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# TERRORIST FINANCING

## U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms





Highlights of [GAO-04-163](#), a report to congressional requesters

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## U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms

### Why GAO Did This Study

Cutting off terrorists' funding is essential to deterring terrorist operations. The USA PATRIOT Act expanded the ability of law enforcement and intelligence agencies to access and share financial information regarding terrorist investigations, but terrorists may have adjusted their activities by increasing use of alternative financing mechanisms. GAO was asked to assess (1) the nature of terrorists' use of key alternative financing mechanisms for earning, moving, and storing terrorists' assets; (2) what is known about the extent of terrorists' use of alternative financing mechanisms; and (3) challenges that the U.S. government faces in monitoring terrorists' use of alternative financing mechanisms.

### What GAO Recommends

GAO recommends that (1) the Director of the FBI systematically collect and analyze data concerning terrorists' use of alternative financing mechanisms; (2) the Secretary of the Treasury and the Attorney General produce the planned report based on up-to-date law enforcement investigations on precious stones and commodities; and (3) the IRS Commissioner establish interim procedures for sharing information on charities with state charity officials. The DOJ did not formally respond to our recommendation. The Treasury agreed to produce the planned report and IRS committed to expedite issuance of procedures.

[www.gao.gov/cgi-bin/getrpt?GAO-04-163](http://www.gao.gov/cgi-bin/getrpt?GAO-04-163).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Loren Yager at (202) 512-4128 or [yagerl@gao.gov](mailto:yagerl@gao.gov).

### What GAO Found

Terrorists use many alternative financing mechanisms to earn, move, and store assets (see table). They earn assets by selling contraband cigarettes and illicit drugs, by misusing charitable organizations that collect large donations, and by other means. They move funds by concealing their assets through nontransparent mechanisms such as charities, informal banking systems, and commodities such as precious stones and metals. To store assets, terrorists may choose similar commodities that maintain their value and liquidity.

The extent of terrorists' use of alternative financing mechanisms is unknown, owing to the criminal nature of terrorists' use of alternative financing mechanisms and the lack of systematic data collection and analysis of case information. The Federal Bureau of Investigation (FBI) does not systematically collect and analyze data on these mechanisms. Furthermore, the Departments of the Treasury and of Justice have not yet produced a report, required under the 2002 National Money Laundering Strategy, which was to form the basis of a strategy to address how money is moved or value transferred via trade in precious stones and commodities.

In monitoring terrorists' use of alternative financing mechanisms, the U.S. government faces a number of challenges, including accessing ethnically or criminally based terrorist networks, targeting high-risk financing mechanisms that the adaptable terrorists use, and sharing data on charities with state officials. The Internal Revenue Service (IRS) has committed to, but has yet to establish, procedures for such data sharing.

**Examples of Alternative Financing Mechanisms That May Be Used to Earn, Move, and Store Terrorist Assets**

Alternative financing mechanisms	Earning	Moving	Storing
<b>Trade in commodities</b>			
Illicit drugs	X		
Weapons	X		
Cigarettes	X		
Diamonds	X	X	X
Gold		X	X
<b>Systems</b>			
Charities	X	X	
Informal banking		X	
<b>Currency</b>			
Bulk cash		X	X

Sources: GAO analysis based on government, industry, and research sources.

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**Abbreviations**

ATF	Bureau of Alcohol, Tobacco, Firearms, and Explosives
DEA	Drug Enforcement Administration
DHS	Department of Homeland Security
DOJ	Department of Justice
FBI	Federal Bureau of Investigation
FinCEN	Financial Crimes Enforcement Network
HAMAS	Harakat al-Muqawama al-Islamiya–Islamic Resistance Movement
ICE	Bureau of Immigration and Customs Enforcement
INTERPOL	International Criminal Police Organization
IRS	Internal Revenue Service
OGQ	Operation Green Quest
TFOS	Terrorist Financing Operations Section
U.N.	United Nations
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act

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United States General Accounting Office  
Washington, DC 20548

November 14, 2003

The Honorable Richard J. Durbin  
Ranking Minority Member  
Subcommittee on Oversight of Government Management,  
the Federal Workforce and the District of Columbia  
Committee on Governmental Affairs  
United States Senate

The Honorable Charles E. Grassley  
Chairman  
Caucus on International Narcotics Control  
United States Senate

U.S. government officials recognize that cutting off terrorists' funding is an important means of disrupting their operations. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act),<sup>1</sup> enacted shortly after the terrorist attacks of September 11, 2001, expanded the ability of law enforcement and intelligence agencies to access and share financial information regarding terrorist investigations. As initial U.S. and foreign government deterrence efforts focused on terrorists' use of the formal banking or mainstream financial system, terrorists may have been forced to increase their use of various alternative financing mechanisms. These mechanisms enable terrorists to earn, move, or store assets and may include a variety of commodities and informal financial systems.

You requested that we review what is known about terrorists' use of alternative financing mechanisms.<sup>2</sup> In response, in this report we assessed (1) the nature of terrorists' use of key alternative financing mechanisms for earning, moving, and storing terrorists' assets; (2) what is known about the extent of terrorists' use of alternative financing mechanisms; and (3) the challenges that the U.S. government faces in monitoring terrorists' use

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<sup>1</sup>Pub. L. No. 107-56 (Oct. 26, 2001).

<sup>2</sup>Terrorists are individuals who are part of international organizations with the will and means to target the United States or U.S. interests abroad with violent or dangerous acts calculated to intimidate, coerce, or retaliate against government conduct (see 18 U.S.C. 2331(1), 18 U.S.C. 2332b(g)(5)).

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of alternative financing mechanisms. As agreed with your staff, the alternative mechanisms that this report addresses include the use of commodities, bulk cash,<sup>3</sup> charities, and informal banking systems, sometimes referred to as hawala.<sup>4</sup> We primarily focused on religious extremist movements in the Middle East noted in the National Strategy for Homeland Security, including al Qaeda, HAMAS (Harakat al-Muqawama al-Islamiya—Islamic Resistance Movement), and Hizballah. In a subsequent report that you have requested, we will specifically address coordination of U.S. and international efforts abroad to deter terrorists’ use of alternative financing mechanisms.<sup>5</sup>

In conducting our review, we examined documentation and interviewed officials from U.S. agencies, including the Departments of Justice, the Treasury, Homeland Security, State, and Defense, as well as from the intelligence community. We also assessed information provided from various nongovernmental organizations, industry and charitable associations, researchers in the field, and the United Nations. In addition, we conducted fieldwork in Belgium and France, where we interviewed officials from several international entities including the Financial Action Task Force on Money Laundering, INTERPOL (International Criminal Police Organization), the European Union, and the World Customs Organization. At these locations, we also assessed information from government, law enforcement, and industry officials, as well as U.S. embassy officials. As discussed with your offices and agreed with U.S. law enforcement agencies, we have limited our reporting of specific examples of terrorists’ use of alternative financing mechanisms to publicly available information to ensure that law enforcement operations are not

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<sup>3</sup>The use of bulk cash refers to smuggling currency, travelers checks, or similar instruments across borders by means of a courier rather than through a formal financial system.

<sup>4</sup>According to the 2002 National Money Laundering Strategy, informal value transfer systems (referred to here as “informal banking systems”) are known by a variety of names reflecting ethnic and national origins predating the emergence of modern banking and other financial institutions. Included, among others, are systems such as *hawala* or *hundi*, terms commonly used when referring to Indian, Pakistani, and Middle Eastern systems. These systems provide mechanisms for the remittance of currency or other forms of monetary value—most commonly gold—without physical transportation or use of contemporary monetary instruments.

<sup>5</sup>Also at your request, we addressed U.S. domestic coordination efforts to deter terrorist financing under a separate report focusing on the National Money Laundering Strategy. See U.S. General Accounting Office, *Combating Money Laundering: Opportunities Exist to Improve the National Strategy*, [GAO-03-813](#) (Washington, D.C.: Sept. 26, 2003).

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jeopardized. It is important to note that there are few such cases. Further details about our scope and methodology are contained in appendix I.

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## Results in Brief

Terrorists use a variety of alternative financing mechanisms to earn, move, and store their assets based on common factors that make these mechanisms attractive to terrorist and criminal groups alike. For all three purposes—earning, moving, and storing—terrorists aim to operate in relative obscurity, using mechanisms involving close knit networks and industries lacking transparency. More specifically, first, terrorists earn funds through highly profitable crimes involving commodities such as contraband cigarettes, counterfeit goods, and illicit drugs. For example, according to U.S. law enforcement officials, Hizballah earned an estimated profit of \$1.5 million in the United States between 1996 and 2000 by purchasing cigarettes in a low tax state for a lower price and selling them in a high tax state at a higher price. Terrorists also earned funds using systems such as charitable organizations that collect large sums in donations from both witting and unwitting donors. Second, to move assets, terrorists seek out mechanisms that enable them to conceal or launder their assets through nontransparent trade or financial transactions such as the use of charities, informal banking systems, bulk cash, and commodities that may serve as forms of currency, such as precious stones and metals. Third, to store assets, terrorists may use similar commodities, because they are likely to maintain value over a longer period of time and are easy to buy and sell outside the formal banking system.

Owing to the criminal nature of terrorists' use of alternative financing mechanisms and the lack of systematic data collection and analysis, the extent of terrorists' use of alternative financing mechanisms is not known. U.S. law enforcement agencies, and specifically the Federal Bureau of Investigation (FBI), which leads terrorist financing investigations, do not systematically collect and analyze data on alternative financing mechanisms. The lack of such data hinders the FBI from conducting systematic analysis of trends and patterns focusing on alternative financing mechanisms. Without such an assessment, the FBI does not have analyses that could aid in assessing risk and prioritizing efforts. Moreover, despite an acknowledged need for further analysis of the extent of the use of alternative financing mechanisms by terrorists, few rigorous studies have been conducted. For example, the Departments of the Treasury and Justice did not produce a report on the links between terrorist financing and precious stone and commodity trading, as was required by March 2003 under the 2002 National Money Laundering Strategy.

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In monitoring terrorists' use of alternative financing mechanisms, the U.S. government faces a number of significant challenges, a few of which include accessibility, adaptability of terrorists, and competing priorities. First, according to law enforcement agencies and researchers, it is difficult to access or infiltrate ethnically or criminally based networks that operate in a nontransparent manner, such as informal banking systems or the precious stones and other commodities industries. Second, the ability of terrorists to adapt their methods hinders efforts to target high-risk industries and implement effective mechanisms for monitoring high-risk industry trade and financial flows. According to the FBI, once terrorists know that an industry they use to earn or move assets is being watched, they may switch to an alternative commodity or industry. Finally, competing priorities create challenges to federal and state officials' efforts to use and enforce applicable U.S. laws and regulations in monitoring terrorists' use of alternative financing mechanisms. For example, although the Internal Revenue Service (IRS) agreed with us in 2002 to begin developing a system, as allowed by law, to share with states data that would improve oversight<sup>6</sup> and could be used to deter terrorist financing in charities, the IRS has not made this initiative a priority due to competing priorities.

In this report, we recommend that the Director of the FBI, in consultation with relevant U.S. government agencies, systematically collect and analyze information involving terrorists' use of alternative financing mechanisms. We also recommend that the Secretary of the Treasury and the Attorney General produce the report on the links between terrorism and the use of precious stones and commodities that was required by March 2003 under the 2002 National Money Laundering Strategy based on up-to-date law enforcement investigations. Finally, we recommend that the Commissioner of the IRS, in consultation with state charity officials, establish interim IRS procedures and state charity official guidelines, as well as set milestones and assign resources for developing and implementing both, to regularly share data on charities as allowed by federal law.

The Department of Justice (DOJ) did not formally respond to our recommendation that the Director of the FBI, in consultation with relevant

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<sup>6</sup>See U.S. General Accounting Office, *Tax-Exempt Organizations: Improvements Possible in Public, IRS, and State Oversight of Charities*, [GAO-02-526](#) (Washington, D.C.: Apr. 30, 2002).

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U.S. government agencies, systematically collect and analyze information involving terrorists' use of alternative financing mechanisms. However, in DOJ's technical comments they agreed with our finding that the FBI does not systematically collect and analyze such information, but they did not specifically agree or disagree with our recommendation. In response to our recommendation regarding a planned report on precious stones and commodities, the Department of the Treasury responded that the report would be issued as an appendix to the 2003 National Money Laundering Strategy. However, the strategy was to be issued in February 2003 and had not been issued as of our receipt of Treasury's comments on October 29. The IRS agreed with our overall recommendation to establish IRS procedures and state charity official guidelines to regularly share data on charities as allowed by federal law. The IRS also committed to expedite its efforts to establish procedures and guidelines by one year, the end of calendar year 2003, rather than 2004 as originally planned. However, the IRS did not address establishing milestones and assigning resources to meet the target date or interim guidelines should they miss the 2003 target date.

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## Background

In its fight against terrorism, the United States has focused on individuals and entities supporting or belonging to terrorist organizations including al Qaeda, Hizballah, HAMAS and others. Al Qaeda is an international terrorist network led by Osama bin Laden that seeks to rid Muslim countries of western influence and replace their governments with fundamentalist Islamic regimes. The al Qaeda network conducted the September 11 attack on the United States and was responsible for the August 1998 bombings of U.S. embassies in Kenya and Tanzania, as well as other violent attacks on U.S. interests. Al Qaeda reportedly operates through autonomous underground cells in 60 to 100 estimated locations worldwide, including the United States. Hizballah is a Lebanese group of Shiite militants that seeks to create a Muslim fundamentalist state in Lebanon modeled on Iran. Hizballah has planned, or been linked to, numerous terrorist attacks against America, Israel, and other western targets. Although Hizballah's leadership is based in Lebanon, Hizballah is a vast organization with a global network of supporters and established cells in Africa, North and South America, Asia, and Europe. According to the State Department, HAMAS has pursued the goal of replacing Israel with an Islamic Palestinian state.<sup>7</sup> While HAMAS supplies humanitarian aid to Palestinians

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<sup>7</sup>U.S. Department of State, *Patterns of Global Terrorism 2002* (Washington, D.C.: April 2003).

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and has participated in peaceful political activity, the organization conducts large-scale suicide bombings. According to the State Department, HAMAS currently limits its terrorist operations to targeting Israeli civilians and the Israeli military in the Gaza Strip, the West Bank, and Israel, but Americans have been killed in HAMAS attacks, and the organization raises funds in North America and Western Europe.

These terrorist organizations are known to have used alternative financing mechanisms to further their terrorist activities. Government officials and researchers believe that terrorists do not always need large amounts of assets to support an operation, pointing out that the estimated cost of the September 11 attack was between \$300,000 and \$500,000. However, government officials also caution that funding for such an operation uses a small portion of the assets that terrorist organizations hold—assets earned, moved, or stored through mainstream financial or alternative financing mechanisms. According to the Treasury’s Office of Foreign Assets Control, the support infrastructure critical for indoctrination, recruitment, training, logistical support, the dissemination of propaganda, and other material support requires substantial funding.

A number of strategies and laws guide the U.S. government in deterring terrorists’ use of alternative financing mechanisms.<sup>8</sup> Among the strategies, for example, the Departments of Justice and the Treasury publish an annual *National Money Laundering Strategy*, which has increasingly focused on terrorist financing, including alternative financing methods. This strategy sets goals for U.S. agencies in combating terrorist financing and reports on progress made in implementing these goals. In addition, the Department of State issues an annual *International Narcotics Control Strategy Report*,<sup>9</sup> which features a section describing mechanisms, cases, and efforts to deter terrorist financing. Moreover, the *President’s National Security Strategy of the United States of America*<sup>10</sup> calls for the United States to work with its allies to disrupt the financing of terrorism by blocking terrorist assets, and the *National Strategy for Combating*

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<sup>8</sup>We did not evaluate the adequacy or implementation of these strategies, with the exception of the 2002 National Money Laundering Strategy as it pertains to alternative financing mechanisms.

<sup>9</sup>U.S. Department of State, *International Narcotics Control Strategy Report* (Washington, D.C.: March 2003).

<sup>10</sup>Office of Homeland Security, the White House, *President’s National Security Strategy of the United States of America* (Washington D.C.: July 2002).

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*Terrorism*<sup>11</sup> includes an objective to interdict and disrupt material support for terrorists. Regarding laws, the authority of the USA PATRIOT Act of 2001 significantly expanded U.S. law enforcement's ability to deter, investigate, and prosecute cases of terrorist financing. More recently, the United States enacted the Suppression of the Financing of Terrorism Convention Implementation Act of 2002,<sup>12</sup> which implements the requirements of the 1999 International Convention for the Suppression of the Financing of Terrorism. Among its provisions, this act makes it a crime to provide or collect funds with the intention of using the money for terrorist activities.<sup>13</sup>

Deterring terrorists' use of alternative financing mechanisms falls within the overall U.S. interagency framework of plans, agency roles, and interagency coordination mechanisms designed to combat terrorism. In general, the National Security Council manages the overall interagency framework. The National Security Council heads the Counterterrorism Security Group, which is composed of high-level representatives (at the Assistant Secretary level) from key federal agencies that combat terrorism. To implement directives and strategies, various federal agencies are assigned key roles and responsibilities based on their core missions. Numerous components of the Departments of Justice, the Treasury, State, Homeland Security, and other agencies participate in efforts to combat terrorist financing (see table 1). In addition, the intelligence community plays a significant role.<sup>14</sup>

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<sup>11</sup>The White House, *National Strategy for Combating Terrorism* (Washington D.C.: February 2003).

<sup>12</sup>Pub. L. No. 107-197, Title II (June 25, 2002).

<sup>13</sup>See 18 U.S.C. 2339C(a)(1).

<sup>14</sup>The intelligence community includes the Office of the Director of Central Intelligence; the Central Intelligence Agency; the National Security Agency; the National Imagery and Mapping Agency; the National Reconnaissance Office; the Defense Intelligence Agency and other offices within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs and the intelligence elements of the Army, the Navy, the Air Force, and the Marine Corps; the FBI; the Department of the Treasury; the Department of Energy; the State Department's Bureau of Intelligence and Research; and such other elements of any department or agency as may be designated by the President or jointly by the Director of Central Intelligence and the head of the department or agency concerned.

**Table 1: Key U.S. Government Entities Responsible for Deterring Terrorist Financing**

<b>Department</b>	<b>Bureau/division/office</b>	<b>Role</b>
Central Intelligence Agency		Leads gathering, analyzing, and disseminating intelligence on foreign terrorist organizations and their financing mechanisms; charged with promoting coordination and information-sharing between all intelligence community agencies.
Homeland Security	Bureau of Customs and Border Protection	Detects movement of bulk cash across U.S. borders and maintains data about movement of commodities into and out of the United States.
	Bureau of Immigration and Customs Enforcement (ICE - formerly part of the Treasury's U.S. Customs Service)	Participates in investigations of terrorist financing cases involving U.S. border activities and the movement of trade, currency, or commodities.
	U.S. Secret Service	Participates in investigations of terrorist financing cases, including those involving counterfeiting.
Justice	Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF)	Participates in investigations of terrorist financing cases involving alcohol, tobacco, firearms, and explosives.
	Civil Division	Defends challenges to terrorist designations.
	Criminal Division	Develops, coordinates, and prosecutes terrorist financing cases; participates in financial analysis and develops relevant financial tools; promotes international efforts and delivers training to other nations.
	Drug Enforcement Administration (DEA)	Participates in investigations of terrorist financing cases involving narcotics and other illicit drugs.
	Federal Bureau of Investigation (FBI)	Leads all terrorist financing investigations and operations; primary responsibility for collecting foreign intelligence and counterintelligence information within the United States.
National Security Council		Manages the overall interagency framework for combating terrorism.
State	Bureau of Economic and Business Affairs	Chairs coalition subgroup of a National Security Council Policy Coordinating Committee, which leads U.S. government efforts to develop strategies and activities to obtain international cooperation.
	Bureau of International Narcotics and Law Enforcement Affairs	Implements U.S. technical assistance and training to foreign governments on terrorist financing.
	Office of the Coordinator for Counterterrorism	Coordinates U.S. counterterrorism policy and efforts with foreign governments to deter terrorist financing.
Treasury	Executive Office for Terrorist Financing and Financial Crime	Develops U.S. strategies and policies to deter terrorist financing, domestically and internationally; develops and implements the National Money Laundering Strategy as well as other policies and programs to prevent financial crimes.

Department	Bureau/division/office	Role
	Financial Crimes Enforcement Network (FinCEN)	Supports law enforcement investigations to prevent and detect money laundering, terrorist financing, and other financial crime through use of analytical tools and information-sharing mechanisms; administers the Bank Secrecy Act.
	Internal Revenue Service (IRS) Criminal Investigation	Participates in investigations of terrorist financing cases with an emphasis on charitable organizations.
	IRS Tax Exempt and Government Entities	Administers the eligibility requirements and other IRS tax law that apply to charitable and other organizations that claim exemption from federal income tax.
	Office of Foreign Assets Control	Develops and implements U.S. strategies and policies to deter terrorist financing; imposes controls on transactions; and freezes foreign assets under U.S. jurisdiction.
	Office of the General Counsel	Chairs Policy Coordination Committee for Terrorist Financing, which coordinates U.S. government efforts to identify and deter terrorist financing; coordinates U.S. government actions regarding implementation of, and imposition of, economic sanctions under Executive Order 13224 with respect to the freezing of terrorist-related assets.
	Office of International Affairs	Provides advice, training, and technical assistance to nations on issues including terrorist financing deterrence.

Sources: GAO, using information from the Departments of Justice, the Treasury, State, and Homeland Security.

## Terrorists Use Various Alternative Financing Mechanisms to Earn, Move, and Store Their Assets

Terrorists use an assortment of alternative financing mechanisms to earn, move, and store their assets. Terrorists, like other criminals, focus on crimes of opportunity in vulnerable locations worldwide and seek to operate in relative obscurity by taking advantage of close-knit networks of people and nontransparent global industry flows when earning, moving, and storing their assets.<sup>15</sup> To earn assets, they focus on profitable crimes or scams involving commodities such as smuggled cigarettes, counterfeit goods, and illicit drugs and the use of systems such as charitable organizations that collect large sums. To move assets, terrorists use mechanisms that enable them to conceal or launder their assets through nontransparent trade or financial transactions such as charities, informal banking systems, bulk cash, and commodities such as precious stones and metals. To store assets, terrorists may use commodities that are likely to

<sup>15</sup>These preexisting networks are based on ethnic, geographic, or criminal links, providing access to people with similar interests and to established financing structures founded on trust-based relationships and often lacking substantial formal documentation.

maintain their value over time and are easy to buy and sell outside the formal banking system. For example, terrorists may use precious stones and metals that serve as effective forms of currency. Table 2 shows examples of mechanisms that terrorists may use to earn, move, and store assets and also shows that terrorists may use assets for more than one purpose.

**Table 2: Examples of Alternative Financing Mechanisms That May Be Used to Earn, Move, and Store Terrorist Assets**

Alternative financing mechanisms	Earning	Moving	Storing
<b>Trade in commodities</b>			
Illicit drugs	X		
Weapons	X		
Cigarettes	X		
Diamonds	X	X	X
Gold		X	X
<b>Systems</b>			
Charities	X	X	
Informal banking		X	
<b>Currency</b>			
Bulk cash		X	X

Sources: GAO analysis based on information from government, industry, and research sources as noted in the scope and methodology.

## Terrorists Earn Assets via Systems and Commodities That Are Highly Profitable

Terrorists earn assets through illicit trade in myriad commodities, such as drugs, weapons, and cigarettes, and systems, such as charities, owing to their profitability. Like other criminals, terrorists can trade any commodity in an illegal fashion, as evidenced by their reported involvement in trading a variety of counterfeit and other goods.<sup>16</sup> However, although terrorists are generally motivated by ideological factors rather than pure profit, terrorists, like other criminals, benefit most from smuggling those commodities with the highest profit margins. Terrorist organizations have also earned funds using systems such as charitable organizations. The

<sup>16</sup>Although U.S. law enforcement agencies discussed some examples of terrorists' use of scams involving common household commodities and the illicit sales of a variety of counterfeit goods, with the exception of one public cigarette case, examples are not included in this report because, according to the FBI, the cases are still open and discussion may jeopardize investigations and prosecutions.

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potential misuse of charitable contributions by terrorist organizations can take many forms, sometimes with the knowledge of the charity or donor and sometimes without their knowledge.

### Trafficking in Illicit Drugs and Weapons to Earn Assets

Globally, trafficking in illicit drugs and weapons is a profitable means for terrorists to earn assets. Terrorists have been reportedly involved in trafficking illicit drugs, the most lucrative commodity illegally traded, according to the U.S. State Department's Bureau of International Narcotics and Law Enforcement Affairs.<sup>17</sup> According to the U.S. State *Department's 2003 International Narcotics Control Strategy Report*, this trade is valued in the billions and allows drug traffickers to corrupt government and law enforcement officials worldwide, particularly in countries with weakly enforced laws and regulations where officials are poorly paid. In East Asia, trafficking in drugs and weapons—as well as engaging in organized crime and official corruption—are serious international crimes that terrorist organizations have exploited to finance their operations.<sup>18</sup> In South Asia, al Qaeda is reported to have trafficked heroin to support its operations and Osama bin Laden was reportedly involved.<sup>19</sup> In Latin America, terrorists trafficked in drugs and arms to finance their activities. In some South American countries, international terrorist groups have established support bases that sustain their worldwide operations. For example, the triborder area where the borders of Argentina, Brazil, and Paraguay converge continues to be a safe haven for Hizballah and HAMAS, where the organizations raise funds to finance their operations through criminal enterprises. According to the DEA, terrorist operatives associated with Hizballah generate significant income from contraband, including drugs in several Latin American countries, to support their organization in Lebanon.

### Cigarette Smuggling and Counterfeiting to Earn Assets

Terrorists have earned assets through the highly profitable illicit trade in cigarettes. According to officials from the ATF, Hizballah, HAMAS, and al Qaeda have earned assets through trafficking in contraband cigarettes or

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<sup>17</sup>The estimated 100 metric tons of cocaine that the U.S. government seizes each year could be worth as much as \$10 billion to the drug trade.

<sup>18</sup>U.S. General Accounting Office, *Combating Terrorism: Interagency Framework and Agency Programs to Address the Overseas Threat*, [GAO-03-165](#) (Washington, D.C.: May 23, 2003).

<sup>19</sup>Southeast Asian terrorist organizations that have cells linked to al Qaeda were discovered in 2001 in Malaysia and Singapore, and their activities, movements, and connections traverse the entire region, but little information is available about their financing methods.

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counterfeit cigarette tax stamps.<sup>20</sup> ATF officials told us that as of August 20, 2003, they were investigating at least six such cases with ties to terrorist groups. ATF officials also believe that there are several other investigations under way that may produce evidence linking them to terrorist groups. In the one closed case example, during 2002, an ATF investigation revealed a conspiracy where the defendants were illegally trafficking cigarettes from 1996 to 2000 between North Carolina, a low tax state, and Michigan, a high tax state, and funneling some of the illegal proceeds back to the Hizballah. In this case, family and religious ties enabled the smugglers to sell illegal cigarettes at a network of small convenience stores in Michigan. Figure 1 shows how the Charlotte, North Carolina, Hizballah cell profited from this illegal activity. The total value of the assets seized was about \$1.5 million and consisted of cigarettes, real property, and currency. The investigation resulted in at least two convictions, in June 2002, for cigarette trafficking, money laundering, and providing material support to a terrorist organization.<sup>21</sup> More generally, the opportunity to earn illegal profits in the cigarette industry is significant given the growing trend of counterfeit cigarettes and Internet cigarette sales.<sup>22</sup> According to a European Commission Anti-Fraud Office official, cigarette smuggling is widespread in Europe, and in many eastern European countries smuggled cigarettes are commonly used as currency. (The Anti-Fraud Office could not formally discuss ongoing cases involving terrorists' links, because it would jeopardize ongoing investigations.)

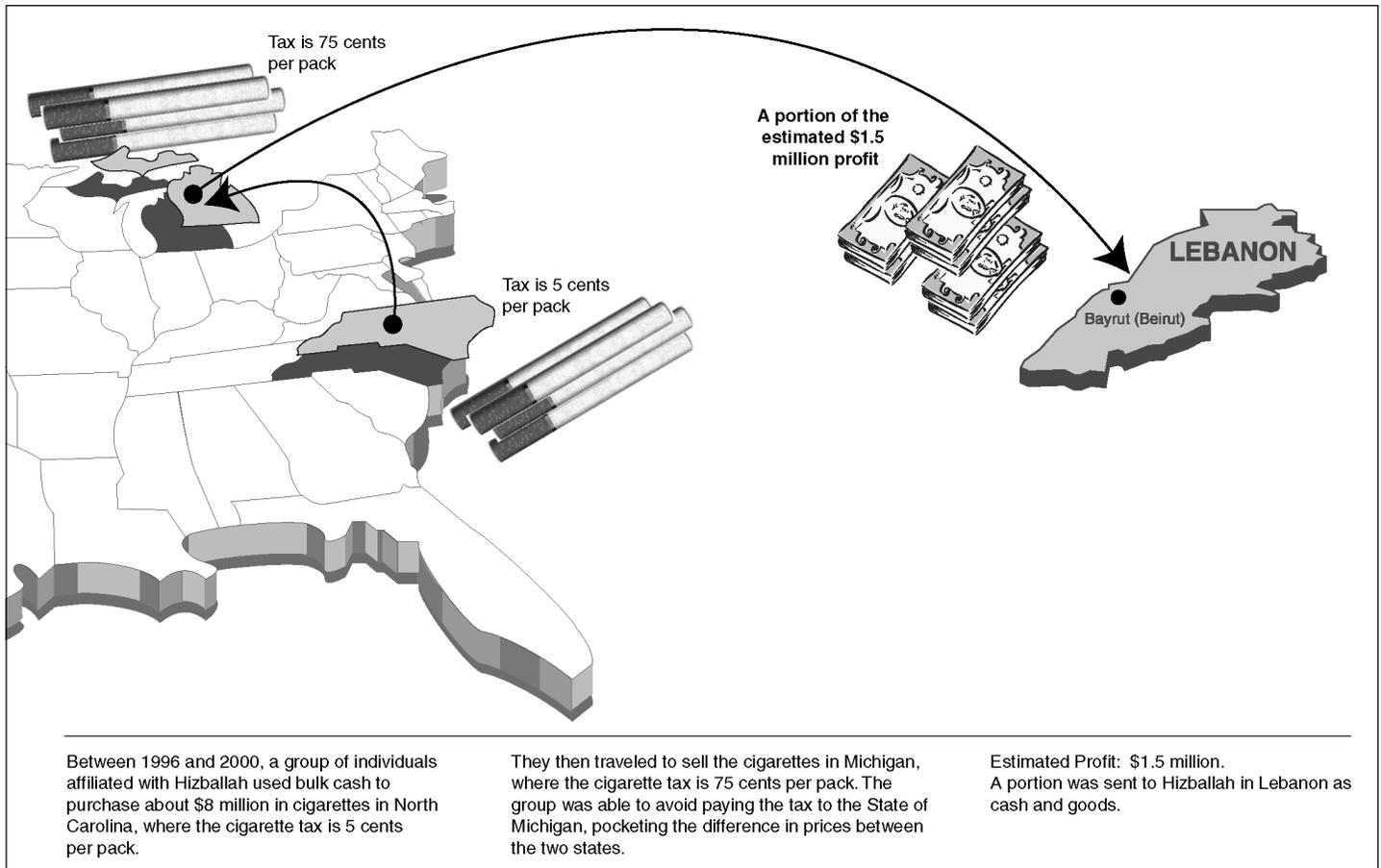
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<sup>20</sup>In the United States, many states require the payment of an excise tax, a tax on the sale or manufacture of a commodity, usually a luxury item, on the sale of cigarettes. Some states require proof of payment in the form of tax stamps.

<sup>21</sup>According to DOJ, the investigation also resulted in an additional 22 convictions by plea bargain on related charges.

<sup>22</sup>The Phillip Morris Company estimates that the revenue loss to New York City from one shipping container of counterfeit cigarette sales is roughly \$1.6 million.

**Figure 1: Hizballah Financiers Earn Assets through Cigarette Smuggling**



Sources: GAO, using information from the Bureau of Alcohol, Tobacco, Firearms, and Explosives, and court documents.

### Misuse of Charitable Organizations to Earn Assets

Terrorist organizations have earned funds using systems such as charitable organizations that provide a ready source of sizable funds generated from religious, ethnic, or geographic ties between people with similar interests.<sup>23</sup> In many countries, charitable giving is a religious duty and, although most contributions are intended for legitimate humanitarian purposes, terrorists are able to divert these funds owing to the lack of

<sup>23</sup> According to DOJ, it has issued indictments in five cases involving the misuse of a charitable organization to earn assets, move assets, or both. Additionally, the FBI has discussed two additional ongoing cases.

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oversight or financial controls for charities to ensure that moneys are spent according to their intended purpose. The potential misuse of charitable contributions by terrorist organizations can take many forms. According to the Financial Action Task Force on *Money Laundering's 2002-2003 Report on Money Laundering Typologies*, some charitable organizations were established with a stated charitable purpose but may actually exist in part or only to earn funds for a terrorist organization. For example, according to the Treasury, Holy Land Foundation for Relief and Development in Texas raised \$13 million in the United States in 2000, claiming that the money it solicited went to care for needy Palestinians, although evidence shows that HAMAS used some of the money that the Holy Land Foundation raised to support suicide bombers and their families.<sup>24</sup> Terrorists or their supporters may also infiltrate legitimate charitable organizations and divert funds to directly or indirectly support terrorist organizations. In both cases, the charitable organizations may collect donations from both witting and unwitting donors. An example of a witting donor would be one who donated funds to a charity knowing that the funds would go to al Qaeda. An unwitting donor would be one who donated funds to the charity not knowing that funds would go to al Qaeda.

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### Terrorists Move Assets via Systems and Commodities That Allow Ease of Concealment and Liquidity

To move assets, terrorists use mechanisms that enable them to conceal or launder their assets through nontransparent trade or financial transactions such as charities, informal banking systems, bulk cash, and commodities such as precious stones and metals. Although charities and informal banking systems serve many legitimate purposes, they entail a significant degree of nontransparency that terrorist groups and their supporters can exploit to move funds raised in the United States and elsewhere across borders. To carry assets across borders without detection, terrorists seek to smuggle bulk cash or convert their assets into commodities that are relatively liquid and easy to conceal. Terrorists can also convert their assets into internationally traded commodities that serve as forms of currency, such as gold, but are not subject to standard financial reporting requirements. Commodities that can be smuggled owing to their ease of concealment are particularly attractive. While terrorists use legitimate systems and commodities in an illicit manner to move their assets, they may also use illicit means such as trade-based money laundering to move

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<sup>24</sup>In *Holy Land Foundation v. Ashcroft*, 219 F.Supp.2d 57, 75 (D.D.C. 2002), *aff'd*, 333 F.3d 156 (D.C. Cir. 2003), the U.S. Court of Appeals for the District of Columbia Circuit found the evidence tying the Holy Land Foundation for Relief and Development to the terrorist organization Hamas to be substantial.

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Misuse of Charities to Move Assets

assets or settle accounts. Moreover, according to law enforcement officials, they may use more than one mechanism, layering their activities, to better hide the trail of their transactions.

Terrorists may be attracted to charities to move their assets owing to the industry's nontransparent nature. According to the Financial Action Task Force on *Money Laundering's 2002-2003 Report on Money Laundering Typologies*, in addition to serving as a direct source of income, some charities may have served as a cover for moving funds to support terrorist activities, usually on an international basis. For example, according to court documents,<sup>25</sup> the Global Relief Foundation, an Illinois-based charity, sends more than 90 percent of its donations abroad, and, according to DOJ, the foundation has connections to and has provided support and assistance to individuals associated with Osama bin Laden, the al Qaeda network, and other known terrorist groups. The Global Relief Foundation has also been linked to financial transactions with the Holy Land Foundation. Similarly, the DOJ asserts that the Illinois-based Benevolence International Foundation moved charitable contributions fraudulently solicited from donors in the United States to locations abroad to support terrorist activities.<sup>26</sup> As shown by the shaded locations in figure 2, the foundation has offices worldwide through which it could facilitate the global movement of its funds.

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<sup>25</sup>*Global Relief Foundation vs. Paul H. O'Neil, et al.*, 207 F. Supp. 2d 779, U.S. District Court, Northern District of Illinois, Eastern Division, June 11, 2002.

<sup>26</sup>*U.S. v. Enaam Arnaout, Case No. 02CR892*, U.S. District Court, Northern District of Illinois, Eastern Division, April 2002.

**Figure 2: Location of Benevolence International Foundation Offices Worldwide**



Sources: GAO, using information from the Office of Foreign Assets Control, and Map Art.

### Misuse of Informal Banking Systems to Move Assets

Terrorist organizations use a type of informal banking system sometimes known as hawala to move their assets, owing to the system's nontransparent and liquid nature. An informal banking system is one in which money is received for the purpose of making it, or an equivalent value, payable to a third party in another geographic location, whether or not in the same form. Such transfers generally take place outside the conventional banking system through nonbank money services businesses or other, often unregulated and undocumented, business entities whose primary business activity may not be the transmission of money.<sup>27</sup> Traditionally, expatriates—traders and immigrant laborers—used informal banking systems by sending money home from or to countries lacking formal and secure banking systems. Informal systems are still used by

<sup>27</sup>For example, according to an FBI press release, on August 13, 2003, a New York diamond jeweler was indicted for conspiring to operate an unlicensed money remittance system (informal banking system). Prosecutors alleged that the system was to be used in a terrorist financial transaction involving the purchase of a shoulder-fired missile.

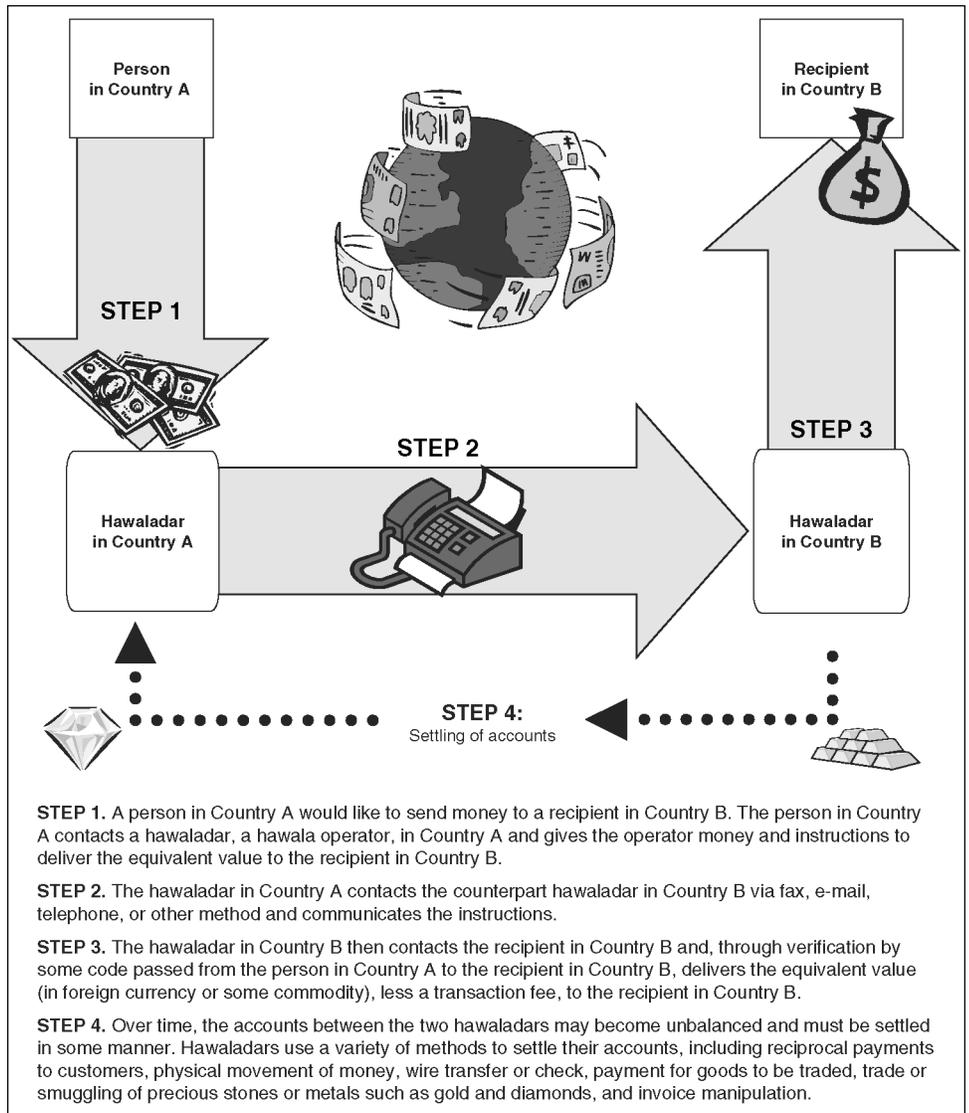
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immigrant ethnic populations in the United States and elsewhere today.<sup>28</sup> Such systems are based on trust and the extensive use of connections such as family relationships or regional affiliations. These systems also often involve transactions out of the United States to remote areas with no formal banking system or to countries with weak financial regulations, such as Afghanistan and Somalia, where the Al Barakaat informal banking system moved funds for al Qaeda. Figure 3 provides an example of how a simple hawala transaction can occur.

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<sup>28</sup>U.S. and international law enforcement officials, as well as academic researchers, have identified a variety of ethnically based informal banking systems that originated in China, India, Pakistan, Vietnam, and Somalia, among numerous others. Officials and researchers note that these informal banking systems generally predate formal banks, and that some groups may consider them more familiar and trustworthy than formal banks.

**Figure 3: Example of Hawala-type Transaction**



Sources: GAO, using information from the Department of the Treasury, the Financial Action Task Force on Money Laundering (FATF), Interpol, U.S. law enforcement, and other experts.

According to FinCEN, while the majority of informal banking systems' activity may be legitimate in purpose, these systems have been used to facilitate the financing of terrorism and the furtherance of criminal

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## Smuggling of Bulk Cash to Move Assets

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activities.<sup>29</sup> As a result, law enforcement and international entities have focused a great deal of attention on the possibility that terrorist financing takes place through informal banking systems such as hawala to move money, particularly since September 11. For example, according to the FBI, some of the 19 September 11 hijackers allegedly used hawala to transfer thousands of dollars in and out of the United States prior to their attacks. Somalis working in the United States used the Al Barakaat informal banking network, founded with a significant investment from Osama bin Laden, to send money to their families in Somalia.<sup>30</sup> According to a September 2002 Treasury fact sheet on terrorist financing, Al Barakaat's worldwide network was channeling several million dollars a year to and from al Qaeda.<sup>31</sup>

The law enforcement community has long suspected that some terrorist organizations use bulk cash smuggling to move large amounts of currency. Bulk cash smuggling is an attractive financing mechanism because U.S. dollars are accepted as an international currency and can always be converted; there is no traceable paper trail; there is no third party such as a bank official to become suspicious of the transaction; and the terrorist has total control of the movement of the money. Conversely, the factors against cash smuggling include the costs of couriers and equipment, the risk of the courier stealing the money, the risk of informants within the network, or losses due to border searches or government inquiries that could compromise the network or mission. In the United States, bulk cash smuggling is a money laundering and terrorism financing technique that is designed to bypass financial transparency reporting requirements.<sup>32</sup> Often the currency is smuggled into or out of the United States concealed in

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<sup>29</sup> *A Report to the Congress in Accordance with Section 359 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, Submitted by the Secretary of the U.S. Department of the Treasury, (Nov. 2002).

<sup>30</sup> According to DOJ, Al Barakaat operated a hybrid hawala in which its informal system interconnected with the formal banking system. Because Al Barakaat also used financial institutions, law enforcement was able to discover the transactions to Somalia by analyzing Suspicious Activity Reports generated by the banks pursuant to their obligations under the 1970 Bank Secrecy Act [Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended in 12 U.S.C. §§ 1829(b), 1951-1959 (2000); 31 U.S.C. §§ 5311-5330 (2000)].

<sup>31</sup> Treasury did not report a time frame during which this money was channeled.

<sup>32</sup> Financial transparency reporting requires Currency and Monetary Instrument Reports, which obligates the filer to declare if he or she is transporting across the border \$10,000 or more in cash or monetary instruments.

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Trafficking in Precious Stones  
and Metals to Move Assets

personal effects, secreted in shipping containers, or transported in bulk across the border via vehicle, vessel, or aircraft. According to the FBI, some of the 19 September 11 hijackers allegedly used bulk cash as another method to transfer funds.

Furthermore, in response to the September 11 events, Customs<sup>33</sup> initiated an outbound-currency operation, Operation Oasis, to refocus its efforts to target 23 identified nations involved in money laundering. According to the Department of Homeland Security's (DHS) ICE, between October 1, 2001, and August 8, 2003, Operation Oasis had seized more than \$28 million in bulk cash. However, according to ICE officials, while some of the cases involved were linked to terrorism, they were unable to determine the number and the extent to which these cases involved terrorist financing.

Terrorist organizations have also reportedly traded in precious stones such as diamonds to launder money or transfer value because it is easy to conceal these materials and transfer them. Terrorists can move their assets by converting moneys into a commodity, such as diamonds, that serves as a form of currency. U.S. law enforcement and others told us that there is a potential for the use of gold to move assets, but little has been reported on the link between terrorists and gold, other than by the media.

As we previously reported,<sup>34</sup> diamonds can be used in lieu of currency in arms deals, money laundering, and other crimes. Diamonds are also easily smuggled because they have high value and low weight and are untraceable and odorless.<sup>35</sup> The international diamond industry is fragmented, with numerous small mining operations located in remote areas of Africa, in countries that have porous borders and no rule of law. There is limited transparency in diamond flows owing to the complex way in which diamonds move from mine to consumer, the existence of significant data inconsistencies, and the industry's historical avoidance of close scrutiny. Diamonds are often traded fraudulently, and smuggling

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<sup>33</sup>Operation Oasis was established under the former U.S. Customs Service. The U.S. Customs Service was transferred to the Department of Homeland Security and its investigators were transferred to ICE.

<sup>34</sup>U.S. General Accounting Office, *International Trade: Critical Issues Remain in Deterring Conflict Diamond Trade*, [GAO-02-678](#) (Washington, D.C.: June 14, 2002).

<sup>35</sup>According to the Congressional Research Service, a pound of diamonds in 2002 was worth around \$225,000, compared with a pound of cash that was worth \$45,000 and a pound of gold, which was worth \$4,800.

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## Use of Trade-based Money Laundering to Move Assets

routes for rough diamonds are well established by those who have used such routes for decades to evade taxes or move stolen diamonds. According to a Belgian law enforcement official, a substantial number of the diamonds traded in Antwerp, the world's largest trading center, are sold on the black market with no transaction records. Most officials and researchers we spoke with recognized a highly probable link between Hizballah and a part of the Lebanese diamond-trading network in West Africa. The U.N. Special Court Chief Prosecutor and the Chief Investigator in Sierra Leone both reported that the problem is current.

Moreover, though U.S. law enforcement has been unable to substantiate the reports, officials from the U.N. Special Court for Sierra Leone,<sup>36</sup> representatives of Global Witness (a London-based nongovernmental organization), media, and other U.S. and international experts have also stated that al Qaeda was reportedly buying diamonds from rebel groups in West Africa in the months leading up to September 11 and may still be involved in the trade.<sup>37</sup> According to officials of the U.N. Special Court and Global Witness, they have witnesses of such a connection. U.S. government officials both within and among agencies remain divided over whether there is sufficient evidence to establish a current link between al Qaeda and the diamond trade.

Gold also presents an opportunity for moving terrorist assets.<sup>38</sup> As highlighted in a number of money-laundering cases, gold can be smelted into any form, camouflaged, and smuggled across borders. Because its form can be altered, gold used in trade often has no valid paper trail.

ICE officials and researchers have focused on the possibility that terrorists may use trade-based money laundering to move their assets, owing to its

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<sup>36</sup>In August 2000, the United Nations and the government of Sierra Leone agreed to establish a Special Court for Sierra Leone to prosecute persons bearing responsibility for serious violations of international humanitarian law and Sierra Leonean law committed in the territory of Sierra Leone since November 1996.

<sup>37</sup>Al Qaeda first set up diamond mining and trading companies during the 1990s in Kenya and Tanzania. Although these diamond-trading operations were not fully developed, they did provide some financial returns and expertise for involvement in diamond trading in Sierra Leone.

<sup>38</sup>According to the DHS ICE, in a drug-trafficking sting operation in the jewelry district of New York, 11 individuals were indicted for money laundering by accepting more than \$1 million cash in exchange for smelted gold items and diamonds they had reason to believe were going to be smuggled to South America.

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criminal and nontransparent nature.<sup>39</sup> ICE defines trade-based money laundering as the use of trade to legitimize, conceal, transfer, and convert large quantities of illicit cash into less conspicuous assets such as gold or diamonds. In turn, these criminal proceeds are transferred worldwide without being subject to bank secrecy laws. For example, hawala operators reportedly use false (under- or over-) invoicing<sup>40</sup> to balance books or move assets. According to the FBI, some cases of terrorist use of trade-based money laundering to move assets may exist but are too sensitive for discussion at this time.

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### Terrorist Organizations May Store Assets in Cash or Commodities That Serve as Forms of Currency and Maintain Value and Liquidity

Terrorists may store assets in cash, or in commodities, that serve as forms of currency that are likely to maintain value over longer periods of time and are easy to buy and sell outside the formal banking system. However, little has been reported concerning the storing of terrorist assets in alternative financing mechanisms. The FBI testified in the case of the *United States versus the Benevolence International Foundation* that a key associate of Osama bin Laden kept thousands of dollars of cash in several currencies in shoeboxes in his apartment.<sup>41</sup> According to a September 2002 United Nations Security Council letter, al Qaeda was believed to have shifted a portion of its assets to gold, diamonds, and other untraceable commodities. In 2002, we reported that diamonds might be used as a store of wealth for those wishing to hide assets outside the

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<sup>39</sup>According to the 2002 National Money Laundering Strategy, the Black Market Peso Exchange, the largest known trade-based money laundering system in the Western hemisphere, is a system that converts and launders illicit drug proceeds from dollars to Colombian pesos. Typically, narcotics dealers sell Colombian drugs in the United States and receive U.S. dollars. The narcotics traffickers thereafter sell the U.S. currency to a Colombian black market peso broker's agent in the United States. In return for the dealer's U.S. currency deposit, the agent deposits the agreed-upon equivalent of Colombian pesos into the cartel's bank account in Columbia. At this point, the cartel has successfully converted its drug dollars into pesos, and the Colombian broker and his agent now assume the risk for integrating the drug dollars into the U.S. banking system. The broker funnels the money into financial markets by selling the dollars to Colombian importers, who then purchase U.S. goods that are often smuggled back into Columbia to avoid taxes and customs duties.

<sup>40</sup>False invoicing is a simple way of moving money across borders. For example, if a container of goods is worth \$100,000, but is invoiced for \$150,000, the subsequent payment of \$150,000 will allow the movement of \$50,000 to illicitly cross borders.

<sup>41</sup>*United States vs. Benevolence International Foundation, Inc. and Enaam Arnaout*, Case Number 02 Cr. 0414, United States District Court, Northern District of Illinois, Eastern Division, April 2002.

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banking sector, where assets could be detected and seized.<sup>42</sup> According to Global Witness, a nongovernmental organization, British forces in Afghanistan found an al Qaeda training manual in December 2001 that addressed how to smuggle gold. While various press reports suggested that al Qaeda was shifting assets into gold last fall, U.S. law enforcement has been unable to substantiate these allegations. Terrorists may store their assets in gold because its value is easy to determine and remains relatively consistent over time. There is always a market for gold given its cultural significance in many areas of the world, such as Southeast Asia, South and Central Asia, the Arabian Peninsula, and North Africa.<sup>43</sup> Gold is considered a global currency and is easily exchanged throughout the world.

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## Extent of Use of Alternative Financing Mechanisms Is Unknown

The true extent of terrorist use of alternative financing mechanisms is unknown, owing to the criminal nature of the activity and the lack of systematic data collection and analyses. Although we recognize that the criminal nature of terrorist financing prevents knowing the full extent of their use of alternative mechanisms, systematic data collection and analyses of case data does not yet exist to aid in determining the magnitude of the problem. The limited and sometimes conflicting information available on alternative financing mechanisms adversely affects the ability of U.S. government agencies to assess risk and prioritize efforts on terrorist financing mechanisms.

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## Criminal Nature of Terrorists' Use of Alternative Financing Mechanisms Precludes Knowledge of True Extent

It would be unrealistic to expect U.S. law enforcement to determine the full extent of terrorist or criminal use of alternative financing mechanisms. As we noted, terrorists, like other criminals, strive to operate in obscurity and thus seek out nontransparent mechanisms that have little or no paper trail, often operating in weakly regulated industries. The terrorist link may be difficult to determine or define. While dollar amounts of funds frozen in terrorist-related bank accounts have been used to serve as rough indicators of the extent of terrorist financial flows through the formal financial networks, researchers and government officials have presented

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<sup>42</sup>[GAO-02-678](#).

<sup>43</sup>For example, in many of these countries, gold is commonly displayed in weddings, as a form of economic status, or to settle books in informal banking systems.

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few such indicators about terrorist assets outside of formal mechanisms.<sup>44</sup> Further, limited useful information exists about the total annual flow of assets through some types of alternative financing mechanisms, such as informal banking systems, and on what portion of that total may be terrorist assets. For example, there is a wide range of estimates about the total annual flow of transactions through informal banking systems; the United Nations estimates \$200 billion, the World Bank and International Monetary Fund estimate tens of billions of dollars, and a FinCEN report noted that quantifying the amount with certainty is impossible. Moreover, officials and researchers we spoke with could not provide estimates on the extent of terrorist use of informal banking systems and other alternative financing mechanisms.

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## U.S. Law Enforcement Does Not Systematically Collect and Analyze Data on Terrorists' Use of Alternative Financing Mechanisms

U.S. law enforcement agencies—specifically, the FBI, which leads terrorist financing investigations and operations—do not systematically collect and analyze data on terrorists' use of alternative financing mechanisms.<sup>45</sup> When agencies inform the FBI that an investigation has a terrorist component, the FBI opens a terrorism case. However, the FBI cannot, through its existing processes, furnish the numbers of open or closed terrorist financing cases and cannot furnish the numbers of those cases broken down by funding source. According to the FBI's Terrorist Financing Operations Section (TFOS) officials,<sup>46</sup> most, if not all, terrorist cases involve a financial aspect, known as a "funding nexus," which is normally considered to be a component of the overall investigation. However, the FBI does not currently isolate terrorist financing cases from substantive international terrorism cases, and its data analysis programs do not designate the source of funding (i.e., charities, commodities, etc.) for terrorist financing. The lack of such data hinders the FBI from conducting systematic analysis of trends and patterns focusing on alternative

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<sup>44</sup>According to the Treasury's Office of Foreign Assets Control, the United States had frozen \$719,832 in al Qaeda assets as of July 31, 2003.

<sup>45</sup>Once a U.S. law enforcement agency (for example, ATF, DEA, ICE, etc.) identifies a terrorist nexus in an investigation they are to notify the FBI. Information is to be shared through the FBI-led Joint Terrorism Task Forces in the field or the National Joint Terrorism Task Force in FBI headquarters. Agencies have representatives at each others' locations to facilitate information-sharing.

<sup>46</sup>The FBI's Terrorist Financing Operations Section provides overall operational command to the interagency National Joint Terrorism Task Force at FBI headquarters and the Joint Terrorism Task Forces in the field that conduct terrorist financing investigations and operations.

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financing mechanisms from its case data. Without such an assessment, the FBI would not have analyses that could aid in assessing risk and prioritizing efforts to address these and other mechanisms. According to TFOS, it and the DOJ Counterterrorism Section have initiated a number of proactive data mining<sup>47</sup> and data link analyses using a number of government and private data sources to identify potential terrorists and terrorist-related financing activities, but these initiatives generally focus on formal financial systems, not alternative financing mechanisms.

According to the Chief of TFOS, the FBI plans to collect information from the field offices through its Crime Survey/Threat Assessment and Annual Field Office Reports, and these tools might include information on alternative financing mechanisms. However, the formats and results of these tools were not available to us during our review. Although the FBI reported that it solicited information from the field on identified threats and efforts including terrorist financing, we received no evidence showing that these reports addressed alternative financing mechanisms using a systematic methodology. The FBI disseminated its Crime Survey/Threat Assessment to all of its field offices, and the responses were due to FBI headquarters in August 2003 after we completed our fieldwork. According to the TFOS Chief, this information from the field was to highlight the threats identified in the field and might include discussions of alternative financing mechanisms. Also, according to the TFOS Chief, the Annual Field Office Reports were to be disseminated in April 2003 and finalized before conclusion of our fieldwork on July 30, 2003. However, as of July 30, 2003, the Annual Field Office Reports had not been finalized, and their status was unavailable. According to the TFOS Chief, the Annual Field Office Reports, once finalized in their new format, would furnish myriad useful documentation concerning the FBI's efforts within the International Terrorism program and the terrorist financing arena. However, it remained unclear to what extent these documents would address alternative financing mechanisms.

The DHS's ICE, which participates in terrorist financing investigations in coordination with the FBI, also does not systematically collect and analyze data on terrorists' use of alternative financing mechanisms. The former U.S. Customs Service initiated Operation Green Quest (OGQ) in October

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<sup>47</sup>Data mining is the process of extracting meaningful information from large databases. Once extracted, the information can be analyzed to reveal hidden patterns, trends, relationships, and correlations between the data.

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2001 to focus on terrorist financing,<sup>48</sup> and some of its data collection and analysis were intended to focus on alternative financing mechanisms. However, first, Customs officials were unable to furnish accurate numbers of open and closed terrorist financing cases. According to OGQ officials, they had approximately 580 open terrorist financing cases and 559 closed cases between OGQ's inception in October 2001 and February 2003. However, Customs officials told us that, although cases may initially be thought to have a terrorist link and be categorized as such in their database, they might not be recategorized as nonterrorist cases once no terrorist link was found. Rather, the database captured criminal cases that may or may not have had a terrorist link; and the number of actual cases with a terrorist link, which would also depend on how "link" is defined, is not readily known. Second, ICE officials and former OGQ officials confirmed that they could not readily distinguish among the types of alternative financing mechanisms in their case database. According to these officials, it would take an intensive effort to segregate data by categories of alternative financing mechanisms. They said that they believed they could accomplish this, but that it would take resources and time, because the system was not set up to search for these mechanisms. Further, this method does not identify a terrorist link, requiring further effort to determine whether such a link existed.

Moreover, while ICE officials use an analytical tool known as the Numerically Integrated Information System to investigate money laundering, terrorist financing, and other criminal activities, the tool, while useful, could not be used to automatically analyze information on alternative methods of terrorist financing and the extent of their use. The tool enables users to analyze databases for anomalies, criminal patterns, and specific transactions in global commerce when the user knows what to look for, based on other information or a tip; however, the tool does not automatically identify problem areas for attention. For example, if ICE officials know to compare export and import data between the United States and another country, and that country shares its data, then trade anomalies can be identified and further investigated using a number of databases and features. Customs officials used the system to identify

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<sup>48</sup>According to the May 13, 2003, *Memorandum of Agreement between the Department of Justice and the Department of Homeland Security Concerning Terrorist Financing Investigations*, after June 30, 2003, OGQ no longer existed as a program name. DHS was to pursue terrorist financing investigations and operations solely through its participation in the FBI's National Joint Terrorism Task Force, the Joint Terrorism Task Forces, and the Terrorist Financing Operations Section.

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money laundering based on irregular patterns in the gold trade between the United States and Argentina. However, the tool cannot be used to automatically flag anomalies in all U.S. imports and exports. Officials agreed that an automated feature would be beneficial and they believed that it would be developed in the future.<sup>49</sup> Further, according to the May 13, 2003, DOJ and DHS memorandum of agreement concerning the FBI's management of terrorist financing cases, resulting DHS analyses will be shared with the FBI, but it remains unclear how or if this information might be integrated with FBI databases or analyses.

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### Analysis and Reporting on Terrorist Use of Alternative Financing Is Limited and Sometimes Conflicting

Despite an acknowledged need from some U.S. government officials and researchers for further analysis of the extent of terrorists' use of alternative financing mechanisms, in some cases, U.S. government reporting on these issues has not always been timely or comprehensive. This could affect planning efforts. Upon requesting U.S. government studies on terrorist or criminal use of alternative financing mechanisms, we found that few rigorous studies exist. We also found that studies from researchers and information from various government and nongovernmental sources sometimes conflict.

The Departments of the Treasury and of Justice have yet to produce their report on how money is being moved or value is being transferred via the trade in precious stones and commodities. This report was required by March 2003 under the 2002 National Money Laundering Strategy. The information gained in the report was to form the basis of an informed strategy for addressing this financing mechanism. According to Treasury officials, the report was drafted in April and will be released as an appendix in the yet-to-be-released 2003 National Money Laundering Strategy. The draft was not made available for our review, and it remains unclear whether the report addresses the recent investigative efforts of other U.S. government and international entities on this subject. Moreover, we found widely conflicting information in numerous interviews concerning the use of precious stones and commodities and in the available reports and documentation.

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<sup>49</sup> According to ICE's technical comments on our draft report, an artificial intelligence function is being developed for utilization in the NIIS program, but ICE did not provide evidence of its development or what it would accomplish regarding alternative financing mechanisms.

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Further, while a Treasury report to Congress on informal value transfer systems, required under the USA PATRIOT Act,<sup>50</sup> described informal banking systems and related regulations, as required, it did not discuss terrorist use of such systems and did not include a review of the potential use of precious stones and commodities in such systems. While a discussion of precious stones and commodities was not specifically required under the USA PATRIOT Act, the report notes that there is a need for further research, particularly with regard to understanding the range of mechanisms associated with informal banking systems, including the use of gold and precious gems in hawala transactions, among others.

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## Key Challenges Impede Monitoring of Terrorists' Use of Alternative Financing Mechanisms

The U.S. government faces challenges in monitoring terrorists' use of alternative financing mechanisms, a few of which include accessibility to networks, the adaptability of terrorists, and competing priorities within the U.S. government.<sup>51</sup> We recognize the inherent difficulty in monitoring terrorists' use of alternative financing mechanisms and highlight three key challenges in this report. First, accessing the networks through which alternative financing mechanisms operate is difficult for U.S. authorities, because such systems are close knit and nontransparent. Second, the adaptable nature of terrorist groups can hinder authorities' efforts to target industries and systems vulnerable to terrorists' use. Finally, when monitoring alternative financing mechanisms, U.S. agencies face competing priorities that may present challenges for utilizing and enforcing existing laws and regulations or fully implementing strategic efforts.

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## Accessing Terrorists' Close-knit, Nontransparent Financing Networks Presents Challenges for U.S. Law Enforcement

The difficulty of accessing the networks through which alternative financing mechanisms operate represents a significant challenge for U.S. efforts to monitor terrorists' use of such mechanisms. In particular, these networks are difficult to access because they are close knit and based on trust. Informal banking systems, the diamond industry, and organized crime networks such as those that smuggle cigarettes and drugs are examples of alternative financing mechanisms that share these common factors. Similarly, terrorist organizations such as al Qaeda and Hizballah

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<sup>50</sup>Pub. L. No. 107-56, Sec. 359(d).

<sup>51</sup>As stated previously, issues concerning coordination and cooperation among U.S. government agencies and international entities abroad will be covered in a subsequent GAO report.

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are close knit and difficult to penetrate. The closeness and high degree of trust between parties to terrorist financing networks are often based on long-standing ethnic, family, religious, or organized criminal ties. According to officials from U.S. law enforcement and the Treasury, investigators who seek to monitor such networks rely on developing inside sources of information, but the high degree of trust within the networks poses challenges for recruiting informants and conducting undercover operations. Law enforcement and the Treasury also report that language and cultural barriers can increase the difficulty of accessing such networks by impeding communication between government officials and parties to the networks.

Nontransparency in many of these alternative financing mechanisms poses another challenge to U.S. law enforcement's ability to access and monitor terrorists' use of them. One component of this nontransparency is lacking or indecipherable transaction records. While officials report that transaction records in the formal banking sector have been critical to their ability to freeze terrorists' assets, the lack of a paper trail created by alternative financing mechanisms limits investigators' ability to track and apprehend terrorist financiers. In one case, DEA pursued drug smugglers with suspected terrorist links who used hawala to transfer their profits to Lebanon. However, the indecipherable records of the hawala transactions to Lebanon impeded DEA's ability to trace the money once it reached Lebanon. As a result, DEA was not able to ascertain if the smugglers were providing material support to terrorists.

In addition to the lack of a paper trail, key trade data and accountability measures for industries vulnerable to terrorist financing can be poor or nonexistent, contributing to this nontransparency. For example, international data on the diamond industry show that import, export, and production statistics often contain glaring inconsistencies.<sup>52</sup> Comprehensive international trade data on the industry are not available in volume terms, even though volume data are a better indicator of true trade flows. These data flaws inhibit analysts' ability to find patterns and anomalies that could reveal criminal smuggling of the diamonds, including for terrorist financing. Further, as we previously reported, while a recent international initiative to curb trade in illicit diamonds, known as the

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<sup>52</sup>Data inconsistencies may be attributed to various factors, including poor quality of data generated from many mining and trading nations, differences in how customs officials appraise shipments, industry practices such as selling goods on consignment or unloading stockpiles, false declarations by importers on the diamonds' origin, and smuggling.

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Kimberley Process, incorporates some elements of increased transparency, critical shortcomings exist with regard to internal controls and monitoring.<sup>53</sup>

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### Terrorists' Adaptability Hinders Efforts to Target High-risk Mechanisms of Terrorist Financing

Terrorist organizations' adaptability can hinder U.S. law enforcement's efforts to target industries and mechanisms that are at a high risk for terrorist financing. According to law enforcement and researchers, once terrorists know that authorities are scrutinizing a mechanism they use to earn, move, or store assets, they may switch to an alternate industry, commodity, or fundraising scheme to avoid detection. According to a former intelligence official, in one case, terrorists who were counterfeiting household appliances switched to creating their own appliance brand when law enforcement began to scrutinize their activities. Analysts from the former Customs Service have identified various counterfeit goods including CDs, DVDs, and apparel as having a possible connection to terrorist financing.

Additionally, according to researchers, terrorist groups such as al Qaeda can exploit their geographically diffuse structure to move the location of their operations if they are notified that authorities are pursuing their financing activities in a particular location. The DOJ reports that the Director of the Pakistan office of the Benevolence International Foundation, an international charity whose U.S. Executive Director was indicted for supporting al Qaeda and other terrorist organizations,<sup>54</sup> avoided a Pakistani intelligence investigation by moving to Afghanistan with the foundation's money and documents. Within the United States, geographic flexibility may also facilitate terrorist financing. For example, according to IRS investigators and researchers, terrorists may have moved their charity from one state to another and changed the charity's name to evade law enforcement.

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<sup>53</sup> [GAO-02-678](#). Our assessment of the Kimberley Process found that it lacked controls to ensure that it would be effective in stemming the flow of conflict diamonds. We recommended that the Secretary of State, in consultation with the relevant government agencies, work with Kimberley Process participants to develop better controls including a reasonable control environment, risk assessment, internal controls, information-sharing, and monitoring. Our recent follow-up work showed that these weaknesses remain and could be exploited by financiers of terrorism.

<sup>54</sup> On February 10, 2003, the U.S. Executive Director pled guilty to a racketeering conspiracy, admitting that he fraudulently solicited charitable organizations in order to provide financial assistance to persons engaged in violent activities overseas. According to DOJ, he was sentenced to 11 years in prison.

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This adaptability also presents challenges in monitoring terrorists' use of informal banking systems, such as hawala. The USA PATRIOT Act strengthened existing anti-money laundering laws by requiring that operators of informal banking systems register with FinCEN and obtain state licenses, where required under state law. The act also requires that informal banking systems report suspicious transactions to FinCEN and maintain anti-money laundering programs. However, officials and researchers report that these requirements are difficult to enforce, and it is likely that numerous small hawala operations remain unregistered and noncompliant with one or more of these requirements. Terrorists may have adapted to these new regulations by developing and maintaining relationships and conducting business with the hawala operators that remain underground, increasing the likelihood that their transactions will not be detected.

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### Competing Priorities Present Challenges for Monitoring of Alternative Financing Mechanisms

Addressing competing priorities presents challenges for U.S. government agencies' efforts to monitor use of alternative financing mechanisms. Increased emphasis on combating terrorism and terrorist financing since the September 11 terrorist attacks has placed greater urgency on preexisting responsibilities for some agencies. New laws such as the USA PATRIOT Act are generally recognized as assisting U.S. law enforcement efforts but also increase the workload of agencies. While the FBI is the lead agency on terrorist financing investigations, all agencies have an inherent responsibility to aid in this effort. However, some agency officials noted that new tasks sometimes compete with traditional roles or increase workloads, creating a strain on their resources, which could slow the sharing of potentially useful information. As a result, agencies may fail to fully utilize existing laws or fully implement strategic efforts in a timely manner, as described below.

### Oversight of Charities

Competing priorities slowed IRS plans to take advantage of law enabling greater information-sharing with the states. Although the IRS told us in February 2002 that it had begun to develop a system to share data with the states for the oversight of charities as allowed by law,<sup>55</sup> the IRS has not

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<sup>55</sup>The appropriate state officials can obtain details about the final denials of applications, final revocations of tax-exempt status, and notices of a tax deficiency under section 507, or chapter 41 or 42, under the Internal Revenue Code. However, IRS does not have a process to regularly share such data. See U.S. General Accounting Office, *Tax-Exempt Organizations: Improvement Possible in Public, IRS, and State Oversight of Charities*, [GAO-02-526](#) (Washington, D.C.: Apr. 30, 2002).

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made this initiative a priority and has not developed and implemented this system. While neither the IRS's nor the states' primary goal is deterring terrorism, using data-sharing systems is even more important now, when feasible, in light of the charities cases involving terrorist financing. States have an important role in combating terrorist financing because states share overall oversight responsibility for charities with the IRS. Further, according to state officials, questionable charities tend to move from state to state to avoid detection. According to the President of the National Association of State Charitable Organizations, the system of proactive information-sharing discussed with us in 2002 (including final denials of applications, final revocations of tax-exempt status, and notices of a tax deficiency) could be very useful for states in identifying and shutting down suspect charities, including charities involving terrorist financing. This system would establish uniform procedures for sending information from the IRS to states, including information about charities that have misused their funds.

IRS officials attributed delays in fully developing and implementing the system to a number of factors, including competing priorities in the department and the desire to combine this effort with the potential for increased information-sharing that may be allowable under pending legislation.<sup>56</sup> However, IRS officials agreed that they could have developed this system without passage of further legislation, and while they stated that they had begun to do so, as of July 31, 2003, when we concluded fieldwork, they had provided no evidence of work completed to date and had not specified a time frame for how and when implementation would be completed. Subsequently, on September 4, 2003, the IRS provided us with draft IRS procedures and draft guidelines for state charity officials. Officials said they were reviewing the drafts, and their proposed completion date for this information-sharing program is December 31, 2004. The IRS did not establish milestones for meeting the completion date and did not establish interim guidelines. The President of the National Association of State Charitable Organizations told us that if the issuance of guidelines for state charity officials were further delayed, then interim guidelines would be useful.

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<sup>56</sup>S.476, the Charity Aid, Recovery, and Empowerment Act of 2003.

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## Anti-money Laundering Programs

The extent of the workload created under the 2001 USA PATRIOT Act initially increased the amount of work required of FinCEN and may have slowed efforts to take full advantage of the act concerning the establishment of anti-money laundering programs. The information to be gained under the regulations, through financial institution registration and submission of required Suspicious Transaction Reports, was intended to be shared with law enforcement and intelligence analysts in their efforts to detect and deter terrorism. In October 2002, FinCEN officials told us that they had insufficient resources to draft regulations required under the act and they had not decided how to prioritize the workload. According to the 2002 National Money Laundering Strategy issued by the Departments of the Treasury and Justice, the process was made more challenging by the fact that many of the new provisions imposed regulations on various sectors and financial institutions that were not previously subject to comprehensive anti-money laundering regulations, such as automobile and boat dealers, pawn brokers, and dealers in precious metals, stones, or jewels. This meant that time and resources were needed to study and consult with law enforcement and industry leaders. FinCEN rules for dealers in precious metals, stones, or jewels were proposed on February 21, 2003, and have not been finalized.

## National Money Laundering Strategy

Implementation of the 2002 National Money Laundering Strategy, which ostensibly directs the U.S. government's resources against money laundering and terrorist financing, has proven to be challenging partially owing to the number of competing priorities. The 2002 strategy states that the U.S. government has moved aggressively to attack terrorist financing by refocusing its ongoing anti-money laundering efforts and acknowledges the larger burden placed on agencies owing to provisions of the USA PATRIOT Act. The 2002 strategy contains 19 objectives and 50 priorities but does not assign resources to these priorities based on a risk or threat assessment. Although the Secretary of the Treasury and the Attorney General issued the annual strategy, Justice officials, including FBI officials, told us that the strategy contained more priorities than could be realistically accomplished, and said that it did not affect how they set priorities or aligned resources to address terrorist financing. Treasury officials said resource constraints and competing priorities were the primary reasons why strategy initiatives, including those related to alternative financing mechanisms, were not met or were completed later than expected. Moreover, although the 2003 National Money Laundering

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Strategy was to be issued in February 2003,<sup>57</sup> according to Treasury officials, as of July 31, 2003, the new strategy had not been published owing to the demands involved in the creation of DHS. At the conclusion of our review, Treasury officials told us that the Secretary of DHS would be added as a signatory to the 2003 National Money Laundering Strategy. However, subsequently, when reviewing the draft of this report, Treasury, DOJ, and DHS officials told us that the Secretary of the DHS would not be a signatory to the 2003 National Money Laundering Strategy.

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## Conclusions

Efforts to disrupt terrorists' ability to fund their operations may not succeed if they focus solely on the formal banking or mainstream financial sector. To form a viable strategy, the U.S. government and others face challenges in understanding the nature and extent of terrorists' use of alternative financing mechanisms and in monitoring these and emerging mechanisms. While we recognize that the full extent of criminal activity cannot be determined, information can be systematically collected and synthesized to provide a useful gauge. We recognize that such analyses are difficult, but without an attempt to do so, information about terrorists' usage and potential usage remains unknown, leaving vulnerabilities for terrorists to exploit. Since current FBI systems do not allow for such data collection and synthesis, linkages, patterns, and emerging trends may not be effectively identified and, thus, resources may not be focused on the most significant mechanisms. Further, without rigorous assessments of high-risk industries and systems, critical information may remain unidentified or unexplored, leaving such industries and systems vulnerable to exploitation by terrorists. Without good data and analysis, leading to viable threat assessments and strategies, U.S. government officials cannot make good decisions among competing priorities and the resources to address them.

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## Recommendations for Executive Action

To establish a basis for an informed strategy to focus resources on the most significant mechanisms that terrorists use to finance their activities, we recommend that the Director of the FBI, in consultation with relevant

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<sup>57</sup>The Money Laundering and Financial Crimes Strategy Act of 1998 (Strategy Act, see Pub. L. No. 105-310, 112 Stat. 2941 codified as 31 U.S.C. §§ 5340-42, 5351-55 (1998)) requires the President –acting through the Secretary of the Treasury and in consultation with the Attorney General and other relevant federal, state, and local law enforcement and regulatory officials –to develop and submit the annual National Money Laundering Strategy to Congress by February 1 of each year from 1999 through 2003.

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U.S. government agencies, systematically collect and analyze information involving terrorists' use of alternative financing mechanisms.

Moreover, to create a basis for an informed strategy for determining how money is being moved or value is being transferred via the trade in precious stones and commodities, we recommend that the Secretary of the Treasury and the U.S. Attorney General produce a report on this subject, fulfilling their overdue action item under the 2002 National Money Laundering Strategy. Such a report should be based on up-to-date law enforcement investigations of links between precious stones and commodity trading and the funding of terrorist groups, as required under the strategy.

Finally, to improve the oversight of charities, leading to the possible disruption of terrorist financing, we recommend that the Commissioner of the IRS, in consultation with state charity officials, establish interim IRS procedures and state charity official guidelines, as well as set milestones and assign resources for developing and implementing both, to regularly share data on charities as allowed by federal law.

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## Agency Comments and Our Evaluation

We provided draft copies of this report to the following agencies for review: the Department of Justice, the Department of the Treasury, the Internal Revenue Service, the Department of Homeland Security and the Department of State. We received formal comments from the Treasury and IRS (see apps. II and III). We received technical comments from DOJ, DHS, and State, which we incorporated in the report as appropriate.

The DOJ did not formally respond to our recommendation that the Director of the FBI, in consultation with relevant U.S. government agencies, systematically collect and analyze information involving terrorists' use of alternative financing mechanisms. However, in DOJ's technical comments, they agreed that the FBI does not systematically collect and analyze such information, but they did not specifically agree or disagree with our recommendation. DOJ commented that it designates sources of funding in its terrorist financing cases, but it does not initiate or organize investigations on an industrywide basis or as a result of the type of commodity used or particular means of transfer. Additionally, DOJ suggested that the effort might more appropriately be a function of the Treasury based on Treasury's prior work on alternative financing mechanisms. However, according to FBI TFOS, their mission is to centralize and coordinate all terrorist financing investigations. As stated in this report, TFOS officials said that they and the DOJ Counterterrorism

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Section have already initiated a number of data mining and data link analysis initiatives to identify terrorist-related financing activities focusing on formal financing systems, but not alternative financing mechanisms. Further, TFOS officials said they plan to evaluate the feasibility of adding a separate designation for terrorist financing in their data system according to the source of funding. We continue to believe the FBI should work in consultation with relevant U.S. government agencies to systematically collect and analyze information involving terrorists' use of alternative financing mechanisms, which would include strategizing with and engaging the expertise of other agencies such as Treasury and DHS, among others.

In response to our recommendation that the Secretary of the Treasury and the U.S. Attorney General produce a planned report on precious stones and commodities, the Department of the Treasury responded that the report would be issued as an appendix to the 2003 National Money Laundering Strategy. However, the strategy was to be issued in February 2003 and had not been issued as of our receipt of Treasury's comments on October 29, 2003. Further, the Treasury did not address whether their report would include up-to-date information from law enforcement investigations of links between precious stones and commodity trading and the funding of terrorist groups, as required under the strategy. The Department of Justice did not comment on this recommendation. We continue to recommend that their report be based on up-to-date law enforcement investigations given the conflicting views and the lack of comprehensive reporting on terrorists' use of precious stones and commodities.

The IRS agreed with our overall recommendation to establish IRS procedures and state charity official guidelines to regularly share data on charities as allowed by federal law. Although IRS told us at the conclusion of our fieldwork that they planned to establish this information-sharing program by December 31, 2004, in response to our draft report and recommendation, the IRS committed to expediting its efforts by one year, having procedures in place by the end of calendar year 2003. Subsequent to our fieldwork, the IRS exhibited progress by producing draft procedures and guidelines. However, the IRS did not address our recommendation to establish milestones and assign resources to meet the target date or interim guidelines should they miss the 2003 target date. Given the complexity and time needed to complete the effort, as described by the IRS, we continue to recommend that the IRS establish milestones and assign resources to ensure that it meets its new target date. We also

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continue to recommend that IRS establish interim procedures and guidance should the IRS not meet its target date.

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As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Attorney General, the Secretary of Homeland Security, the Secretary of State, the Secretary of the Treasury, the Commissioner of Internal Revenue, and interested congressional committees. We also will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please call me at (202) 512-4128. Other contacts and staff acknowledgments are listed in appendix IV.



Loren Yager  
Director, International Affairs and Trade

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# Appendix I: Objectives, Scope, and Methodology

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The Ranking Minority Member of the Senate Committee on Governmental Affairs' Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia and the Chairman of the Senate Caucus on International Narcotics Control asked us to assess (1) the nature of terrorists' use of key alternative financing mechanisms for earning, moving, and storing terrorists' assets; (2) what is known about the extent of terrorists' use of alternative financing mechanisms; and (3) the challenges that the U.S. government faces in monitoring terrorists' use of alternative financing mechanisms.

To determine the nature of terrorists' use of some key alternative financing mechanisms for earning, moving, and storing assets, we reviewed past GAO work, studies, analyses, and other documents prepared by experts from U.S. agencies, international organizations, and other groups. We also interviewed officials of the U.S. government, international entities, foreign governments, industry, and nonprofit groups, as well as representatives from academia and research institutions. Our scope and methodology were limited by the lack of complete access to sensitive information and documentation. In cases where little documentation was provided and views conflicted, we corroborated information to the extent possible and noted the conflicting views.

We reviewed available documentation and interviewed officials from the following U.S. departments and agencies:

- the Department of Justice (Criminal Division; Federal Bureau of Investigation; Bureau of Alcohol, Tobacco, Firearms, and Explosives; Drug Enforcement Administration);
- the Department of the Treasury (Executive Office of Terrorist Financing and Financial Crime, Office of Foreign Assets Control, Financial Crimes Enforcement Network, Internal Revenue Service (IRS), and the Office of International Affairs);
- the Department of Homeland Security (Bureau of Immigration and Customs Enforcement);
- the Department of State (Office of the Coordinator for Counterterrorism, Bureau of International Narcotics and Law Enforcement Affairs, and Bureau of Economic and Business Affairs);
- the Department of Defense (Office of the Secretary of Defense, Office of Naval Intelligence, Defense Intelligence Agency);

- the Central Intelligence Agency;
- the Congressional Research Service;
- the U.S. Mission to the United Nations;
- the U.S. Embassy in Belgium (political and economic officers, Department of Homeland Security (Customs), Drug Enforcement Administration, Federal Bureau of Investigation, Defense);
- the U.S. Embassy in France (Department of Homeland Security (Customs), Federal Bureau of Investigation);
- the U.S. Mission to the European Union; and
- U.S. representatives to INTERPOL.

We also reviewed and assessed available documentation and interviewed officials from the following international entities:

- the United Nations;
- INTERPOL;
- the Financial Action Task Force on Money Laundering;
- the World Customs Organization;
- the European Union;
- the Charities Commission on England and Wales; and
- the Supreme Headquarters Allied Powers Europe (one of the North Atlantic Treaty Organization's military commands).

Additionally, we interviewed officials from Belgian law enforcement, the Federal Prosecutor's Office, and the Ministry of Foreign Affairs, Foreign Trade and International Cooperation. We also interviewed experts from India and Pakistan on hawala systems. We interviewed the Chief Prosecutor and Chief Investigator for the United Nations Special Court for Sierra Leone. Moreover, we reviewed studies and analyses and interviewed officials from industry, nonprofit groups, academia, the media, and research institutions such as the Belgian Diamond High Council, the Phillip Morris Company, Global Witness, the International

Peace Information Service, Council on Foreign Relations, Business Exposure Reduction Group, the Washington Institute for Near East Policy, and the Investigative Project, among others.

To determine what is known about the extent of terrorists' use of alternative financing mechanisms, we reviewed studies, analyses, and other documents and interviewed officials from the U.S. government, international entities, foreign governments, industry, nonprofit groups, academia, and research institutions. We attended and reviewed briefings from the Federal Bureau of Investigation and the U.S. Customs Service (now part of the Department of Homeland Security) on their data collection, databases, and analysis methods and discussed with them what their systems could and could not do. We were limited by the lack of complete access to sensitive information and by the lack of available and reliable data to determine the extent of terrorists' use of alternative financing mechanisms. Our reporting on the current FBI data collection and analysis methods was curtailed by the Department of Justice due to sensitivity concerns. We also discussed studies completed and expected from the Departments of the Treasury and Justice as required under the 2002 National Money Laundering Strategy with officials from these departments.

To determine challenges that the U.S. government faces in monitoring terrorists' use of alternative financing mechanisms, we reviewed past GAO work and documents from U.S. and foreign governments, industry, and international entities including strategies, such as the National Money Laundering Strategy; laws, regulations, rules, policies, procedures, and actions; and studies. For example, we analyzed federal and state tax laws pertaining to the oversight of charitable organizations, including reviewing Internal Revenue Code section 6104 on information-sharing between IRS and state regulators. Further, we interviewed officials from these organizations to corroborate analysis and documentary evidence. We also interviewed officials from the National Association of State Charitable Organizations and state Attorneys General Offices from California, New York, Pennsylvania, and Texas to identify challenges to deterring the use of charitable organizations in terrorist financing. According to the President of the National Association of State Charitable Organizations, California, New York and Pennsylvania are heavily regulated states while Texas is not. Additionally, we reviewed FinCEN issuance of rules and regulations as allowed under the USA PATRIOT Act. Further, we assessed and obtained views on competing priorities involved in implementing the 2002 National Money Laundering Strategy.

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**Appendix I: Objectives, Scope, and  
Methodology**

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We conducted our fieldwork in Washington, D.C., and New York, N.Y.; Brussels and Antwerp, Belgium; and Paris and Lyon, France. We performed our work from August 2002 through July 2003 in accordance with generally accepted government auditing standards.

# Appendix II: Comments from the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

The page numbers in this letter refer to a draft of this report. We have indicated page number changes.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

October 29, 2003

Mr. Loren Yager  
Director, International Affairs and Trade  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Yager:

The Department of the Treasury greatly appreciates the opportunity to review and comment upon the GAO's report: "Terrorist Financing: U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms." Overall, we believe the report does a very good job of assimilating a wide variety of information and explaining the complexity of this issue. As reflected below, we have several comments, and we would appreciate the opportunity to meet with GAO staff once more fully to explain our concerns.

Our comments that relate to the Report as a whole are as follows:

The report consistently speaks in terms of terrorists "earning" funds. We request that the word "earn" be changed to "raise" throughout this report. The concepts differ, especially in the area of charities. The term "earn" means that one receives something as a return for effort given or services rendered. The term "raise" means to gather, or collect, something for a purpose. Therefore, the term "raise" appears to be the more accurate term in the context of this report...

The other concepts of "move" and "store" are useful in this report, although one could argue for a "use" category as well, especially from the operational perspective. For example, buying the truck and the bomb "used" to perpetuate the terrorist acts are examples of "using" funds and result in transactions that can be identified and followed as well.

Page two of the report mentions that the GAO will specifically address coordination of U.S. and international efforts abroad to deter terrorist's use of alternative financing mechanisms in a subsequent report. Treasury stands ready to provide comprehensive material to the GAO for this purpose. One of the primary missions of Treasury's Executive Office for Terrorist Financing and Financial Crimes (EOTFFC) is representing the U.S. in international bodies dedicated to fighting terrorist financing and money laundering.

See comment 1.

See comment 2.

For example, Treasury's leadership role in international bodies such as the Financial Action Task Force (FATF) has led to the creation of more expansive and stringent anti-money laundering and counter-terrorist financing international standards and best practices. These standards directly relate to alternative financing mechanisms mentioned in your report such as charities, alternative remittance systems (e.g., hawala), and dealers in precious metals and stones. Through our efforts, we have created standards and best practices guidelines on regulating charities and alternative remittance systems. In addition, dealers in precious metals and stones are defined as non-financial businesses and are now required to implement customer due diligence, record keeping and suspicious transaction reporting requirements.

Finally, in order to diminish the attractiveness of alternative mechanisms, the Treasury Department has undertaken a series of bilateral and multilateral initiatives focused on channeling remittances through the formal financial systems. These initiatives are designed to heighten international attention on the market incentives that drive legitimate customers to use informal remittance channels and to address structural and other impediments in the formal financial system that may prevent the provision of efficient and accessible remittance services.

Our comments on specific portions of the Report are as follows:

**Table 1 on Key U.S. Government Entities**

The following changes are requested:

The role of the Executive Office of (change to "for") Terrorist Financing and Financial Crimes should be changed to the following: "Works domestically and internationally to preserve and protect the integrity of the financial system and the economic and physical safety of America. Ensures that all possible diplomatic, policy, and strategic steps are taken to prevent the corruption of the financial system and to prevent terrorism and other financial crimes."

Regarding the role of the Financial Crimes Enforcement Network (FinCEN), the following statement should be added to their role: "Administers the Bank Secrecy Act (BSA)."

The role of the Internal Revenue Service CI in the anti-terrorist financing arena is much broader than merely supporting investigations of charities. We request that the language describing the IRS role be changed to the following: "Identifies cases that might lead to terrorist connections, and supports investigations of terrorist financing involving all methodologies, including money remitters, bulk cash movements and charities, described in this report."

See comment 3.

See comment 4.

See comment 5.

See comment 6.

We also request that Treasury's Office of the General Counsel be added to the list of relevant offices within Treasury. Its current role, which may change in the near future, is defined as follows: "Chairs Policy Coordination Committee (PCC) for Terrorist Financing. Coordinates U.S. government actions regarding implementation of, and imposition of economic sanctions under, Executive Order 13224 to with respect to the freezing of terrorist-related assets."

**Report on Trade Based Money Laundering in Terrorist Financing**

See comment 7.

Throughout the report, reference is made that the Departments of the Treasury and Justice have not yet produced a planned report, which was to form the basis of a strategy to address how money is moved or value transferred via trade in precious stones and commodities. As stated in our interviews, the said report is contained in an Appendix to the 2003 National Money Laundering Strategy (NMLS) which is being transmitted to Congress shortly.

**FinCEN report to Congress on Informal Value Transfer Systems**

Now on p. 28.

On page 20 of the draft GAO report, a paragraph mentions FinCEN's report to Congress on Informal Value Transfer Systems (IVTS). The comments there appear to expand the scope of the report beyond what was required at the time. Thus, the comments about the IVTS report are inaccurate on two points. First, the report under Section 359 of the PATRIOT Act was not intended to discuss use of precious stones and commodities. The legislative requirement was first to evaluate the risk posed by hawala-type IVTS in moving monetary value into, out of or within the United States. Section 359 asked that the FinCEN report comment on the need for additional legislation, including whether existing thresholds for reporting suspicious transactions should be changed. No requirement -- express or implied -- to look at commodities or precious stones in the IVTS context was made, during FinCEN's discussions with congressional staff when Section 359 was being drafted, nor at any time during the research/drafting process. Second, the report did not discuss terrorist use of IVTS because there was no direct evidence that terrorists had used the system in the U.S. (Use in other criminal activity was found and was discussed in the report.) Therefore, we request that the text of that paragraph be changed to the following language:

See comment 8.

See comment 9.

"Further, a Treasury report to Congress on informal value transfer systems, required under the USA PATRIOT Act, while describing informal banking systems and related regulations, as required, did not discuss terrorist use of such systems and did not include a review of the potential use of precious stones and commodities in such systems. Further, Treasury issued a report to Congress evaluating the risk posed by hawala-type Informal Value Transfer Systems in moving monetary value into, out of or within the U.S. and to provide comment on the need for additional regulations to address any such risk, as required under the USA PATRIOT Act."

**Anti-Money Laundering Programs/Regulations**

Enclosed with these comments is a Summary of the Anti-Money Laundering Provisions of the USA PATRIOT Act and the steps taken to implement them. This summary is also contained as an Appendix to the 2003 NMLS. In order to reflect accurately the progress made on imposing regulations on various sectors, the GAO may wish to include this summary in its report.

On page 24, please delete the following sentence: "In November 2002, FinCEN officials told us that they had insufficient resources to draft regulations required under the act and they had not decided how to prioritize the workload." This statement might have been taken out of context and was not directly related to the regulatory requirements. FinCEN has met most of the USA Patriot Act deadlines. On page 24, the last sentence of the paragraph on *Anti-Money Laundering Programs* should be changed to the following:

"This meant that time and resources were needed to study and consult with law enforcement and industry leaders. FinCEN rules concerning anti-money-laundering programs for money service businesses, which include hawalas, were issued in an interim final status on April 29, 2002, and remained open for comment. The comment period closed 30 days after the issuance of the interim final rule, on May 29, 2002. All financial institutions subject to rules were required to be in full compliance within 90 days of the interim final rule. FinCEN rules for dealers in precious metals, stones, or jewels were proposed on February 21, 2003, and have not been finalized."

Thank you for the opportunity to comment on the draft report. We look forward to meeting with you again and continuing to work with you on this important issue.

Sincerely,  


Juan C. Zarate  
Deputy Assistant Secretary  
Executive Office for Terrorist Financing  
and Financial Crimes

Enclosure

Now on p. 33.

See comment 10.

See comment 11.

## GAO Comments

1. The term “earn” more fully captures the criminal effort involved in the range of alternative terrorist financing mechanisms.
2. While the use of terrorist funding may provide transactions that can be investigated, the scope of this review focused on how terrorists earn, move, and store their assets. The final use of terrorist funding is not relevant in the context of this report.
3. We amended the description of the Executive Office for Terrorist Financing to incorporate additional information provided. The description was edited in a manner consistent with those of the other agencies in the table and it captures both the information provided in the Executive Office’s Mission Statement as well as the agency comments.
4. We amended the description of the Financial Crimes Enforcement Network in Table 1 to include its role in administering the Bank Secrecy Act.
5. The description used was obtained from IRS Criminal Investigation and is consistent with the format used for other agencies.
6. We incorporated the description of the Treasury’s Office of the General Counsel in Table 1.
7. We respond to this comment on page 28.
8. We agree that the USA PATRIOT Act did not specifically require that the Department of the Treasury report to Congress on informal value transfer systems include a discussion of precious stones and commodities. While a discussion of precious stones and commodities was not specifically required under the USA PATRIOT Act, the Treasury report notes that there is a need for further research, particularly with regard to understanding the range of mechanisms associated with informal banking systems, including the use of gold and precious gems in hawala transactions, among others. We modified our report, accordingly.
9. The Department of the Treasury’s comments state that their report to Congress on informal value transfer systems did not discuss terrorists’ use of these systems because there was no direct evidence that terrorists had used these systems in the United States. However, the Treasury report states that “these [informal value transfer] systems have been used to facilitate the financing of terrorism” and the USA PATRIOT Act requirement for the report addresses the transfer of

money both domestically and internationally. The Treasury report provides no further discussion on the link between terrorist financing and these systems.

10. The sentence is characterized accurately. The context of the discussion was the development of regulations required under the USA PATRIOT Act.
11. We have omitted the example concerning the timeline for finalizing anti-money laundering program rules for money service businesses due to conflicting information presented by FinCEN during our review and the Department of the Treasury's comments.

# Appendix III: Comments from the Internal Revenue Service



COMMISSIONER

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

October 28, 2003

Mr. Loren Yager  
Director, International Affairs and Trade  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Yager:

I am responding to your report entitled *TERRORIST FINANCING: United States Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms* (GAO-04-163). The Internal Revenue Service is very committed to shutting down the stream of terrorist funding, and we consider it one of our highest priorities.

Although the Federal Bureau of Investigation (FBI) is designated as the primary agency in terrorist financing matters, our Criminal Investigation Division (CI) special agents have led this effort in a number of ways and are an integral part of the Joint Terrorism Task Forces (JTTF). These JTTF team members bring invaluable assistance from their many years of experience working complex financial investigations. CI also furnishes forensic financial accountant expertise in several overseas assignments, often alongside the FBI. CI participates in every major terrorist financing investigation, many of which involve violations of the Internal Revenue Code and related offenses. CI also assists the Treasury Department in efforts to locate and freeze terrorist funds and repatriate stolen Iraqi assets.

I agree that law enforcement agencies should have a better approach to assessing the use of alternative financing mechanisms. The GAO findings regarding the misuse of charities to raise funds and the transmission of illegal proceeds are consistent with our experience in this area. The report was well balanced in setting forth the significant challenges to increasing law enforcement's tracking of terrorism alternative financing. The IRS has long dealt with similar obstacles in the trade-based part of the underground economy and in our investigations of the laundering of illegal proceeds.

Criminal Investigation has been proactively educating the civil functions of the IRS regarding the various methods of terrorist funding. Specifically, CI is working with the IRS Tax Exempt and Government Entities (TE/GE) Division to educate the auditors about the use of charitable organizations by terrorist organizations. CI agents taught numerous TE/GE training seminars. Recently, CI and TE/GE jointly made presentations to financial analysts from both the CIA and FBI on issues regarding the procedure for revocation of exempt status and indicators of potential misuse of

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charitable organizations. We are also working to obtain additional security clearances for TE/GE personnel so that they may continue to actively participate and assist in terrorist financing investigations.

I also agree that the IRS should expedite the process of establishing procedures and guidelines to share data on charities with states as allowed by federal law. Let me assure you that the lack of formal procedures has not hampered our continuing work with the states. We have a good existing partnership with state charity officials and have always shared information as permitted by law on important topics. In the area of terrorist financing for example, we have shared with the National Association of State Charities Officials the list of organizations designated as terrorist organizations by Executive Order. We have also briefed their membership on our activities in this area. We will continue to share important information as necessary.

As you note, the GAO issued an April 30, 2002 report, Tax-Exempt Organizations-Improvements Possible in Public, IRS, and State Oversight of Charities (GAO-02-526), in which it recommended that IRS develop, in consultation with state charity officials, procedures to regularly share IRS data with states as allowed by federal law.

An IRS team has developed a program of information sharing as provided by section 6104(c) of the Internal Revenue Code. The team drafted procedures and guidelines for information sharing with the states that will appear in the Internal Revenue Manual (IRM). This draft was shared with the National Association of State Charities Officials, and we are in receipt of their comments. I am confident that we will have formal procedures in place by the end of this calendar year.

As you are aware, pending legislation (e.g., S. 476, the Charity Aid, Recovery, and Empowerment Act of 2003) would increase available information sharing with the states. If passed, we will take expeditious steps to implement the provisions of that legislation.

If you have any questions, or if you would like to discuss this response in more detail, please contact Vicki Duane, Deputy Director, Operations Policy and Support, at 202-622-6547.

Sincerely,

  
Mark W. Everson

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# Appendix IV: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

Elizabeth Sirois (202) 512-8989  
Kathleen Monahan (415) 904-2237

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## Staff Acknowledgments

In addition to those individuals named above, Kate Blumenreich, Tracy Guerrero, Janet Lewis, Kendall Schaefer, Jenny Wong, Mark Dowling, Rona Mendelsohn, and Reid Lowe made key contributions to this report.

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