written agreement documenting the terms of the vehicle rentals, so we are concerned that the arrangement gives the appearance that ATF rented the vehicles from the informant to financially reward the informant for his cooperation. Further, we were unable to determine whether these vehicles were used to further the investigations or that they were used solely for the churning investigations that paid for them.

Transcription Services

During our case review, we also identified expenditures related to translation and transcription services, such as the transcription of wiretaps and the translation and transcription of audio recordings of undercover surveillance operations. We found that churning investigations expended a total of \$685,208 for transcription services. We did not identify any issues specifically related to these expenditures.

Equipment, Accessories, and Supplies

A total of \$368,291 was spent by the 20 investigations we reviewed on equipment, accessories, and supplies. The equipment included, but was not limited to, computers, cameras, cell phones, surveillance devices, Global Positioning System (GPS) devices, forklifts, safes, and cash counting machines. Accessories included such items as iPhone and iPad covers, phone chargers, and other items purchased in conjunction with equipment purchases. Supplies included widely used office supplies such as paper and ink cartridges.

We determined equipment such as iPhones, iPads, and GPS devices were routinely purchased without documentation demonstrating the operational need for the specific undercover investigation. For example, in one investigation, 20 GPS units were purchased at a total cost of \$7,750 without documentation of the operational need or supporting evidence that ATF did not already have comparable equipment available for that investigation. These units were distributed to other agents in the field office as well as Task Force Officers outside of ATF, and the lead Special Agent for the case was not able to provide documentation to indicate who had possession of each of the GPS devices, nor could he demonstrate that the devices were being used solely to support the churning investigation. Further, although there had been no investigative activity for almost 1 year, some of the GPS units were still in the possession of and being used by Special Agents and Task Force Officers. This is a violation of ATF policy, which requires all property that is purchased in furtherance of the undercover churning operation to be used only for that specific investigation. These problems strongly indicate that ATF does not have mechanisms in place to ensure its Special Agents adhere to this policy.

As noted in a 2011 ATF internal audit, churning funds may not be used to purchase items or services that are normally furnished by ATF to assist Special Agents in investigations. However, we identified several purchases of supplies and equipment that gave the appearance that this was occurring. For example, one investigation purchased seven cameras for \$14,000. Another spent \$2,743 for training guns, a ballistic shield, and other related accessories that would normally be furnished by ATF. The case files for these investigations contained no explanation for why churning funds needed to be used for these purchases.

We also found that two investigations spent \$11,000 in churning funds to lease forklifts and pallet jacks from an ATF confidential informant. This is the same confidential informant that received payments described above in the Utilities section and the Rent and Vehicle section. Our concerns about

the appearance of related-party transactions described in those sections also apply to the payments for the forklifts and pallet jacks. Specifically, the informant was a tobacco distributor and was not in the business of leasing material handling equipment. In addition, there was no contract or written agreement documenting the terms of the leases, so we are concerned that the transactions give the appearance that ATF leased the equipment from the informant to financially reward him for his cooperation. Also, we were unable to determine whether the equipment was used solely to further the investigations or that they were used solely for the churning investigations that paid for them.

In addition, as with the other expenditure categories we reviewed, we also identified expenditures listed as equipment with no supporting documentation, including one charge of \$3,422 reflected in bank records but for which no supporting documentation was included in the file.

ATF policy requires that all equipment purchased with churning funds be returned to the General Services Administration at the conclusion of an investigation. However, we found that Special Agents were not required to maintain a physical inventory of items purchased with churning funds: only 1 of the 20 investigations we reviewed maintained a complete inventory, including a location and disposition, of the property purchased with churning funds. As a result, ATF was not able to adequately track and monitor assets purchased and used throughout investigations.

Moreover, we found that while some Special Agents maintained an accounting of all assets, others did not. Those Special Agents that did not maintain an accounting of all non-tobacco assets said that they could reconstruct an inventory from monthly churning reports. However, by not maintaining an inventory during the investigations, neither Special Agents nor supervisors could adequately track assets during the course of the investigation. Further, the absence of an accurate, periodic inventory prevents ATF from being able to monitor whether the assets purchased with churning funds had been used for other investigations.

The absence of an inventory control mechanism increases the risk that equipment purchased during the investigation will not be disposed of by the General Services Administration as required, that churning funds will be used in furtherance of non-churning operations, and that government resources are subject to increased theft, fraud, waste, and abuse.

Unknown Expenses

In our review of the 20 churning cases, we defined unknown expenditures as those that did not have sufficient supporting documentation to show the purpose of the expenditure. We found that supporting documentation was not available for 32 credit card transactions totaling \$166,019. In these instances, the requests for and records of expenditures did not itemize the expenses, and there were no receipts or other supporting documentation to explain or account for the expenditures.

Controls Over Tobacco

When our audit began, ATF had no written policies and procedures for procuring tobacco, maintaining an inventory of tobacco products on hand, or tracking tobacco products used in ATF undercover investigations. Specifically, ATF tobacco investigations were not required to order tobacco products through ATF's Procurement Specialist, who is specifically charged with procuring tobacco from tobacco manufacturers for use in ATF operations, thereby impeding ATF's ability to track, monitor, and reconcile the amount of tobacco ordered and used in these investigations. Furthermore, there were no policies requiring each churning investigation to track the amount of tobacco products ordered, received, traded, sold, given away, or destroyed during undercover investigations. Given the large amount of money spent by ATF churning investigations to purchase cigarettes – ATF agents spent \$108 million to purchase more than 9.9 million cartons of cigarettes in the 20 investigations we reviewed – it is vital that ATF be able to account for all of the tobacco products it uses in its churning investigations.

Tobacco Procurement

At the time our audit began, we found that ATF's controls over the purchase of tobacco products were insufficient based on the 2005 Memorandum and our review of ongoing and recently closed cases. While ATF has since taken steps to improve these controls with a new procurement policy, implemented in March 2011, as well as the 2011 Memorandum, we still have concerns about the ability of ATF agents to purchase tobacco products with churning funds without proper permission or adequate oversight.

In 2010, prior to our audit, an OIG criminal case involving a joint tobacco diversion investigation between ATF and a local police department, led to the conviction of an ATF Special Agent. The ATF Special Agent was convicted of selling untaxed cigarettes to one of his informants outside the

scope of the joint investigation. The Special Agent had purchased cigarettes from a major manufacturer in connection with the joint investigation but then diverted a portion of the product to a private storage facility that he had rented. After doing so, the Special Agent notified the informant, who retrieved the cigarettes and left a payment for the Special Agent. Through this scheme, the Special Agent made about \$20,000 to \$25,000 in a 3-month period.

Because ATF did not have adequate internal controls in place to monitor the activities of the Special Agent throughout the undercover investigation, ATF did not discover the agent's illegal activities. Instead, the agent's scheme was identified accidentally by a local police officer working on the tobacco diversion investigation. One of the informants to whom the Special Agent had sold cigarettes sent the Special Agent an e-mail on a smartphone assigned to the investigation that was in the possession of one of the local police officers at the time, and the contents of the e-mail led to the investigation into the Special Agent's activities.

In March 2011, during this audit's fieldwork and in response to issues identified in an ATF internal audit, ATF issued a new procurement policy designed to enhance the procurement and management of tobacco.³⁴ The policy included requirements for tobacco procurement through the agreements with tobacco manufacturers. Under this new policy, Special Agents must initiate tobacco requests through their supervisor, ASAC, and SAC. The new procedures also require a member of the ATDD staff to review the request and the investigation within ATF's case management system, N-Force, to ensure that: (1) the case is an actual ATF investigation, (2) the tobacco will be used solely for the investigation noted in the request, and (3) the tobacco is being ordered by ATF and paid for using ATF funds, whether appropriated funds or churning funds.

Our review of the 20 churning investigations found that these policies provided inadequate controls over the procurement of tobacco products. For example, we found no evidence that reconciliations had been performed between the amount of tobacco ordered and the amount used in ATF's undercover investigations. Nor did we find any evidence that ATF had instituted controls adequate to ensure that tobacco was ordered exclusively for tobacco cases. Rather, we found that ATF relied on an honor system for obtaining and using tobacco products.

³⁴ The internal audit was completed by ATF's Office of Professional Responsibility and Security Operations in March 2011.

In addition, although ATF maintains agreements with manufacturers to purchase tobacco for use in undercover operations and has a designated Procurement Specialist to make these purchases, we found that ATF Special Agents, responsible for churning investigations, also procured tobacco through other means, and that these alternative procurement channels were not prohibited by the 2011 memorandum. Further, there was no requirement for Special Agents to notify the Procurement Specialist of tobacco ordered through these other means. Special Agents we interviewed identified two reasons for the procurement outside of ATF's manufacturer agreements. First, while the agreements include some of the most popular cigarette brands, they do not cover all tobacco manufacturers. Because cigarette diversion investigations often included lesser known and generic brands of cigarettes not covered by the manufacturer agreements, Special Agents repeatedly told us they had no choice but to purchase these lower cost cigarettes directly from the manufacturer or from a distributor. Second, as of December 2012, there was only one Procurement Specialist who could purchase cigarettes through the manufacturer agreements at ATF, and when the Procurement Specialist was not in the office, tobacco orders were not processed until the Specialist returned. Special Agents said they therefore often purchased tobacco products from other sources, such as distributors and other ongoing ATF investigations, to avoid lags in the supply of tobacco that could undermine their investigations.

We found that when tobacco was purchased outside of the manufacturer agreements, it went through the same review process as any other purchases with churning funds, such as travel, would go through, including a review and approval through the Special Agent's supervisor. However, because this alternate procurement channel did not involve ATF Headquarters, we also found that these purchases hindered ATF's ability to track, monitor, and reconcile the use of tobacco in ATF investigations.

We believe it is important for ATF to have mechanisms in place to track the disposition of all tobacco procured throughout each investigation. By not having the controls in place to track and monitor tobacco procured and used in its investigations, there is a risk that ATF may significantly increase the supply of tobacco to the illicit tobacco market, compete with legitimate businesses, or be subject to fraud and abuse.

Tobacco Inventory

Because cigarettes and other tobacco products are easily sold, it is vital that ATF investigations maintain accurate inventories so ATF can properly account for all of the tobacco products received and used during its investigations. However, prior to the issuance of the 2011 Memorandum,

ATF did not require that tobacco products be inventoried on a regular basis throughout an ongoing operation. Our review of 20 churning investigations found that only 5 of the investigations conducted any inventory of tobacco at all, and a March 2011 review by the ATF Office of Professional Responsibility and Security Operations was unable to reconcile the final tobacco inventory of ATF churning investigations because nearly all of the investigations did not maintain a tobacco inventory and did not account for damaged inventory.

In response to our questions regarding an inventory of tobacco products, Special Agents told us that several issues made it difficult to account for all of the tobacco purchased by churning investigations. Special Agents stated that they routinely traded tobacco with other ATF investigations and gave cartons of cigarettes to criminal targets as samples. They told us that some tobacco was damaged in transit or by insects and had to be discarded. Some Special Agents stated that they thought that criminal targets sometimes stole cases of tobacco being maintained for investigations. Some Special Agents also told us that maintaining an accurate record of the tobacco purchased and used during churning investigations was difficult due to the sheer volume of tobacco involved in some churning investigations.

We examined the accounting for and disposition of all of the cigarettes on record for the investigations, including the number of cigarettes purchased, sold, or otherwise disposed of on record. As a result of inventory control issues and a lack of documentation, for the 20 investigations we reviewed, we could not reconcile the amount of cigarettes purchased by ATF with the number of cigarettes sold or otherwise disposed of, resulting in an inability to account for approximately 2.1 million cartons of cigarettes (or 420 million cigarettes) purchased by the 20 investigations, 1.4 million cartons of which were attributable to one investigation. We estimate the

retail value of the about 2.1 million cartons of unaccounted tobacco to be more than \$127 million.³⁵

By not having inventory controls in place for tobacco products, there is not only a high risk of theft, but also ATF cannot be assured that those products purchased for churning investigations are being used for their intended purposes. As a result, there is a concern that ATF may not have fully complied with 28 U.S.C. § 533 in the management of its cases, in that proceeds are required to be used in furtherance of the investigation for which authority was granted. ATF's 2011 Memorandum appropriately requires that all tobacco purchased with churning funds be inventoried once a month. However, the Memorandum does not require periodic, physical inventories of the tobacco. In addition, the memorandum does not require the tracking of tobacco products purchased prior to an investigation receiving churning authority, potentially resulting in an inaccurate starting inventory.

We believe ATF needs to establish additional controls to ensure an accurate accounting of all tobacco purchased and sold throughout each of its investigations. Further, ATF should implement policies and procedures to

³⁵ Our estimate of the unaccounted tobacco is based on a retail price of \$5.95 per pack and each carton containing 10 packs. According to Ann Boonn, "State Cigarette Tax Rates & Rank, Date of Last Increase, Annual Pack Sales & Revenues, and Related Data," Campaign for Tobacco-Free Kids, March 6, 2012, the average retail price per pack of cigarettes across all states, including applicable federal and state taxes, was \$5.95, with prices ranging from \$4.02 to \$10.14.

In response to our draft report, ATF officials requested that we use the wholesale price of cigarettes, rather than the retail price, when computing our estimate. These officials stated that the wholesale price was often as low as \$10 per carton, or \$1 per pack. However, we determined that more than 50 percent of the more than 9.9 million cartons of cigarettes purchased for the 20 investigations we reviewed, were premium brands that had a wholesale price of as much as \$30 carton, or \$3 per pack. Moreover, although the wholesale value of the cigarettes represents the cost at which ATF purchased the cigarettes, it would not properly account for the churning funds ATF would have raised had it sold the cigarettes as part of its investigation. Nor does the wholesale price account for the value of the potential tax revenue lost by state and local governments, or the potential profits lost by legitimate businesses, in instances where lost or stolen cigarettes are purchased as a substitute for retail cigarettes.

ensure all tobacco that is given away, damaged, lost, or traded is appropriately accounted for and reported.³⁶

Operational Security

Operational security is an essential element of undercover investigations, and includes the steps taken to minimize the risk of harm to Special Agents, confidential informants, and unwitting members of the public during an investigation. Additionally, operational security includes protecting the identity of confidential informants used to assist in investigative activities.

During our field work we identified several practices that we believe could compromise the churning investigations we reviewed.

Confidential Informants

ATF Order 3250.1A, *Informant Use and Undercover Operations*, requires that the identity of confidential informants be treated with utmost security, and that a confidential identity code be used in all instances where reference is made to an approved informant. The order provides an exception in situations that resulted in a payment of money to a confidential informant. Moreover, ATF Order 3250.1A specified that agent cashier reports, which churning reports are modeled after, only refer to an informant by their confidential informant identity code.

³⁶ After learning of our findings, ATF's Deputy Director ordered ATF forensic auditors to conduct a separate reconciliation of the disposition of cigarettes from two of the largest cases in the OIG's 20 case sample, as those two cases included the substantial majority of the 2.1 million cartons of cigarettes we could not reconcile.

The ATF told us that it reviewed every single Report of Investigation (ROI) from these two cases to see if it referenced the disposition of cigarettes, even if the ROI was not referenced in the case management log. The ATF stated that during this review, it found a limited number of unexplained deposits associated with the two investigations and assumed that those deposits were related to the sale of cigarettes and then estimated the number of cigarettes that were likely sold given the amount of the deposit. Using these methods, the ATF review arrived at a significantly smaller amount of unreconciled cigarettes than our audit. The ATF review did find similar problems as the OIG has described in this report, including "a clear lack of internal controls, oversight, training and policy to guide ATF agents in these cases which resulted in a lack of uniformity in procedures, required documentation, inventory controls, and accountability."

ATF describes its review in more detail in its response to this audit, which is attached as Appendix II. However, for the reasons we outline in our response which is attached as Appendix III, we do not believe the results of ATF's review are comparable to the OIG review.

We determined all confidential informants, used in churning investigations we reviewed, were referred to by the assigned confidential informant number. In 19 of the 20 investigations, the financial and supporting documentation protected the identity of the confidential informant. However, in one investigation, we identified several instances in which both the legal names and informant numbers of confidential informants were identified in financial and other supporting documentation. In one instance, the confidential informant's name was readily identifiable in e-mails from the confidential informant to the case agent. We observed one transaction in which several confidential informants' legal last names and informant numbers were included on the same page. We discussed the issue with the Special Agent assigned to the investigation and he was unable to provide an explanation.

We also found that case information was not routinely maintained using adequate safeguards, such as retaining specific information regarding informants separately or controlling information in a manner that protected the identities of confidential informants. As a result, we recommend that ATF develop and strengthen confidential informant record retention policies and procedures to ensure better protection of the true identities of its confidential informants.

Special Agents

We identified several instances in which Special Agents reimbursed themselves for travel in the form of a check written from the Special Agent's undercover alias to his legal name. One Special Agent stated he did not view this as an operational security issue and added that undercover operations are not risk-free no matter what countermeasures are employed. Additionally, the Special Agent told us the only alternative was to reimburse himself with cash, which could create the appearance of impropriety. Nevertheless, payment directly to a Special Agent's true identity from a churning account risks compromising operational security because it provides a direct link between the agent's true identity and position and the undercover operation.

We also found instances where ATF personnel mixed true and undercover identities in one transaction. For example, one investigation purchased office supplies at a local business and the invoice stated that ATF purchased the items, but the items were paid for using a check from an undercover checking account. This mixing of undercover and true identities could reveal the identity of an ATF operation to the employees of the office supply store and anybody else with access to the transaction's documentation.

Conclusion

Our evaluation of ATF's management of churning investigations at both the Headquarters and Field Division levels revealed that during the audit period substantial weaknesses existed. Most significantly, we found that ATF lacked comprehensive policies and procedures to adequately oversee and manage its churning investigations. Further, because the Undercover Review Committee was inactive during the period covered by our audit, and ATF did not have other controls in place, it could not ensure that churning investigations operated within the scope of the authority they were granted through the Department's approval.

ATF must ensure it has mechanisms in place to adequately track, monitor, and reconcile tobacco used by ATF's churning investigations. Without these safeguards, ATF cannot be assured that tobacco or tobacco proceeds are not subject to waste, theft, fraud, or abuse. Also, by allowing the procurement of tobacco for churning investigations from sources other than through ATF's Procurement Specialist, including the purchase of tobacco between ongoing investigations, ATF cannot determine the amount of tobacco purchased or used in each churning investigation.

Similarly, because ATF did not have a requirement to inventory tobacco products, we were unable to account for more than 2.1 million cartons of tobacco products purchased by the 20 churning investigations we reviewed. We estimate the retail value of the more than 2.1 million cartons to be more than \$127 million. Further, ATF was unable to provide a complete accounting for equipment purchased with churning funds. Without a complete accounting, ATF cannot assure itself that none of the tobacco or equipment purchased with churning funds was misappropriated or wasted, or that churning funds were not used for ATF's overall operations.

We also found significant issues with ATF's controls over cash management during churning investigations. Specifically, we are concerned that field division and field office supervisors did not always ensure Special Agents received authorization prior to using churning funds and did not receive a detailed description of the use of churned funds. During our review, we identified purchases that appeared improper, unnecessary, and unreasonable. We also identified expenditures made using churning funds that were in support of non-churning operations. The equipment, accessory, and supply expenditures we reviewed that lacked corresponding documentation demonstrating the churning investigation's specific need for the items raised questions of whether ATF would have funded the purchases with non-churning funds as organizational expenditures. As a result, we are

concerned that there may have been instances where purchases using churning funds supplemented ATF's non-churning operations, which is prohibited.

Also, because we found that proceeds received as a result of undercover activity were not always deposited in a timely manner, we believe that ATF should establish and implement more stringent controls for the handling, safeguarding, and deposit of all proceeds into undercover bank accounts.

Finally, we identified various practices that we believe could undermine operational security by revealing the true identities of the confidential informants and agents involved in churning investigations.

Money generated through churning investigations belongs to the U.S. Government, and it is ATF's responsibility to ensure that such funds are expended appropriately and as mandated by ATF policy. We believe ATF should develop and implement clear policy regarding the permissible uses of churning funds, implement policies and procedures that minimize the risk of fraud and abuse, and strengthen policies and procedures for protecting the identity of confidential informants and undercover agents.

Recommendations

We recommend that ATF:

7. Develop and finalize churning policy guidance and issue it in an ATF Order.
8. Ensure that all tobacco procured for investigations is adequately documented, tracked, inventoried, and reconciled, including a system for the independent and periodic review and reconciliation of tobacco inventories by headquarters management staff.
9. Develop and implement policies and procedures to ensure that churning investigations do not operate outside the original authority for which they were granted. These policies and procedures could include using the Monitored Case Program to ensure that a churning operation's targeted subject remains the focus of the case throughout the duration of the case.

10. Ensure each churning investigation transaction involving the sale or purchase of tobacco as well as corresponding deposits and expenditures is thoroughly documented in N-Force.
11. Update the Monitored Case Program requirements to ensure ATF Headquarters can adequately monitor churning investigations.
12. Develop and implement a system to ensure proper inventory, management and disposition of non-tobacco assets.
13. Develop and implement policies and procedures to ensure the timely deposit of churning funds.
14. Design and implement a more streamlined process for approving expenditures and consider an electronic version of its approval process.
15. Develop and implement clear policy regarding the permissible uses of churning funds. Such policies should, among other things, identify categories of expenses that are and are not permissible uses of churning funds.
16. Examine and update existing policies and procedures to ensure that churning funds are used only to offset the necessary and reasonable expenses of the same, authorized investigation that generated them, and not used to fund separate investigations or ATF's operations generally.
17. Strengthen policies and procedures to ensure the confidentiality of confidential informants and undercover agents.

STATEMENT ON INTERNAL CONTROLS

As required by the *Government Auditing Standards*, we tested, as appropriate, internal controls significant within the context of our audit objectives. A deficiency in an internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to timely prevent or detect: (1) impairments to the effectiveness and efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations. Our evaluation of ATF's churning authority internal controls was *not* made for the purpose of providing assurance on its internal control structure as a whole. ATF's management is responsible for the establishment and maintenance of internal controls.

As noted in the Findings and Recommendations section of this report, we identified deficiencies in ATF's internal controls that are significant within the context of the audit objectives and that we believe, based upon the audit work performed, adversely affect ATF's ability to provide adequate oversight and management of its churning investigations. The lack of comprehensive policies and procedures has contributed to a lack of consistent oversight and management of ATF's churning investigations.

Because we are not expressing an opinion on ATF's internal control structure as a whole, this statement is intended solely for the information and use of ATF. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

STATEMENT ON COMPLIANCE WITH LAWS AND REGULATIONS

As required by the *Government Auditing Standards*, we tested, as appropriate given our audit scope and objectives, selected transactions, records, procedures, and practices to obtain reasonable assurance that ATF's management complied with federal laws and regulations for which noncompliance, in our judgment, could have a material effect on the results of our audit. ATF's management is responsible for ensuring compliance with federal laws and regulations applicable to ATF. In planning our audit, we identified the following laws and regulations that concerned the operations of ATF and that were significant within the context of the audit objectives:

- 28 U.S.C. § 533, as amended.
- 18 U.S.C. Chapter 114 – Trafficking in Contraband Cigarettes and Smokeless Tobacco (2010).

Our audit included examining, on a test basis, ATF's compliance with the aforementioned laws and regulations that could have a material effect on ATF's operations through interviewing ATF personnel and obtaining and testing tobacco investigation data.

As noted in the Findings and Recommendations section of this report, in addition to the several instances of non-compliance with ATF policy, we found that ATF did not fully comply with the requirements of 28 U.S.C. § 533, as amended. Specifically, we identified a churning investigation that operated without being properly authorized by the ATF or the Department, which was a violation of ATF's churning authority.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of this audit were to determine whether: (1) ATF properly authorizes its income-generating, undercover operations; and (2) ATF provides adequate management and oversight of its income-generating, undercover operations at the headquarters and field division levels.

Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To accomplish our audit objectives, we examined churning investigation case data from February 2006 through June 2011. In order to achieve our audit objectives, we conducted work at the following 8 of ATF's 25 field divisions:

- | | |
|----------------------------|---------------------|
| Atlanta, Georgia | Baltimore, Maryland |
| Charlotte, North Carolina | Detroit, Michigan |
| Kansas City, Missouri | Newark, New Jersey |
| Philadelphia, Pennsylvania | Washington, D.C. |

We interviewed current and former staff members of the Alcohol Tobacco Diversion Division, staff members of the Case Management Branch, Accounting Division staff, attorneys from ATF's Chief Counsel's Office, as well as ATF executives with oversight responsibilities for ATF churning investigations. We also interviewed Special Agents, Group Supervisors, Assistant Special Agents-in-Charge and Special Agents-in-Charge. In total, we interviewed more than 70 ATF officials, as well as other Department officials discussed below.

Investigation Universe and Selection

To ensure our field work was comprehensive and our conclusions derived from sufficient evidence, we judgmentally selected 20 of 35 churning cases to review. We selected which investigations to audit and corresponding field divisions to visit from documentation provided by ATF. The documentation provided by ATF indicated that the 35 churning investigations were led by 14 ATF field divisions. From the universe of 35 investigations, we judgmentally selected which cases we would review based on the number of open churning investigations at the respective 14 field divisions. We relied on a judgmental sample as our case selection methodology to ensure we were able to review the greatest number of cases and the greatest amount of churning funds given time and resource constraints. We reviewed 100 percent of the selected investigations' churning expenditures as well as 100 percent of the proceed transactions and therefore did not rely on a statistical sample. When we conducted our testing we were reasonably assured the information we reviewed was reliable because expenditures and deposits reported on monthly churning reports were reflected on the bank statement of the churning account.

Authorization of Income Generating Operations

We compared the 35 churning authorization requests to the churning approval process, documented by ATF, to determine if ATF was conforming to its own internal standards for approving churning authorization requests. We obtained and reviewed documentation from ATF and the Department to ensure each churning authorization request was approved by the Chief of Alcohol Tobacco Diversion Division, the corresponding ATF Deputy Assistant Director, and the Department Chief of Organized Crime and Racketeering Section (OCRS) in the Criminal Division. We interviewed Alcohol Tobacco Diversion Division officials and the former Chief of OCRS at the Department of Justice.³⁷ ATF officials interviewed, held the direct responsibility for reviewing and approving churning authorization requests within ATF and the Department of Justice. We also compared the 35 churning authorization requests to the criteria in the 2005 Churning Memo to determine if criminal targets were identified in the churning authorization request as specifically as possible.

³⁷ The Alcohol Tobacco Diversion Division was a branch of the Alcohol and Tobacco Enforcement Branch. In January 2009, it was elevated to the Alcohol and Tobacco Diversion Division. In October 2011, the Alcohol and Tobacco Diversion Division reverted to the Alcohol and Tobacco Diversion Branch. For purposes of consistency the report will refer to the Alcohol Tobacco Diversion Division as a Division.

Headquarters Oversight

In order to determine the adequacy of oversight at ATF Headquarters, we interviewed Alcohol Tobacco Diversion Division personnel as well as ATF Special Agents and Group Supervisors to determine the amount of guidance that was being provided by the ATDD. Our interviews included the current chief as well as three former chiefs of the ATDD. In order to assess the adequacy oversight of field operations, to determine if the field was given adequate guidance for procurement, inventory, and expenditures, and to determine whether the field was given controls to limit the scope of churning investigations, we reviewed ATF's tobacco procurement policy, the 2005 and 2011 churning policies, ATF's agent cashier orders, and undercover orders.

Field Oversight

In order to determine the adequacy of ATF's oversight of revenue generating operations at the field division and field office level, we tested the controls associated with operational security, tobacco inventory and churning expenditures. We interviewed Special Agents, Group Supervisors, and Assistant Special Agents-in-Charge or Special Agents-in-Charge. We reviewed monthly churning reconciliation reports as well as the supporting documentation associated with the monthly churning reconciliation report to determine if expenditures conformed to ATF policy. We reviewed ATF's 2005 Churning Memorandum, Agent Cashier Order and Mission Travel Order to determine if churning expenditures conformed to ATF policy. To determine if churning funds were adequately safeguarded, we reviewed Reports of Investigation and Management Logs to verify that proceeds reported on monthly churning reconciliation reports from undercover tobacco sales were deposited into churning accounts. We verified that proceeds were deposited by comparing the Report of Investigation and Monthly Churning report to the investigation's bank statement. In order to determine how each of the 20 churning investigations spent its churning funds we relied on churning monthly reconciliation reports from 20 churning investigations to classify churning expenditures into eight functional expense categories.³⁸

We reviewed ATF Order 3250.1A, *Informant Use and Undercover Operations*, to ensure operational security requirements were implemented by ATF Undercover Revenue Generating Operations specific to confidential informant security and agent security. We compared the financial

³⁸ OMB Circular A-123 advises for each significant account or groups of account for an agency to be able to identify the major classes of transactions that materially affect those accounts. OIG classified the churning transactions for the 20 churning investigations because ATF had not done so for the entire period of the 20 investigations to determine how these investigations spent churning funds.

supporting documentation within the churning case files to the record retention requirements of 3250.1A.

THE BUREAU OF ALCOHOL, TOBACCO, FIREARMS AND EXPLOSIVES' RESPONSE TO THE DRAFT AUDIT REPORT



U.S. Department of Justice

Bureau of Alcohol, Tobacco,
Firearms and Explosives

SEP 16 2013

Washington, DC 20226
www.atf.gov

MEMORANDUM TO: Inspector General

FROM: Director, Bureau of Alcohol, Tobacco, Firearms and Explosives

SUBJECT: Response to the Office of the Inspector General's Audit Report on the Bureau of Alcohol, Tobacco, Firearms and Explosives' Use of Income-Generating, Undercover Operations.

Thank you for allowing the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) the opportunity to review and comment on the report entitled "Audit of the Bureau of Alcohol, Tobacco, Firearms and Explosives' Use of Income-Generating, Undercover Operations." As noted in your report, ATF has exercised its authority to use proceeds generated from undercover operations to offset necessary and reasonable operational expenses (so-called "churning") exclusively for investigations of tobacco diversion, which involve criminal evasion of tobacco taxes.

As early as March 2011, ATF recognized issues with the manner in which income-generating undercover operations were being conducted.¹ ATF subsequently undertook remedial measures to correct operational deficiencies, including the issuance of an April 2011 memorandum and an April 2013 ATF Order (ATF Order 3380.1, Alcohol and Tobacco Enforcement Programs) setting forth more stringent controls and restrictions over the use of funds and procurement in churning operations. The 2013 Order sets out formal policy and instruction for all alcohol and tobacco investigations, including churning investigations. Under current policy, income-generating undercover operations are subject to detailed and rigorous application, review, approval, and oversight mechanisms that include the following:

- o ATF personnel must complete churning investigation training prior to requesting authority to initiate and conduct a churning investigation.
- o ATF's Undercover Review Committee must review and approve all requests for churning authority, which must include the appropriate U.S. Attorney's written concurrence with the investigative plan. The plan must also identify the specific targets of the investigation.
- o ATF will only authorize churned fund expenditures for specific items and/or services. Expenditures will no longer be authorized for travel, confidential informant expenses, or to purchase investigative equipment.

¹ See Appendix I, Timeline of Churning Remedial Measures.

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- All expenditures must be authorized in writing prior to their expenditure. When time-sensitive, supervisor approval for churned fund expenditures may be provided via e-mail to ensure pre-expenditure approval.
- Field offices are required to submit all requests for undercover product via e-mail to an Alcohol and Tobacco Enforcement Branch Outlook mailbox identifying specific information in the request.
- Field offices are required to note in the Case Management Log all undercover product movement.
- Field offices are required to note in the Case Management Log all Churning Undercover Bank Account (UCBA-C) deposits.
- Field offices are required to complete all UCBA-C deposits within 24 hours of the undercover sale.
- On a monthly basis, investigations must submit ATF Monitored Case briefing reports to ATF executives that identify the total amount of product procured and sold via undercover sale to each individual suspect, as well as the total of proceeds deposited to the UCBA-C, total UCBA-C funds expended, and current UCBA-C balance.
- Field offices must finalize all churned fund expenditures and dispose of churning property to the General Services Administration within 30 days of the conclusion of the operational undercover phase of the investigation.
- On a monthly basis, the Special Agent Churning Account Manager must conduct a physical inventory check of all undercover products.
- Special Agent Churning Account Managers must utilize accounting software to track all churning property and inventory.
- On a monthly basis, ATF forensic auditors must audit all churning financial and property inventory records.
- On an annual basis, ATF forensic auditors must conduct annual and/or case closing audits at the field office level and provide those results to the Special Agent in Charge and Deputy Assistant Director responsible for the investigation.

The report addresses an audit period of February 2006 through June 2011, a time-frame that predates the implementation of most of these policies. ATF agrees with the audit team that the

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policies and controls governing “churning” investigations during the bulk of the audit period were seriously deficient, and we accept full responsibility for the management and oversight lapses that allowed those deficiencies to develop. ATF believes, however, that readers of the report may inaccurately conclude that these historical problems continue to the current day. They do not. The report’s findings do not reflect current ATF policy or practice in this area. As the measures outlined above reflect, current ATF leadership has vigorously addressed the historical deficiencies identified in the report, and we are committed to ensuring that ATF conducts all investigations with the highest standards of accountability to the American public.

Reconciliation of Cigarette Inventory

While ATF agrees with the core conclusions set forth in the report with respect to inadequate historical policies, we believe that the report inaccurately implies that ATF cannot account for 2.1 million cartons of cigarettes, and wrongly concludes that this “un-reconciled” inventory should be valued based upon the retail price of cigarettes sold in legal commerce rather than the actual black market prices at which this merchandise was sold in the 20 investigations selected by OIG.

The report finds that, due to inadequate documentation of cigarette inventories within ATF’s case files OIG was unable to reconcile the disposition of 2.1 million cartons of cigarettes. See OIG Report, at iii, 18, 42-44. While ATF agrees that there was inadequate documentation of some tobacco transactions conducted in these investigations, we do not agree that those deficiencies in documentation prevent reconciliation of cigarette inventory to a far greater extent than that reached by the OIG audit team. ATF’s forensic auditors conducted a comprehensive reconstructive inventory² reconciliation of the disposition of cigarettes by reviewing reports of investigation, bank account transactions, expenditure reports, and invoices from the two largest cases among the investigations reviewed by the OIG; these two cases account for nearly 1.8 million of the 2.1 million cigarette cartons that the OIG Auditors were unable to reconcile (*i.e.*, more than 85% of the “un-reconciled” inventory). By expanding its review beyond documentation readily available in case files to the full range of available documentation, the ATF auditors conducted a far more in-depth analysis of the cigarette transactions at issue than did the OIG Audit team.³

In contrast to the 2.1 million cartons of cigarettes that the OIG auditors were unable to reconcile, the results of ATF’s reconstructive inventory showed that only 447,218 cartons of cigarettes could not be fully reconciled (due to insufficient documentation). While ATF stands accountable for all cigarette inventory acquired in these investigations, ATF believes that the results of the

² “Reconstructive inventory” is a well-established methodology used by ATF and other law enforcement investigators in financial investigations, and has been recognized as a reliable basis to support expert testimony in criminal prosecutions.

³ The deficiencies cited by the OIG with respect to documentation of cigarette transactions are primarily deficiencies relating to ATF’s compliance with its own (then-existing) policies.

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could not be fully reconciled (due to insufficient documentation). While ATF stands accountable for all cigarette inventory acquired in these investigations, ATF believes that the results of the reconstructive inventory reconciliation present a more thorough and accurate accounting of cigarettes than the figure reached by the OIG audit.

ATF provided draft language to the OIG that set forth the ATF forensic auditors' analysis, while at the same time acknowledging that OIG did not conduct a peer review of the forensic auditors work papers and supporting documentation and evidence. The OIG declined to include this language in its report. As a result, the report gives the misleading impression that the 2.1 million cartons of cigarettes are actually missing as opposed to lacking proper documentation from an accounting perspective.

Wholesale Versus Retail Price of Cigarettes

The consequence of failing to include the ATF forensic auditors' analysis is magnified by OIG's selection of a retail, rather than wholesale, price to calculate the value of the unreconciled cigarettes. The report concludes that, based upon the retail price of cigarettes, the 2.1 million cartons of unreconciled cigarettes equate to a value of \$127 million. *See* OIG Report, at iii, 18, 43. Using a retail price inflates the value of the cigarettes, particularly in the context of undercover trafficking operations. ATF believes that the value at which it actually sold cigarettes in these investigations -- wholesale pricing -- is the more accurate and appropriate measure of value. The report's rationale that wholesale pricing should not be used because it fails to account for the "churning funds ATF would have raised had it sold the cigarettes as part of its investigation," the value of the "potential tax revenue lost by state and local governments" or "potential profits lost by legitimate businesses" is simply not correct. *See* OIG Report, at 45, n. 36. ATF churning investigations obtain cigarettes primarily from manufacturers at or near their cost, and then sell the cigarettes at wholesale pricing to known black-market traffickers. Black-market traffickers, in turn, realize their profit by evading taxes and selling untaxed product at a discount to legitimate retail pricing. Hence, ATF does not "raise" churning funds from retail sales of cigarettes, and black-market traffickers by definition deprive states of tax revenue and unfairly compete with legitimate retailers by significantly undercutting them on price. Hence, to measure the value of cigarettes utilized in churning investigations using retail pricing simply does not reflect the reality of the market.

Assuming that ATF should be held responsible for 2.1 million cartons of unreconciled cigarettes -- a finding that ATF disagrees with as discussed above -- applying a wholesale price of \$16.36 per carton to that inventory (the actual average price per carton at which ATF actually sold cigarettes in the 20 churning investigations OIG reviewed) would equate to a value of \$34.4 million, not \$127 million. More accurately, applying wholesale pricing to the 447,218 cartons of cigarettes that ATF's reconstructive inventory was unable to reconcile with sufficient documentation, would equate to a value of \$7.3 million.

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Report Recommendations

In undertaking the corrective actions outlined above, ATF has already addressed nearly all of the recommendations in your report. Specifically, ATF believes that OIG Recommendation numbers 2 through 15, and 17 have been addressed by ATF O 3380.1, Alcohol and Tobacco Enforcement Programs, implemented in April 2013 and ATF O 3200.1, Monitored Case Program, implemented in May 2013.

In summary, ATF's primary concern is that the serious findings set forth in the OIG report do not accurately present the complete picture of the ATF today – under current policy, churning operations are conducted in a manner consistent with the OIG recommendations and, more importantly, in a manner that fulfills ATF's core values of safety and accountability.

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Inspector General

APPENDIX 1: TIMELINE OF CHURNING REMEDIAL MEASURES

- In March 2011, ATF's Office of Professional Responsibility and Security Operations (OPRSO) issued an internal ATF report, Report of Churning Account Review identifying issues with the manner in which churning operations were conducted, and recommended a number of corrective actions.
- In the fall of 2011, ATF initiated a comprehensive review of ATF's overall tobacco enforcement programs, with a particular emphasis on the use of churning authority.
- In July 2012, the ATF Assistant Director (Field Operations) issued a memorandum regarding the ATF "Tobacco Enforcement Program," implementing new procedures for approval and oversight of tobacco cases, including requirements for Financial Investigative Services Division (FISD) support to ensure compliance with accounting standards and financial reporting requirements in churning cases.
- In August 2012, the ATF Assistant Director (Field Operations) issued a memorandum regarding "Immediate Corrective Actions for Churning Financial Reporting," implementing corrective actions for the reporting of churning requests and expenditures, including corrections related to the use of financial reporting forms, approval requirements for expending proceeds generated from undercover operations, and reporting requirements for open churning accounts.
- In September 2012, the ATF Assistant Director (Field Operations) convened an Alcohol and Tobacco Enforcement Programs Orders Revision Workshop. This workshop assembled a group of subject matter experts tasked with making sure that key recommendations and interim corrective measures for churning cases were incorporated into the revised order governing alcohol and tobacco enforcement programs.
- In February 2013, the ATF Assistant Director (Field Operations) issued a memorandum regarding "Churning Property and Reporting Requirements," requiring designation of a Churning Account Manager in each field division, setting out procedures for the disposition of churning property and for concluding a churning case, and prescribing a series of churning investigation policy requirements.
- In April 2013 the ATF Assistant Director (Field Operations) issued ATF Order 3380.1, Alcohol and Tobacco Enforcement Programs. This Order sets out formal policy and instructions relating to the alcohol and tobacco enforcement programs within ATF. Chapter C of this Order specifically addresses churning investigations, and includes directions for, among other things, requesting and authorizing churning cases, monitoring churning cases, ensuring that financial and property reports are completed accurately and timely at the field division level and reviewed by FISD prior to being submitted for management approval, managing churning proceeds and undercover bank accounts,

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ensuring that churned fund expenditures are appropriate, and conducting periodic audits of churned funds generated and expended.

**OFFICE OF THE INSPECTOR GENERAL
ANALYSIS AND SUMMARY OF ACTIONS
NECESSARY TO CLOSE THE REPORT**

The OIG provided a draft of this audit report to the Bureau of Alcohol, Tobacco, Firearms and Explosions (ATF) and the Office of the Deputy Attorney General. ATF's response is incorporated in Appendix II of this final report. The Office of the Deputy Attorney General did not provide a formal response but informed the OIG that it concurred with our first recommendation. The following provides the OIG analysis of ATF's response and summary of actions necessary to close the report.

Analysis of ATF's Response

In response to our audit report, ATF did not specifically state whether it agreed or disagreed with our recommendations. Instead, ATF's response stated that it agrees with the audit team that the policies and controls governing churning investigations during the bulk of the audit period were seriously deficient. The response further stated that ATF accepts full responsibility for the management and oversight lapses that allowed those deficiencies to develop. ATF's response addressed the audit recommendations collectively by stating that two ATF orders issued in 2013 address 15 of the 16 recommendations directed to ATF. Therefore, we consider those 15 recommendations to be resolved and open. The remaining recommendation is unresolved.

In its response, ATF stated that readers of the report may inaccurately conclude that these historical problems continue to the current day and that the report does not reflect current ATF policy or practice. As mentioned above, ATF stated that two ATF Orders issued in 2013 have corrected the majority of the deficiencies we noted. However, the OIG has not been provided evidence to verify the sufficiency of actions taken. Therefore, we cannot conclude on the current status of ATF's use of income-generating, undercover operations.

ATF's response stated that the audit report inaccurately implies that ATF cannot account for 2.1 million cartons of cigarettes, and incorrectly concludes that this unreconciled inventory should be valued based on the retail price of cigarettes sold in legal commerce rather than the actual black market prices at which this merchandise was sold in the investigations reviewed by the OIG. We provide the following reply to these statements

before discussing the actions necessary to close this report's recommendations.

Unreconciled Cigarettes

Contrary to ATF's response, we do not state in our report that ATF cannot account for 2.1 million cartons of cigarettes. Instead, we state in our report that, as a result of the lack of inventory controls, including inadequate documentation, we could not reconcile the amount of cigarettes purchased by ATF with the number of cigarettes sold or otherwise disposed of plus the amount of cigarettes on-hand, resulting in a 2.1 million carton difference. Because cigarettes are easily sold on the black market, ATF should have had strong controls, including ongoing inventories, for the cigarettes it purchased and sold.

ATF's response stated that an ATF forensic audit team conducted a comprehensive reconstructive inventory for the two largest cases among the investigations reviewed by the OIG, and that by expanding its review beyond documentation readily available in case files, ATF's reconstructive inventory showed that only 447,218 cartons of cigarettes could not be fully reconciled. ATF's response also stated that while ATF stands accountable for all cigarette inventory acquired for investigations, ATF believes that the results of the reconstructive inventory present a more thorough and accurate accounting of cigarettes.

Regarding ATF's reconstructive inventory, we found that we could not rely on ATF's reconciliation because it: (1) used estimates, (2) included cigarettes not purchased by ATF, (3) was revised several times based on our inquiries and with each revision the number of unreconciled cigarettes increased, and (4) included cigarettes purchased before churning authority was granted.

In October 2012, we met with ATF officials and informed them that we were not able to reconcile approximately 2.1 million cartons of cigarettes. Between January and May 2013, a team of forensic auditors from ATF's Financial Investigative Services Division completed a reconstructive inventory of cigarettes purchased and sold by two of the churning investigations for which the OIG could not reconcile about 1.8 million cartons of cigarettes. According to ATF officials, its reconciliation included an extensive review of records (including documentation not maintained in case files or investigative records), information and documentation obtained from agencies with whom ATF had partnered, and interviews with case agents and staff. Additionally, ATF's review covered a different time period than the

OIG's review by including cigarettes that were obtained for the case prior to receiving churning authority.

When ATF first presented its reconciliation to us in May 2013, covering 2 of the 20 investigations we reviewed and 1.8 million of the 2.1 million cartons of cigarettes we could not reconcile, ATF stated that it had reconciled the disposition of all but 305,678 cartons of the cigarettes purchased by the investigations. The number of cartons of cigarettes ATF currently reports as unreconciled has increased to 447,218 following inquiries by the OIG about the methodology ATF used to perform its reconciliation.

In addition, we do not believe that we could rely on ATF's reconciliation because it used estimates. Specifically, when ATF identified a deposit into a churning investigation account that could not be matched to the sale of cigarettes, the ATF review team assumed that the deposits were attributable to the sale of cigarettes and estimated the number of cigarettes represented by the deposit. We believe ATF's assumption that these undocumented deposits were the result of cigarette sales is potentially faulty because the investigations ATF reviewed sold items other than cigarettes, such as cigars and smokeless tobacco. (Our review focused on reconciling the disposition of only cigarettes because cigarettes were the vast majority of the items purchased and sold by churning investigations). Finally, for one investigation, ATF's reconciliation included cigarettes purchased and sold by a local law enforcement agency as part of a joint investigation. In contrast, our audit focused only on the cigarettes purchased and sold by ATF as part of this investigation.

Finally, in a report provided to us by ATF on its internal reconciliation, ATF noted "a clear lack of internal controls, oversight, training and policy to guide ATF agents in these cases which resulted in a lack of uniformity in procedures, required documentation, inventory controls, and accountability". Further, according to its report, "ATF acknowledges that the lack of policy, controls and training certainly made it difficult for an audit to easily, if not fully, identify and/or reconcile all of the business activity in each of these cases, individually, or in totality."

For these reasons, we are unable to substantiate ATF's review of 1.8 million of the 2.1 million cartons of cigarettes we could not reconcile.

Value of Unreconciled Cigarettes

In its response, ATF stated that it believes that the value of the unreconciled cigarettes discussed in our report should be based on the wholesale price. ATF believes that the value at which it actually sold

cigarettes in these investigations – wholesale pricing – is the more accurate and appropriate measure of value. ATF stated that the OIG report’s rationale that wholesale pricing should not be used because it fails to account for the churning funds ATF would have raised had it sold the cigarettes as part of its investigation, the value of the potential tax revenue lost by state and local governments, or potential profits lost by legitimate businesses is simply not correct. The ATF’s response further stated that churning investigations obtain cigarettes primarily from manufacturers at or near cost, and then sell the cigarettes at wholesale pricing to known black-market traffickers, who in turn realize profit by evading taxes when selling untaxed product at a discount to legitimate retail pricing.

We disagree with this approach and used the average retail price of cigarettes to value the unreconciled cigarettes because the retail price more reasonably accounts for the overall economic impact, including the potential tax revenue lost by state and local governments and the potential profits lost by legitimate cigarette wholesalers and retailers in instances where lost or stolen cigarettes could be purchased as a substitute for retail cigarettes.

Summary of Actions Necessary to Close the Report

1. **Resolved.** The Office of the Deputy Attorney General concurred with our recommendation to consider implementing Department-wide requirements for authorizing churning requests to ensure that such requests are handled consistently across Department components and that best practices are employed by all Department components.

This recommendation can be closed when we receive evidence that the Office of the Deputy Attorney General has implemented Department-wide requirements for authorizing churning requests to ensure that such requests are handled consistently across Department components and that best practices are employed by all Department components.

2. **Closed.** We recommended that ATF consider amending the 2011 Churning Memorandum to add the requirement of consulting with the relevant U.S. Attorney before employing the investigative tactic.

According to ATF Order 3380.1, in addition to other requirements for the approval of churning investigations, the U.S. Attorney’s Office must concur in writing with the investigative plan. Therefore, this recommendation is closed.

3. **Resolved.** We recommended that ATF establish procedures to ensure that requests for churning authority are approved according to existing

ATF polices, including review by ATF's Undercover Review Committee. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence of the procedures that the ATF has put in place to ensure all churning authority requests comply with ATF polices and that the requests are reviewed by ATF's Undercover Review Committee, and that these mechanisms have been implemented.

4. **Resolved.** We recommended that ATF implement effective policies and procedures to ensure targets of income-generating undercover investigations are specifically identified prior to granting the investigation churning authority. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence, such as approved churning authorization requests, showing that approved churning investigation requests specifically identify the targets to be investigated.

5. **Resolved.** We recommended that ATF develop and implement criteria to be used by ATF officials responsible for authorizing churning investigations to determine whether a churning request should be approved. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific criteria ATF has implemented to be used by officials responsible for approving churning investigations.

6. **Resolved.** We recommended that ATF develop and implement effective policies and procedures to ensure unauthorized churning investigations do not occur. These policies and procedures could include periodic reviews of all investigations where income is generated to ensure such income is not used unless appropriately authorized. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific measures ATF has taken to ensure unauthorized churning investigations do not occur.

7. **Closed.** We recommended that ATF develop and finalize churning policy guidance and issue it in an ATF Order. After it received and reviewed the draft audit report, ATF provided us with ATF Order 3380.1, implemented in April 2013. We reviewed ATF Order 3380.1 and found that it adequately addressed our recommendation. Therefore, this recommendation is closed.
8. **Resolved.** We recommend that ATF ensure that all tobacco procured for investigations is adequately documented, tracked, inventoried, and reconciled, including a system for the independent and periodic review and reconciliation of tobacco inventories by headquarters management staff. ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific measures ATF has taken to ensure that all tobacco procured for investigations is adequately documented, tracked, inventoried, and reconciled, including a system for the independent and periodic review and reconciliation of tobacco inventories by headquarters management staff.

9. **Resolved.** We recommended that ATF develop and implement policies and procedures to ensure that churning investigations do not operate outside the original authority for which they were granted. These policies and procedures could include using the Monitored Case Program to ensure that a churning operation's targeted subject remains the focus of the case throughout the duration of the case. ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific measures ATF has taken to ensure churning investigations do not operate outside the original authority for which they were granted.

10. **Resolved.** We recommended that ATF ensure each churning investigation transaction involving the sale or purchase of tobacco as well as corresponding deposits and expenditures is thoroughly documented in N-Force. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific measures ATF has taken to ensure all churning

investigation transactions are documented in N-Force in accordance with ATF policies and procedures.

11. **Resolved.** We recommended that ATF update the Monitored Case Program requirements to ensure ATF Headquarters can adequately monitor churning investigations. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive a copy of ATF Order 3200.1, Monitored Case Program, and evidence to support the specific measures ATF has taken to update the Monitored Case Program requirements to ensure ATF Headquarters can adequately monitor churning investigations.

12. **Resolved.** We recommended that ATF develop and implement a system to ensure proper inventory, management, and disposition of non-tobacco assets. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support the specific system ATF has put in place to ensure proper inventory, management, and disposition of non-tobacco assets.

13. **Resolved.** We recommended that ATF develop and implement policies and procedures to ensure the timely deposit of churning funds. In its response, ATF states this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence to support specific procedures implemented to ensure the timely deposit of churning funds.

14. **Resolved.** We recommended that ATF design and implement a more streamlined process for approving expenditures and consider an electronic version of its approval process. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence of the streamlined process for approving expenditures of churning funds.

15. **Resolved.** We recommended that ATF develop and implement clear policy regarding the permissible uses of churning funds. Such policies

should, among other things, identify categories of expenses that are and are not permissible uses of churning funds. In its response, ATF stated this recommendation has been addressed in ATF Orders 3380.1.

This recommendation can be closed when we receive evidence that ATF has implemented clear policy regarding the permissible uses of churning funds.

16. **Unresolved.** ATF did not state whether it concurred with our recommendation that ATF examine and update existing policies and procedures to ensure that churning funds are used only to offset the necessary and reasonable expenses of the same authorized investigation that generated them, and not used to fund separate investigations or ATF's operations generally.

ATF did not address this recommendation in its response. Therefore, the recommendation is unresolved. This recommendation can be resolved and closed when we receive evidence to support that ATF has mechanisms in place to ensure that churning funds are used only to offset the necessary and reasonable expenses of the same authorized investigation that generated them, and that those funds are not used to fund separate investigations or ATF's operations generally.

17. **Resolved.** We recommended that ATF strengthen policies and procedures to ensure the confidentiality of confidential informants and undercover agents. ATF stated this recommendation has been addressed in ATF Orders 3380.1 and 3200.1.

This recommendation can be closed when we receive evidence that ATF has implemented procedures to ensure the confidentiality of confidential informants and undercover agents.