Interagency Review of Prior Inspector General Recommendations Related to U.S. Export Controls

VOLUME I

September 2008

Report No. D-2008-095

September 30, 2008

PREFACE

We are providing this interagency report for your information and use. This review was conducted as a cooperative effort by the Offices of Inspector General (OIGs) of the Departments of Agriculture, Commerce, Defense, Energy, Homeland Security, State, and the Treasury; the Central Intelligence Agency; and the United States Postal Service.

Public Law 106-65, "National Defense Authorization Act for FY 2000," requires that the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Directors of Central Intelligence and the Federal Bureau of Investigation,[1] conduct an annual review, not later than March 30th of each year beginning in the year 2000 and ending in the year 2007, on the adequacy of export control policies and procedures in the U.S. Government.

This report satisfies our eighth and final statutory reporting requirement under the "National Defense Authorization Act for FY 2000," as amended. The report focuses on whether management effectively addressed recommendations from previous reports required by the Act.[2] This report discusses issues that affect more than one agency and includes separate appendixes containing the agency-specific reports. The report is in three volumes:

- Volume I contains the findings, recommendations, and reports from the Departments of Commerce, Defense, Energy, State, the Treasury, and the United States Postal Service OIGs.

- Volume II, marked For Official Use Only, contains the report that the Department of Homeland Security OIG issued, and a detailed followup report on recommendations made in previous years by the OIGs.

- Volume III, classified as Secret, contains the agency-specific report issued by the Central Intelligence Agency OIG, as well as an appendix to the Department of Commerce OIG's report.

There are no interagency recommendations in this year's report; therefore, management comments are not required. However, we requested management comments on agency-specific draft reports from the appropriate officials and, when provided, we considered them in preparing this report. Management comments provided in response to individual agency reports are included in those reports.

This interagency report is required by Congress and will support Congress and the Administration in shaping future Federal licensing policies and procedures for U.S. exports to countries and entities of concern.

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[1] The Federal Bureau of Investigation does not play an active role in the licensing process for export-controlled technology and therefore did not participate in this interagency review.

[2] The Commerce OIG also conducted a separate review of U.S. dual-use export controls for India.

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Report No. D-2008-095 **September 30, 2008**

Interagency Review of Prior Inspector General Recommendations Related to U.S. Export Controls

Executive Summary

Background

The United States controls the export of dual-use commodities[1] and munitions[2] for national security and foreign policy purposes under the authority of several laws, primarily the Export Administration Act of 1979[3] and the Arms Export Control Act of 1976. Commodities are subject to the licensing requirements contained in the Export Administration Regulations for dual-use commodities or the International Traffic in Arms Regulations for munitions.

From 2000 through 2006, 9 Offices of Inspector General (OIGs)[4] participated in issuing 9 interagency reports and 40 agency-specific reports on U.S. export controls. The OIGs made 273 recommendations in these 49 reports to improve Federal export control policies and procedures. This report provides the status of Federal managers' implementation of those recommendations.

Objective

The main objective of the 2007 review was to determine whether management effectively addressed recommendations in previous reports required by the National Defense Authorization Act.[5]

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[1] Dual-use commodities can be used for commercial or military purposes.

[2] Munitions can be military weapons, ammunition, and equipment.

[3] The Export Administration Act expired in August 1994. However, the President, under the authority of the International Emergency Economic Powers Act (section 1702, title 50, United States Code), continued the provisions of the Export Administration Act through Executive Order 13222, "Continuation of Export Control Regulations," August 17, 2001. On August 3, 2006, the President issued a notice, "Continuation of Emergency Regarding Export Control Regulations," extending Executive Order 13222.

[4] The Department of Agriculture OIG made two recommendations in March 2005. These recommendations were implemented by the Department of Agriculture. Therefore, the Department of Agriculture OIG determined that a followup review and report were not needed.

[5] The Department of Commerce OIG also conducted a separate review of U.S. dual-use export controls for India.

Review Results

To satisfy the final National Defense Authorization Act reporting requirement, the Inspectors General of the Departments of Commerce, Defense, Energy, Homeland Security, State, and the Treasury; the Central Intelligence Agency; and the United States Postal Service followed up to determine whether management effectively addressed export control recommendations made pursuant to the National Defense Authorization Act.

This interagency review determined that 234 of the recommendations (85.6 percent) made to Federal managers from 2000 through 2006 were implemented (closed).[6] However, Federal managers needed to take additional actions to implement the 39 remaining (open) recommendations. These 39 recommendations remained open from 1 to 7 years. The following chart summarizes the status of recommendations made by the interagency OIGs from 2000 to 2006 to control exports.

Status of Recommendations Related to U.S. Export Controls (From 2000 through 2006)

Office of Inspector General	Number of Reports		Number of Recommendations*		
			Closed	Open	Total
Interagency	9		6	1	7
Department of Agriculture		1	2	0	2
Department of Commerce		7	131**	19	150
Department of Defense		7	29	10	39
Department of Energy		7	14	3	17
Department of Homeland Security		3	5	2	7
Department of State		7	28	1	29
Department of the Treasury		3	15	2***	17
Central Intelligence Agency		4	1	1	2
United States Postal Service		1	3	0	3
Total	9	40	234	39	273

*The numbers shown for closed and open recommendations are as of the date of publication of the report for each agency. For further detail on the closed or open status, refer to the agency-specific report recommendations in Volume II of this report.
**Some recommendations were closed although the recommendations were not implemented.
***These recommendations were made to Treasury bureaus that have been transferred to the Department of Homeland Security.

The results of followup work performed and the status of recommendations as determined by the OIGs at Commerce, Defense, Energy, Homeland Security, State, the Treasury, the Central Intelligence Agency, and the United States Postal Service follow.

The Commerce OIG's review of U.S.-India export control activities identified the following concerns that warranted management's attention:

- Dual-use export control policies and practices for India were not fully transparent.

[6] The interagency review focused on the implementation of recommendations as of December 31, 2006.

- Bureau of Industry and Security's end-use check program in India needed to be improved.

- Bureau of Industry and Security needed to enhance its efforts to ensure compliance with license conditions.

With regard to prior Commerce OIG recommendations made from 2000 to 2006 related to export controls, Commerce OIG found that the Bureau of Industry and Security has taken action to address 87 percent of the recommendations. However, several key recommendations from its reports on Export Control Automated Support System modernization efforts (February 2002), deemed export controls (March 2004), chemical and biological export licensing (March 2005), and China export controls (March 2006) remained open. In addition, one recommendation from the March 2002 interagency report on federal automated export licensing systems was still open. All recommendations from Commerce OIG's March 2000 and 2001 reports were closed.

Given the current interest in the Committee on Foreign Investment in the United States both within and outside of the U.S. government, Commerce OIG followed up on its March 2000 report findings and recommendations related to selected aspects of the Committee on Foreign Investment in the United States' monitoring of foreign investment for national security reasons. While questions still remain about the effectiveness of the overall Committee on Foreign Investment in the United States process, Commerce OIG noted that considerable improvements have been made with regard to Committee activities within Commerce.

It should also be noted that based on its follow-up work, Commerce OIG reopened its recommendation related to the Bureau of Industry and Security working with the U.S. Postal Service to increase interagency cooperation and coordination in identifying potential violations of dual-use export control laws.

The Defense OIG found that Department of Defense (DoD) organizations implemented 29 of 39 (74.3 percent) of the recommendations made in 7 reports issued from FY 2000 through FY 2006. However, those organizations needed to fully implement the 10 remaining recommendations. One recommendation remained unimplemented for 7 years.

The Defense OIG made the 39 recommendations to strengthen controls over and reduce the risk of the inappropriate export of goods, services, and technologies such as chemicals, toxins, explosives, electronics, sensors, and lasers. Until the recommended controls are implemented, DoD continues to accept avoidable risks of inappropriately exporting sensitive goods, services, and technology that could threaten our national security.

The Energy OIG reported that of 17 prior recommendations, 14 were closed as of the end of 2006. The open recommendations concerned the dissemination of export control guidance across the Energy complex and access to and training on Commerce's Export Control Automated Support System.

The Department of Homeland Security OIG determined that five of the seven recommendations addressed in three reports issued from 2000 through 2006 were closed. For the two open recommendations, one is related to immigrant applications for approval, and the other is related to Customs and Border Protection staffing.

The Department of State OIG found that the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls, had implemented 28 of the 29 recommendations contained in OIG reports on export controls issued from 2000 to 2006. The OIG's recommendation from its 2006 report that the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls should establish performance measures that detail benchmarks and timeframes for reducing and eliminating the number of unfavorable post-license end-use checks remains unresolved. Nevertheless, the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls stated that over the next year it would consider whether such measures, along with time-lines and benchmarks, would be of value in its compliance and licensing functions. As a result, this recommendation will remain unresolved until the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls makes its final determination.

The Treasury Department OIG determined that the 3 recommendations directed to current Treasury Departmental offices were implemented and are now closed.

The Central Intelligence Agency OIG reported that in response to prior export audit recommendations, the Central Intelligence Agency's Office of Transnational Issues Military Security Group (the Military Security Group) is developing a working relationship with the Department of State's Directorate of Defense Trade Controls (the Directorate) concerning the conventional weapons export market. According to a Directorate representative, meetings between the Military Security Group and the Directorate have been positive and the Directorate is satisfied with the developing relationship with the Military Security Group. The Central Intelligence Agency OIG is aware that the Military Security Group and the Directorate are drafting a new memorandum of understanding, but the Central Intelligence Agency OIG's 2006 audit recommendation will remain open until the new memorandum of understanding is signed by both parties.

The United States Postal Service OIG concluded that the Postal Service has taken actions to address the three recommendations made in 2003. However, the Postal Service OIG encouraged the Postal Service to continue to work with Customs and Border Protection to expand and implement a nationwide outbound mail inspection program to search outbound mail and ensure compliance with export administration regulations.

Followup on Previous Interagency Reviews

As required by the National Defense Authorization Act for FY 2001, Appendix I (Volume II) provides details on recommendations from previous years' agency-specific and interagency reports.

Recommendations and Management Comments

There are no interagency recommendations in this year's report; therefore, management comments are not required. The participating OIGs made recommendations specific to their own agencies. Recommendations, management comments, and OIG responses are included in the separate reports that each office issued. They may be found in Appendix B-1 and B-2 (Commerce), Appendix C (Defense), Appendix D (Energy), Appendix E (State), Appendix F (Treasury), Appendix G (United States Postal Service), and Appendix H (Homeland Security). Appendixes B, C, D, E, F, and G are in Volume I, and Appendix H is in Volume II. A status report on recommendations from previous interagency reviews is in Volume II. Appendixes J and K, in Volume III, contain the

classified results of work completed by the Central Intelligence Agency and the Department of Commerce.

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[1] FOUO – For Official Use Only

[2] NOFORN – No Foreign National

Background

The United States controls the export of dual-use commodities[1] and munitions[2] for national security and foreign policy purposes under the authority of several laws, primarily the Export Administration Act of 1979[3] and the Arms Export Control Act of 1976. Commodities are subject to the licensing requirements contained in the Export Administration Regulations for dual-use commodities or the International Traffic in Arms Regulations for munitions.

Public Law 106-65, "National Defense Authorization Act for FY 2000," requires that the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Directors of Central Intelligence and the Federal Bureau of Investigation, conduct an annual review of the adequacy of export control policies and procedures in the U.S. Government. In addition, the Public Law requires the annual review be conducted not later than March 30th of each year beginning in the year 2000 and ending in the year 2007. An amendment to the National Defense Authorization Act for FY 2001 requires the Inspectors General to report on the status of recommendations made in prior annual reports.

To comply with the first-year requirement of the Act, the OIGs conducted agency-specific and interagency reviews of compliance with license requirements for releasing export-controlled technology to foreign nationals in the United States. Also, the OIGs reviewed Government actions to protect against the illicit transfer of U.S. technology through select intelligence, counterintelligence, and foreign investment reporting and enforcement activities. We issued two interagency reports to fulfill the first-year requirement of the Act: Report No. D-2000-109, "Interagency Review of the Export Licensing Process for Foreign National Visitors," issued on March 24, 2000, and Report No. 00-OIR-05, "(U) Measures to Protect Against the Illicit Transfer of Sensitive Technology," issued on March 27, 2000.

To meet the second-year requirement of the Act, the OIGs conducted an interagency review to assess policies and procedures for developing, maintaining, and revising the Commerce Control List and the U.S. Munitions List. The interagency report, D-2001-092, "Interagency Review of the Commerce Control List and the U.S. Munitions List," was issued in March 2001.

To achieve the third-year requirement of the Act, the OIGs conducted an interagency review of the Federal automation programs that support the export licensing and enforcement process. That interagency report, D-2002-074,

[1] Dual-use commodities can be used for commercial or military purposes.

[2] Munitions can be military weapons, ammunition, and equipment.

[3] Although the act expired on August 21, 2001, the President extended existing export regulations under Executive Order 13222, dated August 17, 2001, invoking emergency authority under the International Emergency Economic Powers Act.

"Interagency Review of Federal Automated Export Licensing Systems," was issued in March 2002.

To accomplish the fourth-year requirement of the Act, the OIGs conducted an interagency review of U.S. Government actions to enforce export controls and prevent or detect the illegal transfer of militarily sensitive technology to countries and entities of concern. That interagency report, D-2003-069, "Interagency Review of Federal Export Enforcement Efforts," was issued in April 2003.

To complete the fifth-year requirement of the Act, the OIGs conducted an interagency review on the release of export-controlled technology to:

- foreign nationals at U.S. academic institutions,
- Federal contractors and other private companies, and
- research facilities.

That interagency report, D-2004-062, "Interagency Review of Foreign National Access to Export-Controlled Technology in the United States," was issued in April 2004.

To attain the sixth-year requirement of the Act, the OIGs conducted an interagency review to assess whether the current export licensing process could help deter the proliferation of chemical and biological commodities. An interagency report, D-2005-043, "Interagency Review of the Export Licensing Process for Chemical and Biological Commodities," was issued on June 10, 2005.

For the seventh-year requirement of the Act, the OIGs conducted an interagency review of controls over exports to China. An interagency report, D-2007-050, "Interagency Review of U.S. Export Controls For China," was issued on January 31, 2007.

For the eighth and final year's requirement of the Act, the OIGs followed up on Federal managers' implementation of the recommendations made from FY 2000 through FY 2006.

Responsibilities of Federal Entities Related to U.S. Export Controls

Agriculture. The Public Health Security and Bioterrorism Preparedness and Response Act of 2002, Title II, Subtitle B, was enacted to enhance controls over dangerous biological agents or toxins. The Act requires that the Secretary of Agriculture, through regulations, establish and maintain a list of each biological agent and each toxin that is determined to have the potential to pose a severe threat to animal or plant health, or to animal or plant products. It also requires that the Secretary establish procedures to protect animal and plant health and animal and plant products in the event of a transfer of biological agents.

The Animal and Plant Health Inspection Service (APHIS) was delegated authority to administer the regulations for the U.S. Department of Agriculture. The Public Health Security and Bioterrorism Preparedness and Response Act of 2002 did not address exports.

Commerce. The Department of Commerce's Bureau of Industry and Security (BIS) administers the Export Administration Regulations by developing export control policies and regulations, issuing export licenses, and enforcing the laws and regulations for dual-use exports. After BIS conducts its initial review, a license application is referred to the Defense, Energy, and State departments, unless those agencies have delegated their decision-making authority to the Department of Commerce.

If the application involves an item controlled for reasons relating to the protection of encryption technologies, Commerce also refers it to the Justice Department. In addition, prior to 2008 BIS referred all export license applications to the Central Intelligence Agency's Center for Weapons Intelligence, Nonproliferation, and Arms Control (WINPAC) for an end-user review.

Defense. Although the Departments of Commerce and State are responsible for issuing export licenses, the Department of Defense reviews license applications and recommends approval, approval with conditions, or denial of licenses involving dual-use and munitions commodities or technology. The Defense Technology Security Administration (DTSA) serves as the Department's focal point for processing license applications and advises the Under Secretary of Defense for Policy on issues related to the transfer of sensitive technology and the export of dual-use items and munitions. DTSA also assists in developing export control policies and procedures that are necessary to protect U.S. national security interests.

Energy. The Energy Department's Office of International Regimes and Agreements reviews license applications and recommends approval, approval with conditions, or denial of licenses. Energy reviews licenses involving nuclear, chemical, biological, and missile dual-use and munitions commodities or technology referred to it by the Commerce and State Departments. Also, Energy's Office of Foreign Visits and Assignments establishes Energy policies for the review and processing of visits and assignments by foreign nationals to Energy.

Homeland Security. As an enforcement arm at U.S. ports for the State and Commerce Departments, the Department of Homeland Security's Customs and Border Protection (CBP) is responsible for ensuring that licensable exports are processed in accordance with applicable laws and regulations. CBP uses the Immigration and Customs Enforcement Exodus Command Center as a liaison with the State and Commerce Departments to answer questions that may arise as to whether a shipment is licensable. CBP officers are directed to send any such questions to the Exodus Command Center for resolution.

State. Under the Arms Export Control Act, the State Department's Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (PM/DDTC)

administers the International Traffic in Arms Regulations (ITAR). The Bureau of Political-Military Affairs administers the ITAR by:

- developing export control policies,
- registering companies and academic institutions to export munitions,
- issuing licenses and compliance provisions, and
- maintaining the U.S. Munitions List.

Also, the State Department reviews munitions export licenses and approves, conditionally approves, or disapproves an applicant's license, including those related to the release of export-controlled technology to foreign nationals in the United States.

Treasury. The Office of Foreign Assets Control (OFAC) administers and enforces economic and trade sanctions against targeted foreign countries, terrorism sponsoring organizations and international narcotics traffickers, based on U.S. foreign policy and national security goals. OFAC regulations require exporters, importers, and others under U.S. jurisdiction to obtain OFAC licenses prior to engaging in any type of commercial transactions with targeted countries or nationals.

Central Intelligence Agency. During fiscal year 2006, the Central Intelligence Agency (CIA) provided intelligence support to the Department of Commerce on dual-use license applications and to the Department of State on munitions license applications. CIA analysts reviewed comprehensive intelligence records to provide information to these agencies that will assist them with making decisions to approve or deny licenses.

In 2006, the Department of Commerce's BIS submitted license applications to the Directorate of Intelligence's WINPAC for review. In addition, to providing intelligence support to BIS, WINPAC analysts and experts were also actively involved in export licensing advisory and oversight groups. As of 1 October 2007, WINPAC scaled back its level of export license application support to the Department of Commerce due to budget constraints. WINPAC personnel will continue to support the export licensing advisory and oversight groups, but will review export license applications only when requested by a member of the dispute resolution committees.

United States Postal Service. Although Export Administration Regulations grant Postal Service officials the authority to inspect items declared for export, the Postal Service is prohibited by law from opening mail that is sealed against inspection without a warrant, unless exigent circumstances exist (for example, where the screening of the mail has disclosed the presence of materials that pose a physical threat to persons or property).

As a result, the Postal Service works with the Bureau of Customs and Border Protection (CBP) to coordinate enforcement activities concerning outbound mail and ensure compliance with export control laws and regulations. CBP personnel

are authorized to open and inspect mail and are co-located at postal facilities nationwide.

Objective

The main objective of the 2007 review was to determine whether management effectively addressed recommendations in previous reports required by the National Defense Authorization Act.[4]

Implementation of Recommendations for Controls Over Exports

The interagency review identified agency-specific areas lacking adequate controls because prior recommendations were not implemented. However, this year's interagency report contains no findings or recommendations. Therefore, management comments are not required.

The participating OIGs made specific recommendations for their own agencies. Those recommendations, management comments, and OIG responses are included in the separate reports that each office issued. See Appendixes B through H, as well as J and K.

[4] The Department of Commerce OIG also conducted a separate review of U.S. dual-use export controls for India.

Appendix A. Scope and Methodology

Interagency Scope

This interagency review assessed the effectiveness of the U.S. Government's export control policies and practices for preventing the unauthorized transfer of sensitive U.S. technology to countries and entities of concern. Specifically, we examined whether our prior recommendations—made from 2000 through 2006—were implemented by management to improve export control policies and procedures.

From 2000 through 2006, 9 OIGs issued 49 reports and made 271 recommendations to improve Federal export control policies and procedures. This report provides the status of Federal managers' implementation of those recommendations.

The participating review teams, from 2000 through 2006, represented the Inspectors General of the Departments of Agriculture, Commerce, Defense, Energy, Homeland Security, State, and the Treasury; the Central Intelligence Agency; and the United States Postal Service.

Interagency Methodology

The nine OIG teams* participated in an interagency working group and held monthly meetings while conducting agency-specific reviews. Those reviews focused on following up on recommendations made in previous OIG reports on controls over exports.

This report summarizes the work completed by eight interagency OIG working group teams. The seven unclassified OIG reports are contained in Volume I, a For Official Use Only report is in Volume II, and a SECRET//NOFORN report and appendixes from the Central Intelligence Agency OIG and the Commerce OIG reports, respectively, are in Volume III. The interagency review was performed between June 2006 and July 2007.

* The Department of Agriculture OIG made two recommendations in March 2005. These recommendations were implemented by the Department of Agriculture. Therefore, it was not necessary that the Department of Agriculture OIG issue a followup report.

Appendix B-1. Department of Commerce Report

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

BUREAU OF INDUSTRY AND SECURITY

U.S. Dual-Use Export Controls for India Should Continue to Be Closely Monitored

Final Report No. IPE-18144/March 2007

PUBLIC RELEASE

Office of Inspections and Program Evaluations

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

March 30,2007

MEMORANDUM FOR: Mark Foulon
Acting Und

FROM: Johnnie E. Frazier

SUBJECT: Final Report: *U.S. Dual-Use Export Controls for India Should Continue to Be Closely Monitored* (IPE-18144)

As a follow-up to our February 23,2007, draft report, attached is our final report on dual-use export controls for India, the eighth report required by the National Defense Authorization Act for Fiscal Year 2000, as amended. As you know, the act mandates that we issue a report to the Congress on the policies and procedures of the U.S. government with respect to the export of technologies and technical information to countries and entities of concern by March 30 of each year through 2007.

While our review found that coordination between the various federal export licensing agencies was adequate during the dispute resolution process for export license applications involving India, we identified several areas of concern related to U.S.-India export control activities. We offer a number of specific recommendations beginning on page 27 that we believe will help strengthen these activities, if implemented. This report contains three classified appendixes that have been provided under separate cover. Appendix D discusses implementation of the Next Steps in Strategic Partnership and is classified SECRET. Appendix E is classified CONFIDENTIAL and highlights concerns related to BIS' end-use check program in India. Appendix F contains a summary of the classified recommendations and is classified SECRET.

We are pleased to note that BIS, in its written response to our draft report, indicated that it plans to take action on many of our recommendations. We request that you provide us with an action plan addressing the status of the recommendations in our report within 60 calendar days.

We thank you and other members of the BIS staff for your assistance and courtesies extended to us during our review. If you would like to discuss this report or the requested action plan, please call me at (202) 482-4661 or Jill Gross, Assistant Inspector General for Inspections and Program Evaluations, at (202) 482-2754.

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SUMMARY

The Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Director of Central Intelligence and the Director of the Federal Bureau of Investigation, are required by the National Defense Authorization Act (NDAA) for Fiscal Year 2000 to conduct an 8-year assessment of whether export controls and counterintelligence measures are adequate for preventing the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. The NDAA mandates that the Inspectors General report their findings to Congress no later than March 30 of each year, until 2007.

To satisfy the NDAA's FY 2007 reporting requirement, the Commerce Office of Inspector General assessed the effectiveness of BIS' export control program for India in conjunction with a separate review to determine the status of prior-year recommendations involving dual-use licensing and enforcement activities. We examined (1) whether BIS' export control policies, practices, and procedures for India are clear, documented, and designed to achieve the desired goals; (2) whether BIS personnel are following the prescribed policies, practices, and procedures relating to India; and (3) how effective BIS is in detecting and preventing the diversion of sensitive commodities to weapons of mass destruction-related programs (either within or outside India).

Following the nuclear tests conducted by both India and Pakistan in May 1998, the United States imposed economic sanctions on both countries. However, in 2001, the President eliminated the sanctions and committed the United States to a "strategic partnership" with India—representing a major change in India-U.S. relations. At that time, both countries agreed to greatly expand cooperation on a wide range of issues, including counterterrorism, regional security, space and scientific collaboration, civilian nuclear safety, and broadened economic ties. Toward that end, BIS has played an active and key role in improving relations with India. Its most direct involvement began in 2002 with the establishment of the U.S.-India High Technology Cooperation Group (HTCG), designed to provide a forum for discussing high-technology issues of mutual interest and to broaden dialogue and cooperation in the area of export controls.[1]

As the world's fastest growing free-market democracy, India presents lucrative and diverse opportunities for U.S. exporters along with unique challenges to U.S. export control policy. In 2005 the value of U.S. merchandise exports to India totaled almost $8 billion—up 30 percent from 2004[2] and nearly double the 2002 figure.[3] BIS reports that only about 1 percent of total U.S. exports to India require an export license, and the agency approves most exports that do require a license provided such items do not contribute to India's nuclear, missile, or chemical and biological weapons programs. Although India is recognized as a democratic partner in the fight against terrorism and as a counterbalance to China, concerns have been raised by nonproliferation specialists about its nuclear capabilities and intentions. As current U.S. policy moves toward "full civil nuclear cooperation" with India, a critical question needs to be

[1]Matthew Borman, Deputy Assistant Secretary for Export Administration, *Overview of U.S.-India Dual-Use Export Policies and Procedures* (presentation given to Indian industry in New Delhi on November 21, 2003).
[2]U.S. Trade Representative, 2006, *National Trade Estimate Report on Foreign Trade Barriers.* Washington, D.C., page 300.
[3]Department of Commerce, U.S. Commercial Service, November 29-December 5, 2006, *Official Mission Statement*.

answered: Does the U.S. government have the capability to implement effective export controls to help ensure U.S. exports to India do not contribute—either directly or indirectly—to Indian nuclear weapons or missile programs?

The number of India export license applications received by BIS increased 30 percent from FY 2002 to FY 2005, but decreased 19 percent from FY 2005 to FY 2006. This decline is attributable to a reduction in licensing requirements for exports to India. The most significant changes occurred in 2005, namely (1) elimination of export and reexport license requirements for most end users in India for items controlled unilaterally by the United States for nuclear nonproliferation reasons, (2) removal of the Indian Space Research Organization (ISRO) headquarters from BIS' Entity List,[4] and (3) elimination of licensing requirements for exports of EAR99 items[5] to several ISRO subordinate entities.

Our review of India export license applications that were escalated to the interagency dispute resolution process in fiscal years 2005 and 2006 found that coordination between the various federal export licensing agencies was adequate. However, our overall review of U.S.-India export control activities identified the following concerns that warrant management's attention:

[4]The Entity List, established in February 1997 by BIS, identifies individuals, groups, organizations, and other entities whose activities offer the potential for diverting exported and reexported items into programs related to weapons of mass destruction. The EAR imposes additional export license requirements for transactions involving listed entities.
[5]EAR99 essentially serves as a "basket" designation for items that are subject to the Export Administration Regulations (EAR) but not listed on the Commerce Control List. EAR99 items can be shipped without a license to most destinations under most circumstances unless certain prohibitions apply (e.g., export to an embargoed destination). The majority of U.S. exports are EAR99 items.
[6]George W. Bush, January 12, 2004. *President's Statement on Strategic Partnership with India*, http://www.whitehouse.gov/news/releases/2004/01/20040112-1.html (accessed January 31, 2007). Alan K. Kronstadt, April 6, 2006. *India-U.S. Relations*, CRS Issue Brief for Congress, IB93097.
[7]*Joint Statement Between President George W. Bush and Prime Minister Manmohan Singh*, July 18, 2005 (http://www.whitehouse.gov/news/releases/2005/07/20050718-6.html (accessed January 31, 2007).

steps outlined under the NSSP. We discuss this issue and our concerns in Appendix D,

We also found a problem with BIS' Entity List—a list of entities worldwide for which the U.S. government requires a license for virtually all items subject to the EAR. Some Indian entities on the list are not clearly identified, which raises the risk that U.S. exporters could inadvertently export controlled dual-use items to these entities without the required license. The Entity List contains 12 Indian entities identified by name along with 3 "types" of Indian end users (e.g., nuclear reactors not operating under International Atomic Energy Agency safeguards. At least 2 of 29 license applications were escalated to the interagency dispute resolution process in FY 2005 because of questions about whether the Indian entity on the application was covered under one of these broad designations of end users (see page 13).

BIS' End-Use Check Program in India Needs to Be Improved. End-use checks seek to verify the legitimacy of dual-use export transactions controlled by BIS. A pre-license check (PLC) is used to validate information on export license applications by determining if an overseas person or firm is suitable for a transaction involving controlled U.S.-origin goods or technical data. Post-shipment verifications (PSVs) strengthen assurances that exporters, shippers, consignees, and end users are complying with the terms of export licenses, by determining whether goods exported from the United States were actually received by the party named on the license and are being used in accordance with license provisions. BIS has an export control officer (ECO) stationed in India to conduct end-use checks.

Our review of BIS' India end-use check program identified several weaknesses. First, the September 2004 End-Use Visit Arrangement between the U.S. Department of Commerce and the Indian Ministry of External Affairs–designed to strengthen existing commitments on export controls—actually limits the effectiveness and utility of end-use checks in India. In addition, while end-use checks involving Indian private sector entities are generally conducted in a timely manner, those involving Indian government or government-affiliated entities have not always been conducted within prescribed time frames. We also found that BIS has not set clear and consistent time frames for two parts of its internal end-use check process: (1) initiating PSVs upon receipt of required shipping documents and (2) notifying the Ministry of External Affairs about end-use check requests.

Furthermore, we determined that BIS failed to follow its end-use check criteria for two PLCs that were cancelled but should have been rated as "unfavorable" because the government entity involved failed to cooperate in the checks. Finally, although the U.S. government is concerned about diversions of sensitive exports to programs involving weapons of mass destruction (either within or outside India), BIS did not adequately target PSVs to help determine whether diversions were occurring. We detail our concerns about these issues in Appendix E, End-Use Checks in India, classified CONFIDENTIAL.

BIS Needs to Enhance Its Efforts to Ensure Compliance with License Conditions. Placing conditions on a license is the U.S government's way of better controlling and monitoring certain shipments. However, license conditions only have the desired effect when exporters and/or end users fully comply with them. In general, BIS has put adequate procedures in place over the last

few years, in response to OIG recommendations, to help ensure compliance with license reporting conditions.[8] However, we found that Export Administration and Export Enforcement, both of which have responsibility for monitoring compliance with certain license conditions, need to improve their implementation of these procedures.

Within Export Administration, we determined that some licensing officers did not fully adhere to BIS procedures for requiring exporters or end users to fulfill the license reporting conditions, that is, to submit documentation related to the shipment. For 5 of the 13 India licenses we identified as having reporting conditions, the licensing officer did not mark the licenses for follow-up. In addition, Export Administration issued a memorandum on May 9, 2006, requiring licensing officers to review technical documentation submitted pursuant to a license condition if the documentation was requested because of BIS national security concerns with the transaction. However, the memorandum specifically excludes those licenses involving reporting conditions placed on a license by the Defense Department unless BIS licensing officers also have a concern with the transaction. As a result, 10 of the 13 India licenses were not marked for licensing officer review because the technical reporting condition was placed by Defense. However, BIS has the authority to administer and enforce the EAR and, as such, is ultimately responsible for monitoring *all* conditions placed on a dual-use license. Furthermore, we determined that staff from the Office of Exporter Services (OExS) were not fully aware of the reporting conditions they were required to monitor, and they were not properly referring noncompliant exporters to Export Enforcement. This breakdown in Export Administration's monitoring process might diminish the deterrent effect that license conditions can have on potential violators (see page 18).

Within Export Enforcement, we found that the Office of Enforcement Analysis (OEA) is not fully adhering to its guidance for monitoring or enforcing compliance with licenses that contain condition 14, which requires exporters to notify OEA within 30 days that a shipment pertaining to a license has taken place. It is one of the most critical conditions placed on a license, because the interagency licensing agencies decided that a PSV was needed to determine whether the goods or technology were being used in accordance with the license provisions. But the PSV cannot be initiated until the shipment has actually taken place. Our review of 24 India licenses containing condition 14 determined that 11 exporters submitted their shipping documents to BIS between 12 to 1,158 days after the 30-day deadline. In fact, of the cases where a PSV was requested, 8 out of 24 PSVs were initiated more than 100 days after shipment. This delay diminishes the possibility of detecting diversions or other violations of license terms and conditions. We also found that OEA (1) recommended approval for additional licenses to exporters that had previously not fully complied with the condition 14 reporting requirement, and (2) did not refer noncompliant exporters to the Office of Export Enforcement for appropriate action (see page 22).

On page 27, we summarize the unclassified recommendations we are making to address our concerns. A summary of classified recommendations can be found in Appendix F, which is SECRET.

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[8]U.S. Department of Commerce Office of Inspector General, June 1999. *Improvements Are Needed to Meet the Export Licensing Requirements of the 21st Century*, IPE-11488; Commerce OIG, March 2003. *Improvements Are Needed to Better Enforce Dual-Use Export Control Laws*, IPE-15155; Commerce OIG, March 2006. *U.S. Dual-Use Export Controls for China Need to be Strengthened*, IPE-17500.

BIS Response to OIG Draft Report and OIG Comments

In its March 23, 2007, written response to our draft report, BIS indicated that it was still in the process of reviewing some of the recommendations while taking steps to address others. The response also highlighted BIS' belief that India has fulfilled its commitment under the Next Steps in Strategic Partnership. Where appropriate, we have made changes to the report in response to both formal and informal comments from BIS. We also discuss pertinent aspects of BIS' response in appropriate sections of the report. The complete responses from BIS are included as appendixes to the unclassified and classified reports.

BACKGROUND

The United States controls the export of dual-use items for national security, foreign policy, and nonproliferation reasons under the authority of several different laws. Dual-use items are commodities, software, and technologies that have predominantly civilian uses, but also can have military, proliferation, and terrorism-related applications. The primary legislative authority for controlling the export of dual-use commodities is the Export Administration Act of 1979, as amended, which is implemented through the Export Administration Regulations (EAR).[1]

The Department of Commerce's Bureau of Industry and Security (BIS) administers the EAR by developing export control policies and regulations, issuing export licenses, and enforcing the laws and regulations for dual-use exports. In FY 2006, BIS had 353 full-time equivalent staff members and an appropriation of approximately $75 million. Its two operating units principally responsible for export controls are Export Administration and Export Enforcement.

U.S.-India Relations and Dual-Use Export Control Concerns

The U.S.-India relationship has undergone a significant transformation since the end of the Cold War. Both countries, "politically and economically distant" for almost half of the late 20th century, are now finding a common ground with respect to their national interests.[2] As the world's fastest growing free-market democracy, India presents lucrative and diverse opportunities for U.S. exporters.[3] In 2005, U.S. merchandise exports to India were almost $8 billion, 30 percent higher than in 2004 and nearly double the 2002 figure. Corresponding U.S. imports from India were $18.8 billion in 2005, up 20.8 percent from the previous year.[4] India is the 22nd largest export market for U.S. goods,[5] and its requirements for equipment and services in the infrastructure, transportation, energy, environmental, health care, high-tech, and defense sectors are expected to exceed tens of billions of dollars in the coming years.[6]

U.S. Export Control Policies and Practices Toward India

India presents unique challenges to U.S. export control policy. Although India is recognized as a democratic partner in the fight against terrorism and as a counterbalance to China, nonproliferation experts have raised concerns about India's nuclear capabilities and intentions. Following the nuclear tests conducted by India and Pakistan in May 1998, the United States

[1] 50 U.S.C app. sec. 2402(2). Although the act expired on August 20, 2001, Congress agreed to the President's request to extend existing export regulations under Executive Order 13222, dated August 17, 2001, as extended by the Notice of August 3, 2006, 71 FR 44551 (August 7, 2006), thereby invoking emergency authority under the International Emergency Economic Powers Act.
[2] U.S. Department of Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement: Under Secretarial Business Development Mission to India.* Washington, DC.
[3] With more than one billion residents, India is the second most populous country and the largest democratic republic in the world.
[4] U.S. Trade Representative, 2006. *National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C., p. 300. Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement.*
[5] U.S. Trade Representative, 2006. *National Trade Estimate Report on Foreign Trade Barriers*, p. 300.
[6] Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement.*

imposed economic sanctions on both countries.[7] At that time, the U.S. government implemented a licensing policy of denial for exports and reexports of items controlled for nuclear nonproliferation and missile technology reasons to India (and Pakistan), with limited exceptions.

In September 2001, President George W. Bush waived the sanctions against India (and Pakistan) and, subsequently, the policy of denial for exports and reexports of items controlled for nuclear nonproliferation and missile technology reasons changed to a case-by-case review. Then, in November 2001, President Bush and then-Indian Prime Minister Atal Bihari Vajpayee committed the United States and India to a strategic partnership, that among other things envisioned full civil nuclear cooperation between the United States and India and reversed almost 30 years of U.S. nonproliferation policy toward that country. Both countries also agreed to greatly expand cooperation on counterterrorism, regional security, space and scientific collaboration, and broadened economic ties. Since that time, two initiatives regarding relations between the United States and India have received wide public attention. The first was what has become known as the Next Steps in Strategic Partnership (NSSP), announced in January 2004. Under the NSSP, the United States and India agreed to increase cooperation in civilian nuclear activities, civilian space programs, and high-technology trade, and expand their dialogue on missile defense. The initiative was to proceed through a series of reciprocal steps that built on each other. They included nuclear safety issues and regulatory changes that would enhance trade in high-technology dual-use goods.[8]

The second major announcement—coinciding with the reported completion of the NSSP—came on July 18, 2005, when President Bush and Prime Minister Manmohan Singh jointly declared that they were committed to transforming the relationship between the United States and India and establishing a "global partnership." Their statement highlighted five broad areas of agreement and cooperation: economic development; energy and the environment; democracy and development; nonproliferation and security; and high-technology and space. In his speech, the President recognized India's "strong commitment" to preventing the proliferation of weapons of mass destruction and noted that "as a responsible state with advanced nuclear technology, India should acquire the same benefits and advantages as other such states." The President added that he would "…work to achieve full civil nuclear energy cooperation with India as it realizes its goals of promoting nuclear power and achieving energy security." However, the President also acknowledged that this would require adjustment to U.S. law (e.g., the Atomic Energy Act of 1954, as amended),[9] and policy as well as international export control regimes (e.g., Nuclear Suppliers Group, which controls items or technologies that could be used in nuclear weapons).[10]

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[7]The sanctions were imposed pursuant to Section 102 (b)(2) of the Arms Export Control Act, also known as the Glenn Amendment of 1994. The Act requires that the President impose sanctions against a "non-nuclear-weapon" state if it "detonates a nuclear explosive device."

[8]George W. Bush. *President's Statement on Strategic Partnership with India*, January 12, 2004, http://www.whitehouse.gov/news/releases/2004/01/20040112-1.html (accessed January 31, 2007); Kronstadt, Alan K. *India-U.S. Relations*, CRS Issue Brief for Congress, April 6, 2006, IB93097.

[9]42 U.S.C. 2153. The Atomic Energy Act prohibits the transfer of nuclear materials and technology to countries that are not signatories to the Treaty on the Non-Proliferation of Nuclear Weapons.

[10]*Joint Statement Between President George W. Bush and Prime Minister Manmohan Singh*, July 18, 2005 (http://www.whitehouse.gov/news/releases/2005/07/20050718-6.html (accessed January 31, 2007).

Toward this end, the U.S. Congress passed and the President signed the United States-India Peaceful Atomic Energy Cooperation Act of 2006 on December 18, 2006. The act enables the United States to enter into an agreement for nuclear cooperation with India if the President makes a determination that various actions have occurred.[11] For instance, the President must find that India has provided the United States and the International Atomic Energy Agency with a credible plan to separate civil and military nuclear facilities, materials, and programs, and has filed a declaration regarding its civil facilities and materials with the International Atomic Energy Agency. The President must also find that India is taking the necessary steps to secure nuclear and other sensitive materials and technology, including:

- Enactment and effective enforcement of comprehensive export control legislation and regulations;
- Harmonization of its export control laws, regulations, policies, and practices with the guidelines and practices of the Missile Technology Control Regime and the Nuclear Suppliers Group; and
- Adherence to the Missile Technology Control Regime and the Nuclear Suppliers Group (NSG) in accordance with the procedures of those regimes for unilateral adherence.

According to BIS, as a result of the HTCG work and in conjunction with the NSSP, the U.S. government eliminated approximately 25 percent of the licensing requirements for exports to India by removing some Indian entities from the Entity List[13] and dropping most unilateral export controls. As a result, U.S. firms can export many formerly controlled items to India

[11]These actions were specified in Section 104 (b) of the Henry J. Hyde United States-India Peaceful Atomic Energy Act of 2006, December 18, 2006.
[12]BIS, November 21, 2003. *Overview of U.S.-India Dual-Use Export Policies and Procedures*, Presentation by Matthew Borman, Deputy Assistant Secretary for Export Administration.
[13]The EAR contains an Entity List that imposes increased export license requirements for transactions involving certain "listed" entities (e.g. companies, organizations, persons). The Entity List was established in February 1997 to inform the public of entities whose certain activities impose a risk of diverting exported and reexported items into programs related to weapons of mass destruction. The list may also include entities sanctioned by the State Department for which United States foreign policy goals are served by imposing additional license requirements on exports and reexports to those entities. The list contains entities from a variety of countries including China, India, Israel, and Pakistan. See chapter I for a discussion about Indian entities on the list.

without a license or under a license exception.[14] BIS reports that approximately 1 percent of total U.S. exports to India require an export license and that it approves most of the exports of controlled items provided that such items would not be used in unsafeguarded nuclear activities, ballistic missiles, or space launch vehicle programs or otherwise be diverted to uses contrary to U.S. policy.

The United States currently controls dual-use exports to India that have potential applications for chemical and biological, nuclear weapons, or missile technology, or that can impact regional stability, national security, and crime control. These controls are primarily derived from multilateral export control regimes, and the list of items controlled is mutually agreed upon by participating countries. There are no U.S. sanctions currently in place against the Indian government, although several Indian entities have U.S. sanctions placed on them for proliferations reasons.

Dual-Use License Application Process for Exports to India

License applications received by BIS are entered into the Export Control Automated Support System (ECASS),[15] where they are screened to determine whether the listed parties have registration numbers or need numbers assigned. ECASS flags applications that require referral to the Office of Export Enforcement (OEE), and sends them simultaneously to OEE and licensing officers in Export Administration. All other applications are referred only to the licensing officers for processing.

According to Executive Order 12981,[16] BIS has 9 days to conduct its initial review of a license application, during which the licensing officer first verifies the export control classification number (ECCN) the applicant obtained from the Commerce Control List (CCL)—a listing of commodities, software, and technology subject to BIS' export licensing authority. Items subject to the EAR but not listed on the CCL are designated as "EAR99."[17]

After verifying the ECCN, the licensing officer reviews the related license requirements and exceptions, determines the reasonableness of the end use specified by the exporter, and documents the (1) licensing history of the exporter and ultimate consignee or end users, and (2) reasons for not referring an application to the other licensing agencies (if applicable). The licensing officer provides a written recommendation on whether to approve or deny the application, and refers it to the Departments of Defense, Energy, and State unless those licensing referral agencies have delegated their decision-making authority to Commerce.[18]

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[14]According to the BIS, a license exception is an authorization granted by BIS that allows exports or reexports of items subject to the EAR that would otherwise require a license.
[15]ECASS is an unclassified system that BIS uses to process and store its dual-use export licensing information.
[16]*Administration of Export Controls*, December 5, 1995.
[17]EAR99 essentially serves as a "basket" designation for items that are subject to the EAR but not specifically listed on the CCL by an ECCN. EAR99 items can be shipped without a license to most destinations under most circumstances unless certain prohibitions apply (e.g., export to an embargoed destination). The majority of U.S. exports are EAR99 items.
[18]BIS refers licenses to the Department of Justice only when the item is controlled for reasons relating to the protection of encryption technologies. As such, per Executive Order 13026, the Department of Justice is a voting representative at all levels of the dispute resolution process for encryption cases (including the Operating Committee, the Advisory Committee on Export Policy, and the Export Administration Review Board).

In addition, BIS requires that its licensing officers forward all India export license applications (with the exception of deemed export license applications and EAR99 items without red flags)[19] to the CIA's Weapons Intelligence, Nonproliferation, and Arms Control Center for an end-user review.

Under Executive Order 12981, each licensing referral agency must provide a recommendation to approve or deny the license application and all related required information to the Secretary of Commerce within 30 days of receiving the referral. To deny an application, a referral agency or BIS is required to cite both the statutory and regulatory basis for denial, consistent with the provisions of the EAA and the EAR. An agency that fails to provide a recommendation within 30 days is deemed to agree with the decision of the Secretary of Commerce (see appendix B for a flow chart depicting the licensing process).

In FY 2006, all export licenses for India were issued with conditions that subjected the exporter to certain restrictions. The conditions are primarily used to control proliferation of the commodity by limiting the end-use or restricting access to the commodity to specific end users (see chapter III for more discussion on license conditions).

Dispute Resolution Process for India Export License Applications

If there is disagreement on whether to approve a pending license application after the 30-day review period or if there is disagreement on the conditions of approval, the application is referred to a higher-level interagency working group called the Operating Committee (OC), which meets weekly (see figure 1 for the number of India export license applications escalated to the OC in FYs 2005 and 2006). Under Executive Order 12981, the OC has voting representatives from the Departments of Commerce, Defense, Energy, and State. Nonvoting members of the OC include appropriate representatives of the CIA and the Joint Chiefs of Staff. The Secretary of Commerce appoints the OC chairman, who considers the recommendations of the referral agencies before making a decision. With one exception, the chairman's decision does not have to follow the recommendations of the majority of the participating agencies, though we found that the chair's decisions for India cases generally

Figure 1: Determinations for India Export License Applications Escalated to the Operating Committee (FY2005 and 2006)

Source: BIS

[19]Red flags indicate possible violators or violations of the EAR.

did reflect interagency consensus.[20] If any of the voting agencies disagree with the OC decision, they have 5 days to appeal.

Appeals at the OC level escalate the decision to the Advisory Committee on Export Policy (ACEP). The ACEP meets monthly if there are applications to decide. It is chaired by the Commerce Assistant Secretary for Export Administration and consists of Assistant Secretary-level voting representatives from the Departments of Defense, Energy, and State. Nonvoting representatives are drawn from the CIA and the Joint Chiefs of Staff. The ACEP's decision is based on a majority vote. In FY 2005, one India export license was escalated to the ACEP; it was ultimately approved with conditions. Two India export license applications were escalated to the ACEP in FY 2006, and both were approved with conditions.

An agency that disagrees with an ACEP decision has 5 days to appeal to the Export Administration Review Board (EARB). The Secretary of Commerce chairs the EARB, whose voting members also include the Secretaries of Defense, Energy, and State. The chairman of the Joint Chiefs of Staff and the director of Central Intelligence are nonvoting members. The EARB's decision is based on a majority vote and a dissenting agency has 5 days to make a final appeal to the President. No export license application for India was escalated to the review board in either FY 2005 or FY 2006.

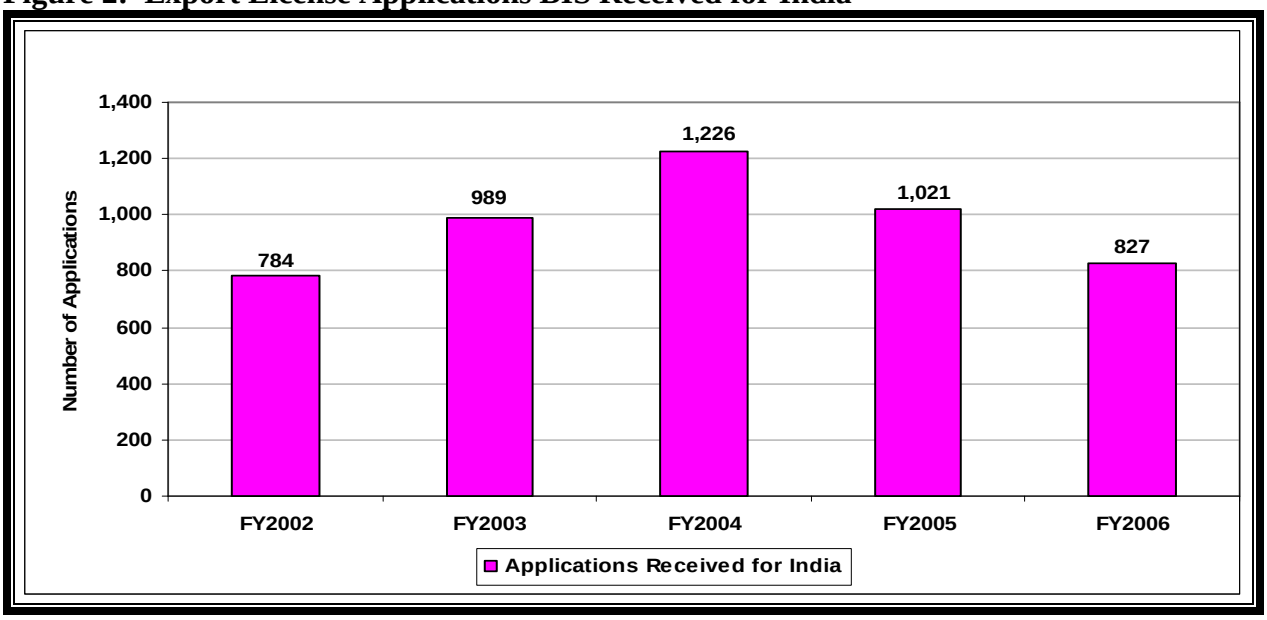
Overall, we found that the interagency escalation process for disputed India export license applications allows dissenting agencies a meaningful opportunity to seek additional review of such cases.

India Export License Application Trends

During FYs 2002 through 2004, the number of dual-use export license applications received for India increased approximately 56 percent from 784 to 1,226. However by FY 2006, this number dropped by approximately 30 percent (see figure 2). Of the 18,698 export license applications BIS received during FY 2006, 827 (approximately 4.4 percent) were for exports to India. A reduction in the number of dual-use export license applications for India is attributable to fewer license requirements, as a result of the NSSP and the ongoing work of the HTCG.

[20]Executive Order 12981, as amended, provides one exception to this rule for " . . . license applications concerning commercial communication satellites and hot-section technologies for the development, production, and overhaul of commercial aircraft engines . . . ." For these applications, the OC chair is to report the "majority vote decision of the OC" rather than his/her decision.

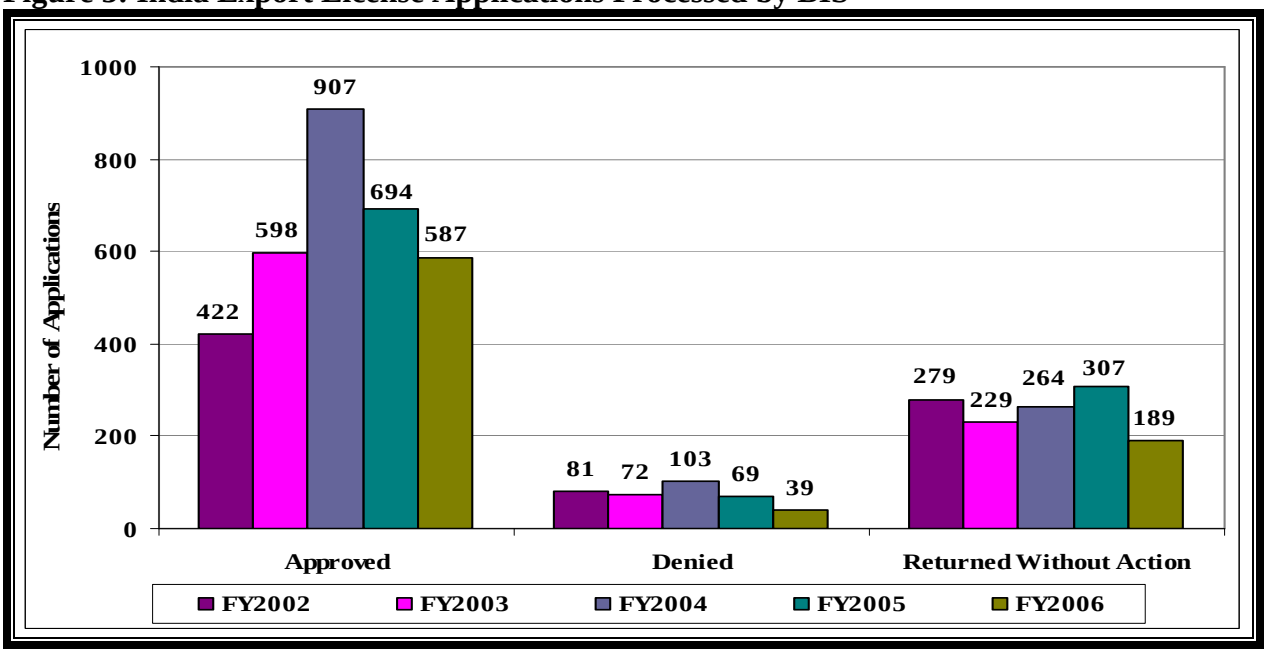
Figure 2: Export License Applications BIS Received for India



Source: BIS

Based on the number of export license applications BIS processed for India during FY 2006, 587 were approved, 39 were denied, and 189 were returned without action (see figure 3 for a breakdown of BIS' determinations for these licenses).

Figure 3: India Export License Applications Processed by BIS



ource: BIS

Trends in Technologies Sought by India Through the Export Licensing Process

Most of the export license applications for India in FY 2006 involved technologies categorized under materials, chemicals, "microorganisms," and toxins; materials processing; telecommunications and information security; and computers (see table 1 for a full listing of the number of export license applications BIS received for each CCL category).

Table 1: BIS License Applications for India by CCL Category (in FY 2006)

Cat ry	tegory	Applications* Received in FY 06
0	Nuclear Materials, Facilities, and Equipment	8
1	Materials, Chemicals, "Microorganisms," and Toxins	225
2	Materials Processing	208
3	Electronics	95
4	Computers	130
5	Telecommunications and Information Security	206
6	Lasers and Sensors	22
7	Navigation and Avionics	56
8	Marine	2
9	Propulsion Systems, Space Vehicles, and Related Equipment	55
EAR99	Classification used for items subject to the EAR but not listed on the CCL	147

***Note:** Because applications may contain a request to export more than one technology, the number of applications in this column does not equal the total number of India export applications BIS received during FY 2006.

ource: BIS

End-Use Checks in India

End-use checks play an important part in the export licensing process by helping BIS determine whether the end users or intermediary consignees are suitable recipients of sensitive U.S. items and technology and would likely comply with applicable license conditions. End-use checks include either pre-license checks (PLCs) or post-shipment verifications (PSVs) and may be requested by any of the executive agencies involved in the interagency licensing process. A PLC is conducted to establish the *bona fides*—or evidence of the qualifications—of a foreign entity involved in the export transaction while the license application is being reviewed. A PSV is conducted on a foreign entity after the license has been approved and the item shipped to help determine whether the licensed item is being used in accordance with license conditions.

The U.S. Department of Commerce and the Indian Ministry of External Affairs entered into an End-Use Visit Arrangement in September 2004. Since November 2004, end-use checks in India have been conducted by an export control officer (ECO) based in New Delhi. ECOs are BIS export enforcement agents who hold the rank of commercial officer in the commercial section of U.S. embassies and consulates.[21] In addition to conducting end-use checks, they handle various other in-country export control activities.

[21]BIS has additional ECOs stationed in Abu Dhabi, United Arab Emirates; Moscow, Russia; Beijing, China; and Hong Kong.

[redacted] (see Chapter II for more discussion on the targeting of end-use checks).

[redacted]

[redacted] A Sentinel trip is performed by domestic BIS export enforcement agents, largely to conduct PSVs. Often, Sentinel teams target some checks that are not requested by licensing officers or other U.S. government officials. Usually, the Sentinel checks involve conducting multiple PSVs at the same entity (so the team—and in this case the ECO in New Delhi—can group multiple checks at the same location), whereas headquarters-initiated checks usually involve conducting only one check at one entity. Therefore, in addition to conducting the end-use checks that were requested by BIS headquarters in FY 2005, the ECO conducted [redacted].

OBJECTIVES, SCOPE, AND METHODOLOGY

The Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the director of Central Intelligence and the director of the Federal Bureau of Investigation, are required by the National Defense Authorization Act (NDAA) for Fiscal Year 2000 to conduct eight annual assessments through FY 2007 of the adequacy of current export controls and counterintelligence measures in protecting against the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. This is the eighth and final review under the NDAA requirement.

To satisfy the NDAA's FY 2007 reporting requirement, the Commerce Office of Inspector General assessed the effectiveness of BIS' export control program for India in conjunction with a review to determine the status of prior-year recommendations involving dual-use licensing and enforcement activities.[23] We examined (1) whether BIS' export control policies, practices, and procedures for India are clear, documented, and designed to achieve the desired goals; (2) whether BIS personnel are following the prescribed policies, practices, and procedures relating to India; and (3) how effective BIS is in detecting and preventing the diversion of sensitive commodities to weapons of mass destruction-related programs (either within or outside India).

We conducted our evaluation from June through November 2006 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency in 2005. At the end of our review, we discussed our findings and conclusions with the Acting Under Secretary for Industry and Security and other senior BIS officials.

Our methodology included the following activities:

U.S. Interviews. Within BIS, we spoke with the Acting Under Secretary, Deputy Assistant Secretary for Export Administration, and the Assistant Secretary and Deputy Assistant Secretary for Export Enforcement. Within Export Administration, we met with the director of the Office of Exporter Services (OExS), the directors of the Offices of Nonproliferation and Treaty Compliance and National Security and Technology Transfer Controls, as well as with staff from each office. Within Export Enforcement, we met with the director and staff of the Office of Export Enforcement (OEE) and the Office of Enforcement Analysis (OEA). We also spoke with staff from OEE's Boston field office regarding closed investigations involving Indian entities. In addition, we met with the chairperson of the Operating Committee, the policy advisor to the Assistant Secretary for Export Administration, the Export Administration Intelligence Liaison, and staff from BIS' Office of Chief Counsel.

We spoke with officials from federal agencies directly involved with or knowledgeable about U.S. dual-use export control policies and procedures related to India. Within the CIA, we spoke with analysts from the Center for Weapons Intelligence, Nonproliferation, and Arms Control. Within the Department of Defense, we spoke with officials from the Defense Technology Security Administration. Within the State Department, we interviewed staff from the Bureaus of South and Central Asia; International Security and Nonproliferation; and Political-Military Affairs, and

[23]A separate report on the status of all open recommendations resulting from Commerce OIG's NDAA reporting will be issued in March 2007.

attended meetings of the Missile Technology Export Control Group and Subgroup on Nuclear Export Coordination. Within the Department of Energy, we met with officials from the Office of International Regimes and Agreements.

Overseas Visit. We also traveled to India to assess U.S. dual-use export control operations. At the post, we interviewed officials at the U.S. embassy in New Delhi. We met with BIS' ECO and accompanied him on two end-use visits to Indian entities located in Chennai and Bangalore (a representative from India's Ministry of External Affairs was also present at the end-use visit in Chennai).

We also spoke with the Commercial Service's (CS) deputy senior commercial officer in India and the two commercial specialists who currently assist the ECO. In addition, we spoke with the embassy's deputy chief of mission and the heads of the consular; defense; economic; environment, science, technology, and health; and political sections; and other relevant U.S. government officials.[24] Finally, we met with Government of India officials from the Defence Research and Development Organization and the Indian Space Research Organization to discuss the progress of end-use visits in India and obtain the Indian government's views on some aspects of U.S. dual-use export controls.

Source:https://www.cia.gov/cia/publications/factbook/geos/in.html

While in India, we also met with representatives from two leading Indian industry associations—the Confederation of Indian Industry and the Federation of Indian Chambers of Commerce—to discuss U.S. export controls and their efforts to promote U.S. and India export control compliance among Indian companies.

Review of export control laws and regulations, relevant BIS guidance, and other documents. We examined current and prior legislation, executive orders, policy papers, and related regulations (including the EAR) that pertained to India. In addition, we reviewed the following documents, covering the period of FYs 2005 and 2006 (unless otherwise indicated):

- Complete licensing histories for 43 India cases escalated to the OC and ACEP
- Records for 106 India end-use checks (including applicable licensing histories) that were initiated or completed (for FY 2005 we only reviewed those checks that received ratings other than favorable)
- Sentinel trip reports from July 2000 to December 2003
- Program material related to the roles and responsibilities of the ECO in India

[24]During our visit we were unable to meet with Homeland Security's Immigration and Customs Enforcement attaché because the position was vacant.

- ECO's subject matter files at post relating to export controls
- Summaries of 124 India technology licenses for FYs 2005-2006 (through April 30, 2006)
- BIS directives and procedures related to license monitoring
- Relevant cable traffic and intelligence reports pertaining to India

OBSERVATIONS AND CONCLUSIONS

I. Dual-use Export Control Policies and Practices for India Are Not Fully Transparent

We also found a problem with the listing of Indian entities found on BIS' Entity List. Specifically, some Indian entities meant to be captured on the list are not clearly identified. As a result, U.S. exporters could inadvertently export dual-use controlled items to these entities without the required license.[25]

A. Questions remain over whether the Government of India has fully implemented two of the export control-related steps under the "Next Steps In Strategic Partnership"

Due to the classified nature of the material discussed in this section, we offer our specific findings and recommendations in Appendix D, which is classified at the SECRET level.

BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it believes that India has fulfilled its commitments under the NSSP. BIS' specific comments and our response are provided in the classified section of this report.

B. BIS' Entity List does not clearly identify some Indian entities

BIS established the Entity List, a supplement to the EAR's export license requirements, in February 1997 to inform the public of entities whose activities impose a risk of diversion of exported and reexported items into programs related to weapons of mass destruction (WMD). In conjunction with the 1998 economic sanctions against India for its nuclear tests, BIS increased

[25]A license is required for the export or re-export of all items subject to the EAR for most of the Indian entities on the *Entity List*. In addition, the nuclear end-use/end-user control in Section 744.2 of the EAR imposes a license requirement on all exports to three activities, one of which is "unsafeguarded" nuclear activities. This license requirement exists independent of the license requirements imposed by the Entity List.

the number of Indian entities on the list from 4 to more than 200. According to BIS, these additional entities were "determined to be involved in nuclear or missile activities."

In March 2000, BIS removed 51 Indian entities from the list after conducting a congressionally-mandated review intended to focus the list on entities that made direct and material contributions to WMD and missile programs. After removing the 51 entities, BIS restructured the list, moving many subordinate organizations affiliated with the listed Indian entities and of interest to the United States to a special appendix to the Entity List. The appendix included over 100 Indian subordinate entities associated with 6 different Government of India agencies.

After the President waived the economic sanctions against India in 2001, BIS removed some Indian entities from the list and deleted the special appendix, reducing the number of named Indian entities on the Entity List at that time to 15.[26] As part of this action, BIS grouped subordinate entities of the Indian Department of Atomic Energy into three types or categories without listing the specific entities by name. The types are as follows:

- Nuclear reactors (including power plants) not under the International Atomic Energy Agency safeguards (excluding Kundankulam 1 and 2),[27]

- Fuel reprocessing and enrichment facilities, and

- Heavy water production facilities and their collocated ammonia plants.

According to representatives of the agencies involved in the interagency licensing process, consolidating these subordinate entities into the three categories without naming them has made it more difficult to determine whether a specific entity is covered by the list. As a result, U.S. exporters could inadvertently export certain sensitive or EAR99 items to these entities without the required license.

We identified two export license applications that were escalated to the Operating Committee, in part, because of disputes among interagency licensing officials as to whether the Indian entities on the applications were covered by the Entity List. Both cases involved subordinates of the Indian Department of Atomic Energy, but the licensing officials could not agree as to whether the entities were "safeguarded" or "unsafeguarded" nuclear facilities—a key factor in determining whether the entities are subject to the list.

It should be noted that in one of the two cases, part of the confusion was based on erroneous information provided by the applicant, who reported on the license application that the ultimate consignee was a subordinate of a listed entity. When the applicant realized that the ultimate consignee was not a subordinate of that entity, he asked BIS to modify the license application accordingly. At this point, according to the OC records, the then-acting OC Chair "suggested that the application be returned without action because the items listed were EAR99 and were destined to a non-listed entity." However, while the ultimate consignee was not a subordinate of

[26]Since that time, an additional 3 Indian entities were removed from the list, making the total now 12.
[27]According to the International Atomic Energy Agency, safeguards are applied to verify a state's compliance with its agreement to accept safeguards on all nuclear material in all its peaceful nuclear activities and to verify that such material is not diverted to nuclear weapons or other nuclear explosive devices.

a listed entity, the Energy representative at the OC reported that it was a subordinate of the Indian Department of Atomic Energy and as such, was still covered by the Entity List. State concurred with this assessment.

Ultimately, it was determined that the ultimate consignees in both cases were "unsafeguarded" facilities and, as a result, were included on the list. Both license applications were subsequently rejected. However, these cases call into question how clear the Entity List actually is with regard to the Indian Department of Atomic Energy subordinates since it led to some confusion during the interagency licensing review process.

The OC chair acknowledged that consolidating the list has created some confusion both for exporters and interagency licensing officials, resulting in an occasional dispute about whether a particular entity was listed. As a result, he prepared a handbook for OC members in early 2006 that includes a section on Indian entries on the Entity List. The section compiles all the *Federal Register* notices relating to the addition and deletion of Indian entities on the list, as well as any licensing policy changes for specific entities since 1998. The chair believes this guidance has eliminated much of the confusion over which subordinate entities are covered by the list.

The OC chair also provided this guidance to BIS licensing officers who attended an OC training session in June 2006. The positive feedback he received on the guidance prompted him to put it on BIS' shared network in October 2006 so that all BIS' licensing officers could have access to it. This document is not available to the public. Thus, while BIS and other U.S. licensing officials now have clearer information on the specific Indian entities on the Entity List, U.S. exporters do not. BIS needs to ensure that U.S. exporters clearly understand which Indian entities are meant to be captured on the Entity List to help ensure export controlled dual-use items are not inadvertently shipped to these entities without the required license.

Recommendation:

We recommend that BIS specifically list all of the Indian entities that should be captured on the Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements.

BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it will review the listing of the Indian entities on the Entity List to determine how additional information can be provided to exporters. The planned completion date for this review is April 30, 2007. We acknowledge BIS' planned efforts in this area and look forward to receiving a copy of the review results upon completion.

II. BIS' End-Use Check Program in India Needs to Be Improved

Given India's importance in U.S. export control matters, BIS assigned one of its export enforcement agents to New Delhi in November 2004 to conduct end-use checks. This move has provided BIS with new opportunities to work more closely with the Government of India on export control matters. However, we identified several weaknesses in BIS' end-use check program for India that should be addressed:

- The End-Use Visit Arrangement[28] between the U.S. Department of Commerce and India's Ministry of External Affairs limits the effectiveness of end-use checks.

- While end-use checks involving Indian private sector entities are generally conducted in a timely manner, the majority of those involving government or government-affiliated entities are not.

- BIS has not set clear and consistent time frames for completing two steps of the end-use check process, namely (1) initiation of PSVs upon receipt of required shipping documents and (2) notification to the Ministry of External Affairs of end-use check requests.

- Two of the India PLCs BIS cancelled in FY 2006 should have been rated "unfavorable" per the bureau's end-use check criteria.

- Although the U.S. government is concerned about diversions of sensitive exports to programs involving weapons of mass destruction, BIS did not adequately target PSVs to determine whether diversions were occurring.

Because of the sensitive nature of these findings, we discuss them in Appendix E, classified at the CONFIDENTIAL level.

BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it disagreed with some of the report findings listed above. However, it agreed to take action to implement a number of the recommendations we proposed. BIS' specific comments and our response are provided in the classified Appendix E to this report.

[28]Commerce and India's Ministry of External Affairs entered into this agreement in September 2004 to establish procedures for full and timely end-use checks.

III. BIS Needs to Enhance Its Efforts to Ensure Compliance with License Conditions

The EAR allows BIS or licensing referral agencies to place conditions on an export license when there are specific concerns about the exporter, end use, or end user. Frequently, the conditions are the result of lengthy negotiations among the licensing referral agencies. They are an important part of the interagency export licensing process and offer BIS an additional means for monitoring certain shipments. BIS monitors export licenses to ensure the holders comply with all license conditions. This endeavor requires the combined efforts of Export Administration and Export Enforcement.

There are 55 standard license conditions. Six of these place reporting conditions on exporters or end users which require them to submit documentation to BIS regarding the shipment (see table 2). [29] A seventh condition—referred to as "Write Your Own"—allows licensing officers to formulate unique requirements, which may include reporting requirements for either the exporter or the end user. Licenses with reporting conditions are tracked in the Follow-up Subsystem within ECASS.

Table 2: License Conditions with Reporting Requirements*

10–Temporary Demonstration	Export Administration	Notify BIS once the licensed item is returned to the United States after its temporary demonstration in another country.
12–Delivery Verification Standard	Export Administration	Provide BIS delivery verification documents.
13–Delivery Verification Triangular	Export Administration	
14–Post-Shipment Verification (PSV)	Export Enforcement	Submit a shipper's export declaration to BIS following the shipment of the item (so that a PSV can be initiated).
17–Aircraft on Temporary Sojourn	Export Administration	Notify BIS after the return of an aircraft on temporary sojourn to a foreign country.
*The table excludes the "Write Your Own" condition (since there is no standard requirement to be followed) as well as the "NDAA PSV" condition (see footnote 30 below).		

Source: BIS and OIG

[29]The NDAA for FY 1998 requires BIS to perform PSVs on all high-performance computers with a computing capability beyond a certain threshold that are exported or reexported to "Tier 3" countries, including China, India, United Arab Emirates, and Israel. BIS implements this provision through condition 34 which requires exporters to submit a post-shipment report to BIS on exports of high-performance computers to "tier 3" countries. The act also requires BIS to submit annual reports to the Congress listing these high-performance computer exports and the results of the PSVs. License condition 34 is tracked separately from the ECASS Follow-up Subsystem.

The OIG previously reported that Export Administration and Export Enforcement did not consistently monitor licenses with reporting conditions and, therefore, did not ensure exporter or end user compliance with license conditions.[30] In response to our recommendations, both units instituted procedures to (1) regularly monitor licenses with reporting conditions that are marked for follow-up by licensing officers, (2) follow up with exporters to request any necessary reporting documentation, and (3) provide for the review of technical documentation submitted by exporters and end users. However, our review found that both Export Administration and Export Enforcement need to improve implementation of the procedures.

A. Export Administration is not adequately monitoring India licenses with reporting conditions

Within Export Administration, the Office of Exporter Services (OExS) is responsible for monitoring exporter compliance with five of the seven reporting conditions, including Write Your Own conditions that have reporting requirements. Of these five conditions, four involve the submission of routine documentation, such as delivery verification, that does not require a level of technical expertise to verify. If a licensing officer marks a license with any of these four conditions, the license is automatically entered into the Follow-Up Subsystem, enabling OExS to follow up with the applicable exporters to ensure that the required documentation is submitted in accordance with the condition.

By contrast, Write Your Own conditions are unique and for each one, the licensing officer must determine whether the condition needs to be entered into the Follow-Up Subsystem. Write Your Own conditions may sometimes require the exporter or end user to provide BIS substantive reports related to the export, such as maintenance reports or technology control plans (TCPs), [31] which require some level of technical review. For these conditions, the licensing officer must choose "yes" or "no" in the Write Your Own screen indicating first whether the condition requires follow-up. If the licensing officer marks "yes" for follow-up, he then must indicate whether the documentation requires a licensing officer's technical review. The license is only entered into the Follow-up Subsystem if the officer marks "yes" for "follow-up" required.

Of the 273 India export license applications included in our sample, only 13 contained reporting conditions that fell under the responsibility of OExS to monitor. Twelve of the 13 licenses contained a Write Your Own condition, whereas the 13th license contained a standard reporting condition requiring the submission of a report summarizing specific details related to demonstrations of the item. Based on our review of these 13 licenses, licensing officers failed to mark 5 of them for follow-up to verify that the reporting conditions were met. We also found that staff from OExS were not fully aware of the reporting conditions they were required to monitor and were not properly referring noncompliant exporters to Export Enforcement. This breakdown in Export Administration's monitoring process might diminish the deterrent effect that license conditions can have on potential violators.

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[30]U.S. Department of Commerce Office of Inspector General (Commerce OIG), June 1999. *Improvements Are Needed to Meet the Export Licensing Requirements of the 21st Century*, IPE-11488; Commerce OIG, March 2003. *Improvements Are Needed to Better Enforce Dual-Use Export Control Laws*, IPE-15155; Commerce OIG, March 2006. *U.S. Dual-Use Export Controls for China Need to be Strengthened*, IPE-17500.

[31]According to BIS, a TCP is a reporting requirement put in place by BIS or Defense in cases when foreign nationals are employed at or assigned to security-cleared facilities that handle export-controlled items or information.

Licensing Officers are not properly marking the "follow-up" box in ECASS for India licenses with Write Your Own conditions

We found that 5 of the 13 licenses that contained a reporting requirement as part of the Write Your Own condition, were not marked for "follow-up" by the licensing officers. These errors occurred despite the fact that each export license application was reviewed and signed off by a countersigner.[32] Because these licenses were not entered into the Follow-up Subsystem, OExS staff did not know to follow up with the exporters to determine whether they had complied with the conditions.

Regardless, two exporters provided the required documentation to OExS. However, OExS did not have any information pertaining to the remaining three licenses. Export Enforcement's Office of Enforcement Analysis (OEA) later informed us that two of the remaining three licenses had been shipped against. However, OEA did not have any records relating to the third license.[33]

In response to similar monitoring weaknesses identified in our March 2006 report on dual-use export controls for China, the director of OExS issued a memorandum on May 9, 2006, reminding licensing officers of the importance of marking a license for follow-up.[34] We do not know whether the May 2006 memo has improved officer compliance with this requirement since the five licenses not marked for follow-up were processed before this memorandum was issued. Under the circumstances, we suggest that OExS review a sample of license applications to see whether licensing officers and countersigners are consistently marking the appropriate licenses for follow-up. Additionally, OExS should contact exporters for the three licenses that were not properly marked for follow-up to determine whether they complied with their reporting requirement.

Licensing officers are not required to review all technical documentation submitted by exporters or end users pursuant to license conditions

Of the 13 India licenses that had reporting conditions, we found that 10 required submission of technical documentation but were not marked for and did not receive the licensing officers' review. Reporting requirements are designed to address particular concerns that either BIS or other licensing referral agencies had about the parties to the transaction or about the transaction itself. In these 10 cases, the licensing officers informed us that because Defense had requested the technical reporting conditions, they did not believe that they were responsible for reviewing the documentation. While Defense may have requested these conditions, BIS ultimately agreed to issue the licenses with the conditions.

Two of the 10 licenses had conditions that required the end user or consignee to develop and implement a technology control plan prior to shipment. Seven licenses required the exporter to submit a service report on the condition and use of the commodity covered under the license,

[32]A countersigner is typically a division director. The countersigning process was established by BIS to help ensure that export license applications are processed appropriately.
[33]Licenses are generally issued for a period of 2 years and the exporter can ship anytime during that period. This license expires in May 2007.
[34]Memorandum from the Director of OExS to BIS Licensing Officers, *Review of Technical Reports Submitted Pursuant to a License Condition*, May 9, 2006.

following any maintenance performed on the equipment. In the last case, the condition required submission of a biannual report to BIS summarizing specific details related to the demonstrations of the item. Aside from licensing officer review, there are no BIS processes in place for reviewing the technical documentation to ensure that exporters or end users comply with such license conditions.

Prior to May 2006, BIS did not require any form of technical review of the documentation submitted to ensure that it meets the requirements of the condition. In response to similar concerns in our March 2006 report on export controls for China, the May 9, 2006, OExS memorandum additionally required licensing officers to review technical documentation submitted pursuant to a license condition if the documentation was requested because of concerns with the transaction. However, the memorandum excludes those licenses involving reporting conditions placed on a license by the Defense Department unless BIS licensing officers also have a concern with the transaction.

With regard to reporting requirements placed on a license as a condition of approval by Defense, BIS reported that Defense has the ability to identify technical reports it wishes to review and BIS provides those reports to them accordingly. BIS further reported that if Defense identifies a problem during its review of the reports, DOD will notify BIS of a compliance issue and raise this in future reviews of license applications involving the applicable exporter. The Acting Under Secretary for Industry and Security stated that he did not know whether Defense actually requests copies of technical reports required as part of license conditions. Based on our discussions with two of the licensing officers who were responsible for several of the licenses referenced above that had technical reporting conditions, it appears that these reports are not routinely provided to Defense.

BIS has the authority to administer and enforce the EAR and, as such, is ultimately responsible for monitoring and enforcing all conditions placed on a dual-use license. Without knowing whether an exporter or end user is fully compliant with license conditions, BIS cannot make informed decisions on future license applications involving the same parties or take appropriate enforcement action on the current license. BIS should revise its procedures with respect to the review of technical documentation by licensing officers to require that *all* technical documentation requested by any licensing agency, and included in an approved license, be examined by the appropriate licensing officer upon submission by the exporter to ensure compliance with the reporting conditions.

OExS staff are not always aware of the reporting conditions they are required to monitor

Our review of the 13 licenses with reporting conditions also revealed that OExS staff (1) prematurely closed out two India licenses that required reporting documents from the exporter or end user, and (2) failed to forward shipping documentation received for one license to OEA.

- **Licenses prematurely closed out.** In the first case,[35] OExS staff did not have any information documenting whether the license was shipped against and could not explain why it was prematurely closed out of the Follow-up Subsystem. However, OEA officials

[35]This license required the submission of a delivery verification report, which is provided to BIS after delivery of goods, and a maintenance report, provided when maintenance is performed on equipment.

apparently had information indicating that the goods had been exported. In the second case,[36] OExS staff had information relating to the date the goods were shipped, but they could not explain why they closed the license out in the Follow-Up Subsystem before receiving the required documentation. According to BIS procedures instituted in early 2005 in response to a recommendation from our March 2003 export enforcement report,[37] OExS staff must obtain all required documentation from the exporter or end user before closing out a license.

- **Failure to forward shipping documentation to OEA.** OExS staff failed to forward shipping documentation they received for one license to OEA so that a PSV could be initiated. This case involved a shipper's export declaration and a post-shipment report, both of which should have been submitted directly to OEA by the exporter, but were mistakenly submitted to OExS after the May 2006 shipment. According to a memorandum issued by the director of OExS in March 2006, OExS staff must forward misrouted shipper's export declarations and all relevant documentation to OEA within 48 hours of receipt of those documents. An OExS employee said that she did not forward the shipping documentation to OEA because she believed monitoring the license conditions in this case was the responsibility of OExS. But if OEA does not receive shipping documents, it has no way of knowing whether exporters have complied with the license condition and cannot initiate a PSV.

BIS should ensure that OExS staff understand which license conditions they are responsible for monitoring and when they should forward documentation to OEA. In addition, OExS should reopen the two licenses that were prematurely closed out of its system and contact the exporters to obtain the documentation needed to fulfill the reporting requirements.

OExS staff are not referring non-compliant exporters to OEE

According to BIS' guidance, OExS staff are required to follow up with exporters that are noncompliant with reporting conditions prior to closing out the license in the Follow-Up Subsystem. The procedures further state that if exporters are non-responsive to requests for information, OExS staff should refer them to the Office of Export Enforcement (OEE). However, in the two cases of noncompliance, both exporters had shipped against their licenses, but neither one had provided BIS all of the required documentation as of October 2006. We brought these cases to the attention of OExS staff members during the course of our review, but they were not referred to OEE. OExS should immediately refer any noncompliant exporters to OEE.

Recommendation:

BIS should, at a minimum, take the following actions to improve its monitoring of license conditions:

[36]This license required the submission of a demonstration report to BIS every 6 months for a period of 2 years.
[37]Commerce OIG, March 2003. *Improvements Are Needed to Better Enforce Dual-Use Export Control Laws*, IPE-15155.

- Determine why there are persistent breakdowns in BIS' process for monitoring license conditions.
- Review a sample of license applications to ensure licensing officers and countersigners are properly marking licenses for follow-up.
- Contact exporters for the three licenses we identified as not marked for follow-up to determine whether the exporters complied with reporting requirements.
- Amend procedures to require licensing officers to review *all* technical documentation submitted by exporters or end users to ensure their compliance with the conditions.
- Ensure that relevant OExS staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to OEE, as appropriate.
- Reopen the two licenses that were closed by OExS and contact the exporters regarding reporting requirements.
- Refer all noncompliant exporters to the Office of Export Enforcement.

BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it is still reviewing our recommendations pertaining to Export Administration's monitoring of license conditions. The planned completion date for this review is April 30, 2007. We look forward to reviewing BIS' response when completed.

B. Export Enforcement needs to improve its monitoring and enforcement of India licenses with condition 14

Within Export Enforcement, OEA is responsible for monitoring licenses marked with the remaining two reporting conditions–the submission of shipper's export declarations, which is referred to as condition 14, and post shipment reports on high-performance computer exports to certain countries, referred to as condition 34.[38] Licenses with condition 14 require a PSV on a specific foreign entity following the first shipment made against the license. Within 30 days of shipment, exporters are required to submit a copy of the shipper's export declaration directly to OEA, which then initiates the PSV to confirm a commodity's stated end-use

Our review of the 24 India licenses from our sample that contained condition 14 revealed that OEA is not fully adhering to its guidance for monitoring licenses with condition 14. Condition 14 is one of the most critical conditions placed on a license because either the interagency

[38]Since licenses with condition 34 are tracked separately from Export Enforcement's Conditions Follow-up Subsystem, we focused our review on licenses with condition 14. However, some of the licenses with condition 14 in our sample also contained condition 34.

licensing agencies or export enforcement officials decided that a PSV was needed to determine whether the goods or technology were actually being used in accordance with that license. However, it should be noted that even when condition 14 is imposed on a license, the PSV might not occur in all cases. For example, if there is no export against the license or if the agency requesting this condition changes its mind (e.g., the item subsequently becomes decontrolled), the PSV may be cancelled. One of the 24 PSVs in our sample was cancelled because the item was decontrolled after the license was issued.

Of the reviewed India licenses that contained condition 14, several exporters submitted their shipping documents to BIS well after the established time frame, which in some cases hinders BIS' ability to detect possible diversions or violations of license conditions. In addition, OEA recommended approval of additional licenses to exporters that had not fully complied with condition 14 reporting requirements on previous licenses and did not refer noncompliant exporters to OEE for appropriate action.

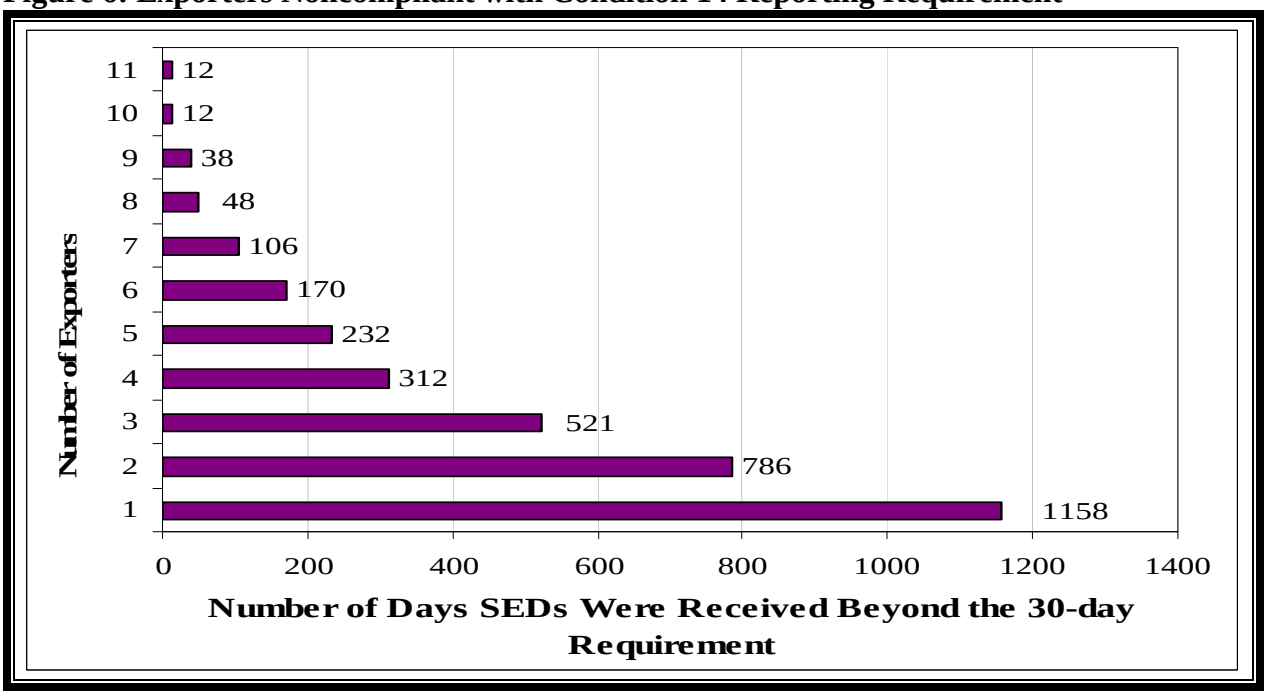
Export Enforcement management is unable to determine whether OEA analysts and supervisors are fully adhering to OEA's follow-up procedures

We determined that exporters submitted their shipper's export declarations after the established 30-day deadline in 11 of the 24 cases—between 12 and 1,158 days beyond the deadlines (see figure 6). In response to our March 2003 export enforcement report, BIS issued procedures requiring its staff to follow up at least twice with the exporter on all licenses with condition 14: first, 1 year after the license's date of issue and then within 30 days of the date of license expiration to see whether shipments have occurred. However, we were unable to determine if OEA followed these procedures in these cases. Specifically, records in OEA's electronic follow-up tickler system for 8 of the 11 licenses[39] in which exporters submitted their shipper's export declarations late did not clearly show what actions were taken to monitor compliance. Seven of the 8 records only showed the date when the follow-up tasks were assigned to an analyst and not what actions the analyst took. The remaining record did not provide any information about OEA follow-up.

Given that the acting director for OEA's South Asia and Europe Division was new to this position at the time of our review and the fact that OEA's follow-up tickler system did not clearly indicate what follow-up action, if any, was taken in these cases, she could not confirm if analysts followed the prescribed procedures for these eight cases. Since only OEA supervisors have access to the Follow-up Subsystem, it was their responsibility to record what actions were taken by the analysts in these cases. However, the acting director for OEA's South Asia and Europe Division suggested that supervisors would be better able to hold analysts accountable if the analysts had access to the Follow-up Subsystem so that they could record the actions they took to monitor these cases.

[39]One exporter was under investigation by OEE at the time of our review, so we did not pursue our inquiry related to this license. While the remaining two licenses had been shipped against, they were granted in March 2006 and, as such, had not reached the one-year mark requirement for follow-up as called for in OEA's guidance.

Figure 6: Exporters Noncompliant with Condition 14 Reporting Requirement



Source: BIS

OEA is not denying noncompliant exporters future licenses or referring them to OEE per its guidance

OEA's procedures require its analysts to (1) refer noncompliant condition 14 exporters to OEE for possible investigation, and (2) recommend denial of any subsequent license applications involving a party who has not complied with a previous license condition. We found also that at least 6 of the 11 noncompliant exporters in our sample received additional licenses after the 1-year deadline established by OEA for its analysts to follow up with exporters to determine compliance with condition 14.

In addition, only 2 of the 11 exporters that submitted their shipping documents to OEA after the established deadline were referred to OEE. The director of OEA informed us that while he was aware of the other 9 noncompliant exporters, he made the decision not to make the referrals. He and the acting director for the South Asia and Europe Division stated that despite BIS' guidance, they generally do not refer these types of cases to OEE because they believe these cases would not be a priority.
We discussed this matter with the director of OEE, and he stated that OEA should refer these types of cases. He stressed that these violations should be examined so that they can consider appropriate enforcement action (e.g., a warning letter or fine).

BIS needs to ensure that its analysts and supervisors closely monitor licenses at the 1-year mark and within 30 days of license expiration to prevent additional licenses from being issued to exporters that do not comply with condition 14, and it should hold those exporters accountable.

Recommendation:

BIS needs to review Export Enforcement's process of monitoring and enforcing license condition 14 and take the following actions:

- Require OEA analysts and supervisors to closely monitor licenses at the specified follow-up time frames, record their monitoring activities in the Conditions Follow-up Subsystem, and recommend that exporters who do not comply with condition 14 be denied additional licenses.

- Refer all noncompliant exporters to the Office of Export Enforcement.

- Hold exporters accountable for noncompliance with condition 14 through appropriate enforcement action.

BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report and our recommendation addressing Export Enforcement's license monitoring and enforcement efforts, BIS stated that it is still reviewing the first part of this recommendation to determine whether it can be implemented using the current license processing system (ECASS), or if some alternative approach is necessary. We look forward to learning of BIS' decision upon completion of its review.

As for the second part of our recommendation related to BIS' adherence to its own guidance on denying licenses to those exporters who do not comply with condition 14 and/or referring noncompliant exporters to OEE, BIS stated that this requirement needs modification. Specifically, BIS reported that it put this requirement into place in October 2003 in response to a previous OIG recommendation, but found that there were many factors involved that needed to be considered before determining whether subsequent licenses should be denied or referrals made to OEE based on a late filing. As such, BIS stated that in cases where OEA believes it is appropriate to refer an investigative lead to OEE, it does so while also screening the party involved and recommending against issuance of any license until the OEE investigation has been concluded.

While we agree that some flexibility might be warranted (e.g., if the exporter is just a *few* days late in providing the required shipping documentation) in determining whether future licenses should be denied or referrals made to OEE based on a late filing, we found no evidence in the case files to indicate any type of analysis was conducted to determine whether or not the late filer should be held accountable for not fully complying with the license condition. In fact, as discussed in our report, the director for OEA and the acting director for the South Asia and Europe Division stated that they generally do not refer these types of cases to OEE because they believe these cases would simply not be a priority. Nonetheless, the director of OEE informed us during our review that these types of cases should be referred to OEE so that they can consider

appropriate enforcement action, such as a warning letter. Therefore, we reaffirm our recommendations on these matters and ask that BIS address them in its action plan.

With regard to the part of our recommendation about holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action, BIS' response stated that its Office of Chief Counsel and OEE, as well as the Department of Justice, determine the appropriate investigation and prosecution for filing documentation late, based on all the facts present. While we agree that these three entities, as appropriate, should make the decision as to what type of investigation and/or prosecution is appropriate on any given case, as stated above, none of the nine cases highlighted in our report were referred to these offices so that an appropriate decision could be made. As such, we reaffirm this part of our recommendation on this matter and ask that BIS address it in its action plan.

Finally, BIS' response noted that the 24 licenses from our sample did not all contain condition 14. We disagree. Our review of these licenses indicated that all 24 contained the standard condition 14 language:

> After the first shipment is made against this license, send one copy of your shipper's export declaration, or automated export system (AES) record, bill of lading or airway bill to the Department of Commerce within 30 days of the date of export. Indicate the license number on each document. Send these documents to the Bureau of Industry and Security, Office of Enforcement Analysis, Room 4065, 14th Street and Constitution Avenue, N.W., Washington, D.C. 20230. These documents must be received by certified mail or via a private courier. They may not be faxed.

While the licensing officers for 2 of the 24 licenses had improperly coded this condition in ECASS as a "Write Your Own" condition instead of condition 14, the intent of the condition was clearly for a PSV to be conducted. In addition, the exporters in these cases were still required to submit the appropriate shipping documents in accordance with the license terms.

SUMMARY OF UNCLASSIFIED RECOMMENDATIONS

We recommend that the Acting Under Secretary for Industry and Security ensure that the following actions are taken:

1. Specifically list all of the Indian entities that should be captured on BIS' Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements (see page 13).

2. Improve Export Administration's license monitoring efforts by:
   a. Determining why there are persistent breakdowns in BIS' process for monitoring license conditions (see page 18).
   b. Reviewing a sample of license applications to ensure licensing officers and counter-signers are properly marking licenses for follow-up (see page 18).
   c. Contacting exporters for the three licenses cited in this report that licensing officers did not mark for follow-up to determine exporters' compliance with reporting requirements (see page 18).
   d. Amending BIS procedures to require licensing officers to review *all* technical documentation submitted by exporters or end users to better ensure their compliance with the conditions (see page 18).
   e. Ensuring that relevant Office of Exporter Services staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to the Office of Export Enforcement, as appropriate (see page 18).
   f. Reopening the two licenses that were closed by Office of Exporter Services staff and contacting the exporters regarding reporting requirements (see page 18).
   g. Referring any noncompliant exporters to the Office of Export Enforcement (see page 18).

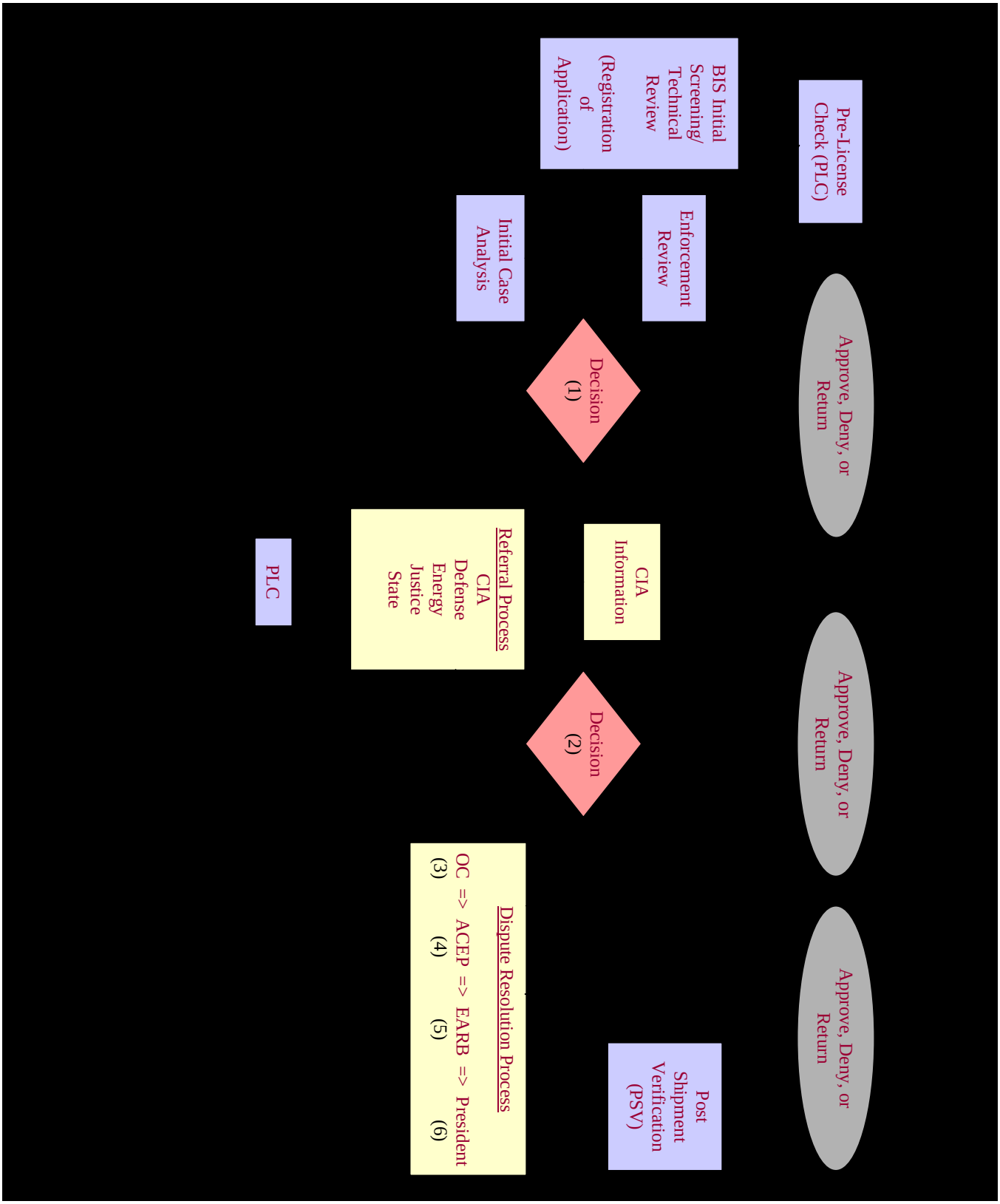
3. Improve Export Enforcement's license monitoring and enforcement efforts by:
   a. Requiring Office of Enforcement Analysis analysts and supervisors to closely monitor licenses at the specified follow-up time frames, recording their monitoring activities in the Conditions Follow-up Subsystem, and recommending that exporters who do not comply with condition 14 be denied additional licenses (see page 22).
   b. Referring all noncompliant exporters to the Office of Export Enforcement (see page 22).
   c. Holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action (see page 22).

APPENDIXES

Appendix A: Acronyms

ACEP	Advisory Committee on Export Policy
BIS	Bureau of Industry and Security
CCL	Commerce Control List
CIA	Central Intelligence Agency
EAR	Export Administration Regulations
ECASS	Export Control Automated Support System
ECCN	Export Control Classification Number
ECO	Export Control Officer
FY	Fiscal Year
HTCG	High Technology Cooperation Group
IPE	Inspections and Program Evaluations
NDAA	National Defense Authorization Act
NLR	No License Required
NSSP	Next Steps in Strategic Partnership
OC	Operating Committee
OEA	Office of Enforcement Analysis
OEE	Office of Export Enforcement
OExS	Office of Exporter Services
OIG	Office of Inspector General
PLC	Pre-License Check
PSV	Post-Shipment Verification
TCP	Technology Control Plan
WINPAC	Center for Weapons Intelligence, Nonproliferation, and Arms Control
WMD	Weapons of Mass Destruction

Appendix B: Interagency Dual-Use Export Licensing Process



Source: Office of Inspector General

Appendix C: BIS Management Response to OIG Draft Report—Unclassified Version

UNITED STATES DEPARTMENT OF COMMERCE
Under Secretary for Industry and Security
Washington. D.C 202230

March 23,2007

MEMORANDUM FOR Johnnie Frazier
Inspector General

FROM: MF Mark Foulon, Acting

SUBJECT: Audit Report No. IPE-18144
Draft Report Date: February 23,2007
Audited Entity: Bureau of Industry and Security

Attached are the Bureau of Industry and Security's comments addressing the Office of the Inspector General's draft report entitled: U.S. Dual Use Export Controls for India Should Continue to Be Closely Monitored. Draft Inspection Report No. IPE-18144, February 2007.

The response consists of two parts. First are comments on the unclassified report's text and recommendations, followed by BIS's response to the report's classified text and recommendations.

Attachment

COMMENTS:

U.S. Dual Use Export Controls for India Should Continue to Be Closely Monitored, Draft Inspection Report No. IPE-18144, February 2007

Comments on the Report's Unclassified Text:

p. ii For reasons discussed in the classified section, BIS believes that India has fulfilled its commitments under the NSSP.

p. iii In the classified section of the report, BIS explains the reasons for its disagreements with certain of the report's findings as stated on this page.

p. iv For reasons discussed in the classified section of the report, BIS believes that performing 8 of 24 PSVs within 100 days of shipment is not a disadvantage.

p. 14 For reasons discussed in the classified section, BIS believes that India has fulfilled its commitments under the NSSP.

p. 15 There were two cases in the Operating Committee (OC) in which there was confusion about whether, or how, a proposed ultimate consignee was on the Entity List. In one of the two cases, the confusion was based on erroneous information provided by the applicant.

p. 17 In the classified section of the report, BIS explains the reasons for its disagreements with certain of the report's findings as stated on this page.

pp. 20-21 On a monthly basis, Defense identifies reports it wishes to review and Commerce provides those reports. If Defense requested copies of technical reports it required as license conditions, those reports would be provided to Defense for its review. Thus, there is a process for Defense to request reports it required in license conditions. If its review of those reports were to identify an issue, it would notify Commerce as a compliance issue and raise this in any future license application involving the exporter.

p. 23 The characterization of condition 14 as "one of the most critical conditions" because it means that the interagency has decided that a post-shipment verification check (PSV) was needed, reflects a misunderstanding of the PSV process, as well as the purpose of condition 14. License condition 14, which specifically requests the licensee to submit shipping documents to BIS within 30 days of the first shipment, is used in instances where Export Enforcement personnel review documentation and initiate a PSV at a later point in time. It can also be imposed on the licensee by the licensing officer when another agency requires that a PSV be conducted as a condition of approval. However, even when condition 14 is imposed, the PSV might not occur, for example, if there is no export against the license or if the agency

1

requesting this condition cancels the request. Commerce has the authority to initiate a PSV at any time, regardless of whether it is included as a condition of the license or whether the license contains condition 14, and independent of the interagency process. Indeed, not all PSVs require condition 14, and not all licenses with condition **14** result in PSVs. Of the **24** India licenses containing PSVs noted in the report, 10 either did not contain condition 14 or the condition was not placed on the license by the interagency, but by an OEA analyst.

Response to the Report's Recommendations:

Recommendation **1:** Specifically list all Indian entities that should be captured on BIS' Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements **(see** page **14).**

BIS Response:

BIS will review the listing of the Indian entities on the Entity List to determine how additional inforination can be provided to exporters. The planned completion date for this review is April **30,2007.**

Recommendation 2: Improve Export Administration's license monitoring efforts by:

a Determine why there are persistent breakdowns in **BIS'** process for monitoring license conditions (see page 19).
b Reviewing a sample of license applications to ensure licensing officers and counter-signersare properly marking licenses for follow-up (see page 19).
c Contacting exporters for the three licenses cited in this report that licensing officers did not mark for follow-up to determine exporters' compliance with reporting requirements (see page 19).
d Amending BIS procedures to require licensing officers to review all technical documentation submitted by exporters or end users to better ensure **their** compliance with the conditions (see page 19).
e Ensuring that relevant **Officer** of Exporter Services staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to the Office of Export Enforcement, as appropriate (see page 19).
f Reopening the two licenses that were closed by Office of Export Services staff and contacting the exporters regarding reporting requirements (see page 19).
g Referring any noncompliant exporters to the Office of Export Enforcement (see page 19).

BIS Response:

BIS is reviewing these seven recommendations. The **planned** conipletion date for this review is April **30,2007.**

Recommendation 3: Improve Export Enforcement's license monitoring and enforcement efforts by:

a. Requiring Office of Enforcement Analysis analysts and supervisors to closely monitor licenses at the specified follow-up time frames, recording their monitoring activities in the Conditions Follow-up Subsystem, and recommending that exporters who no not comply with condition 14 be denied additional licenses (see page **23).**

b. Referring all noncompliant exporters to the Office of Export Enforcement (see page **23.)**

c. Holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action (see page **23).**

BIS **Response:**

a. BIS is reviewing the first part of this recommendation to determine if it can be implemented using the current license processing system (ECASS), or if some alternative approach is necessary.

The second part of the recommendation, to deny licenses to those exporters who do not comply with condition 14, requires modification. BIS put this requirement into place in October **2003** in response to a previous OIG recommendation, but found that there were many factors involved that needed to be considered before BIS should determine to deny subsequent licenses. Thus, BIS believes it is more appropriate to consider **all** of the factors related to a late filing prior to referral to a criminal investigator. In cases where the Export Compliance Analyst believes it is appropriate to refer an investigative lead to OEE, OEA does so and also screens the party involved and recommends against issuance of any license until the OEE investigation has been concluded.

b. As explained above, BIS/OEA considers all of the factors related to a late filing and, if circumstances warrant, refers the matter to OEE for investigation.

c. The Office of Chief Counsel, Office of Export Enforcement, and the Department of Justice determine the investigation and prosecution that is appropriate for filing documentation late, based on all facts present.

Appendix B-2. Department of Commerce Report

Department of Commerce
Office of Inspector General's

Survey of
Selected Aspects of the CFIUS Process

Survey of Selected Aspects of the CFIUS Process

Given the current interest in the Committee on Foreign Investment in the United States (CFIUS) both within and outside the U.S. government, we followed up on our March 2000 findings and recommendations[1] related to select aspects of CFIUS' monitoring of foreign investment for national security reasons. While we still have questions about the effectiveness of the overall CFIUS process, considerable improvements have been made with regard to the CFIUS activities handled within the Commerce Department. We believe these improvements provide for better coordination among departmental bureaus and greater transparency in Commerce's decision-making process.

BACKGROUND

CFIUS was established by Congress in 1975 for the purpose of monitoring and evaluating the impact of foreign investment in the United States. In 1988 the committee's responsibilities were expanded under the Exon-Florio amendment to the Defense Production Act of 1950. Exon-Florio authorizes the President to suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. company that threatens national security. The provision does not provide a precise definition of national security; rather it gives the U.S. government the ability to redefine that term to keep pace with technological and political developments and address emerging threats as they arise. CFIUS is comprised of 12 federal agencies and chaired by the Secretary of the Treasury (see Figure 1). While members of the intelligence community are not voting members of CFIUS, they do provide intelligence assessments on all cases.

Figure 1: CFIUS Member Agencies

U.S. Department of the Treasury
U.S. Department of State
U.S. Department of Defense
U.S. Department of Commerce
U.S. Department of Homeland Security
U.S. Department of Justice
U.S. Trade Representative
Office of Management and Budget
Council of Economic Advisors
National Security Council
National Economic Council
Office of Science and Technology Policy

Source: *Department of the Treasury*

Overall CFIUS Process

Either the U.S. company or the foreign entity involved in an acquisition of or investment in a U.S. company may submit a voluntary notice, or "filing," of the transaction to CFIUS. In addition, under Exon-Florio, a committee member can submit a notice of a proposed or completed acquisition for a national security review. If the committee agrees that the transaction raises national security concerns, the CFIUS staff chair will contact the parties and request a filing. If the parties do not file, any CFIUS member can initiate the filing.

[1]U.S. Department of Commerce Office of Inspector General (Commerce OIG), March 2000. *Improvements are Needed in Programs Designed to Protect Against the Transfer of Sensitive Technologies to Countries of Concern,* IPE-12454-1.

Once the committee receives a complete CFIUS filing from a company, it has 30 days to determine whether the transaction involves national security concerns that should be investigated. Because of the limited time frame for the reviews, the committee encourages companies to pre-file before submitting documentation for an official 30-day review. Pre-filing helps CFIUS evaluate the notifications for any errors or inconsistencies.

If any member of CFIUS has national security concerns regarding the transaction, the committee conducts a 45-day investigation. During the investigation, the agency/agencies requesting the investigation are responsible for information gathering, analysis, and drafting the report and recommendation to the President. Other CFIUS members may be involved in the investigation if they have relevant expertise and issues of concern. Upon completion of the investigation, the President has 15 days to decide whether to prohibit the transaction or allow it to go forward. Upon completion of his review, the President sends a classified report to the Congress, stating his decision and explaining his reasons.

It should be noted that sometimes a transaction is still allowed to proceed, even when a CFIUS member has concerns with the transaction. In these cases, the CFIUS member may enter into a mitigation agreement with the parties. These agreements are aimed at minimizing the threat to national security—while still allowing the transaction to move forward—by requiring the parties in the transaction to establish and implement a set of security and other measures.

Commerce's Internal CFIUS Review Process

Within Commerce, the Secretary has delegated responsibility for coordinating the Department's evaluation of CFIUS filings to the International Trade Administration (ITA). However, the Bureau of Industry and Security (BIS) also plays a critical role in Commerce's CFIUS activities. In addition, the Deputy Secretary is kept apprised of CFIUS cases under review, and may be called upon to decide the Department's position in a specific case if ITA and BIS cannot agree.

Prior to April 2006, the Deputy Under Secretary for ITA was responsible for coordinating the evaluation of CFIUS notifications within Commerce. Since then, ITA's Assistant Secretary for Market Access and Compliance has had the policy lead on CFIUS efforts. However, ITA's Manufacturing and Services' Office of Competition and Economic Analysis (OCEA), where the CFIUS coordinator resides, provides the actual working-level support on CFIUS cases. Since the designation of a new CFIUS coordinator in October 2006, ITA's recommendations are now presented in writing to the Assistant Secretary for Market Access and Compliance. Additionally, the new CFIUS coordinator requires that the following documents be included in each CFIUS case file that ITA reviews:

- Business Fact Sheet. This document provides basic information about the businesses and industries involved in the proposed transaction. On a pilot basis, OCEA is sharing the fact sheets with BIS and the other "economic" agencies within CFIUS (i.e., the United States Trade Representative, State, the Council of Economic Advisors, and the Office of Science and Technology Policy). ITA has not yet decided if it will share these fact sheets with the entire CFIUS group.

- Analysis Memorandum. Relevant Manufacturing and Services units (e.g., Aerospace and Autos, Materials and Machinery, Technology and Electronic Commerce) are required to prepare an in-depth analysis of the proposed transaction and present recommendations on whether it is appropriate for ITA to clear the case.

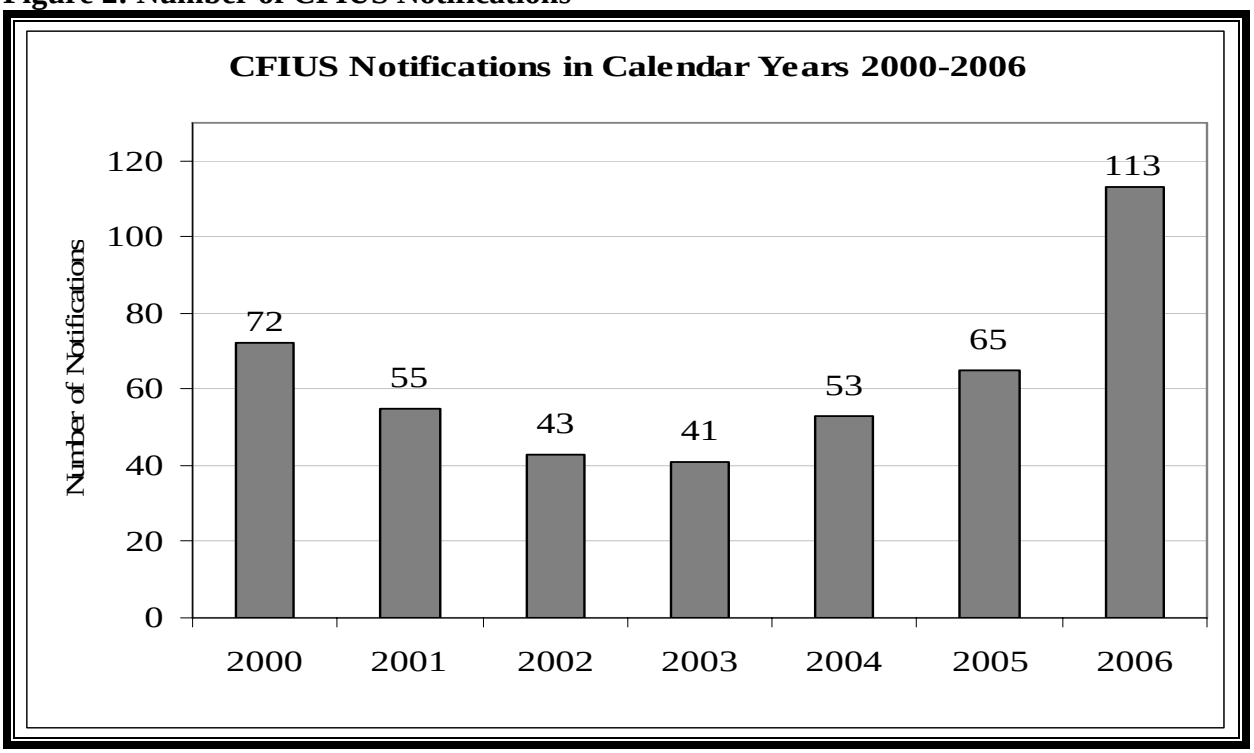
Within BIS, the responsibility for reviewing CFIUS notifications is assigned to Export Administration's Office of Strategic Industries and Economic Security (OSIES). In general, this office is responsible for a wide range of issues that relate to both the national and economic security of the United States. As a participant in the Department's CFIUS process, OSIES' role is to ensure that foreign investment will not negatively impact the U.S. defense industrial base's capacity and capabilities to meet current and future national security requirements. The office's database on CFIUS filings is the only comprehensive database on CFIUS filings available in the Department. In addition, BIS' Export Enforcement units screen all parties associated with CFIUS filings to ensure that there are no export enforcement concerns relevant to the CFIUS case under review.

ITA coordinates the Department's response on CFIUS notifications through its CFIUS Working Group. The group meets weekly and mainly consists of representatives from ITA and BIS. The Department's Office of General Counsel also participates on occasion when legal expertise is required. Additionally, the CFIUS Working Group consults with other Commerce bureaus on a case-by-case basis. For example, the National Institute of Standards and Technology was consulted on a case involving voting machines, and the National Telecommunications and Information Administration was consulted on a case involving a company that manufactured network security products. ITA prepares a weekly report summarizing all pending CFIUS cases for the Deputy Secretary's review. In addition, the Deputy Secretary attends "Deputy meetings" at the Department of the Treasury on CFIUS matters, on an as needed basis.

CFIUS Notifications

Between 2000 and 2006, CFIUS reviewed 442 foreign acquisitions of U.S. companies for potential national security concerns. In 2006 CFIUS reviewed 113 filings, a 74 percent increase over 2005 and more than twice the average number for the past 6 years (see Figure 2). Commerce and Treasury officials attribute this spike in filings to the increased attention to foreign mergers and acquisitions in the aftermath of the 2006 purchase of a British company that managed terminal operations at six key U.S. ports by Dubai Ports World, a United Arab Emirates company. This trend in the number of CFIUS filings appears as if it will continue in 2007, as 29 transactions were filed as of mid-March.

Figure 2: Number of CFIUS Notifications



Source: The Department of the Treasury

The majority of foreign investors involved in CFIUS notifications in 2006 were from the following six countries: United Kingdom, France, Israel, Canada, Australia, and Japan. While there were no filings involving foreign investors from China during this time frame, there was one filing involving a Hong Kong entity. Other foreign investors involved in CFIUS filings include entities from Pakistan, Russia, Venezuela, and the United Arab Emirates.

2006 CFIUS Reforms and Pending Legislation

Given the recent scrutiny of the effectiveness of the CFIUS process by the Congress in the aftermath of the Dubai Ports World case, the Department of the Treasury reports that CFIUS instituted the following reforms in 2006:

- Although current law requires the President to report to the Congress on transactions that receive a presidential decision, CFIUS now provides briefings to the Congress on every case reviewed by CFIUS.

- Only persons confirmed by the Senate can certify the conclusion of a CFIUS review.

- CFIUS encourages parties to transactions to pre-file before filing a formal notice.

- The Treasury Department hosts a weekly policy-level meeting to discuss all pending CFIUS cases.

- The Director of National Intelligence (DNI) was given a more formal role. Through the DNI, the intelligence community provides briefings on every transaction and participates in weekly CFIUS meetings.

In addition, the U.S. House of Representatives passed legislation in February 2007 aimed at reforming the current CFIUS process.[2] Treasury officials expect the Senate to take up the bill in spring 2007. Below are the main provisions of the House bill:

- Foreign government transactions. The bill requires CFIUS to conduct a 45-day national security investigation on all cases involving foreign government control unless the Secretaries of the Treasury, Homeland Security, and Commerce determine, on the basis of the 30-day review of the transaction, that it will not affect the national security of the United States.

- Designation of Vice Chairs. The bill elevates the Secretaries of Commerce and Homeland Security to the status of Vice Chairs of CFIUS and requires that they approve all transactions in addition to the Chairman of CFIUS.

- Unilateral Initiation of Reviews. The bill allows the President, CFIUS, or any member acting on behalf of CFIUS to initiate reviews of any previously reviewed or investigated transaction if any party to the transaction submitted false or misleading information or breached a mitigation agreement.

- Withdrawn Notices. The bill establishes a process for tracking transaction notices that have been withdrawn by the parties before the completion of the 30-day review or 45-day investigation by CFIUS.

- Annual Report to the Congress. CFIUS will be required to submit a report to the Congress before July 31 of each year on all reviews and investigations of transactions.

UPDATE OF PRIOR COMMERCE OIG WORK ON CFIUS PROCESS

In our March 2000 report on CFIUS and other matters, we raised concerns about the overall effectiveness of CFIUS' monitoring of foreign investment in the United States for national security reasons, including (1) the lack of mandatory foreign investment reporting, (2) the low number of investigations conducted on company filings, and (3) the potential conflict of interest or appearance thereof by the Treasury office charged with overseeing CFIUS because of its dual responsibilities to "promote" foreign investment as well as "prevent" such investment when it could result in the loss of sensitive technology or a critical reduction in the defense industrial base.

[2] H.R.556, "National Security Foreign Investment Reform and Strengthened Transparency Act of 2007."

The report also highlighted some issues involving Commerce's process for reviewing CFIUS filings, including (1) whether Commerce's lead responsibility for this program should remain in ITA, the Department's primary trade promotion agency, or be moved to BIS, the Department's primary national security agency, and (2) whether BIS' export enforcement and export licensing units should play a larger role in reviewing CFIUS filings.

To determine what actions have been taken to address these concerns, we met with various officials within ITA, including the Assistant Secretary for Market Access and Compliance, and BIS, including the Assistant Secretary for Export Administration and the director of the Office of Strategic Industries and Economic Security. We also met with the Department of the Treasury's Deputy Assistant Secretary for Investment Security and the CFIUS staff chair. In addition, we reviewed current and proposed laws, policies, and procedures related to the CFIUS process. We also reviewed 10 CFIUS cases, including one from 2005 that was reopened in 2006 based on congressional concerns with the transaction, all 7 from 2006 that went to the investigation phase, and 2 from 2007 that raised possible export control issues.

Given the limited nature of our work, we did not determine how many of the 113 filings were withdrawn and refiled with CFIUS and how well CFIUS monitors this process. We also did not review CFIUS' process for monitoring compliance with mitigation agreements.

The following two sections provide updates on the two areas of CFIUS concerns highlighted in our March 2000 report.

A. *Update of Prior Commerce OIG Concerns Related to the Overall CFIUS Process*

Lack of Mandatory Foreign Investment Reporting—*Update*

During our recent follow-up work, both Treasury and Commerce officials informed us that the controversial and highly publicized Dubai Ports World case made U.S. and foreign entities more aware of the CFIUS process. As a result, the number of filings has increased. However, foreign investment reporting is still a voluntary process. Legislation was proposed in the National Defense Authorization Act for Fiscal Year 2000 to make such reporting to CFIUS mandatory, but the provision was deleted before passage of the bill. To date, Congress has not taken any action to make CFIUS filings mandatory. In addition, the Administration has not proposed mandatory filing. According to Commerce and Treasury officials, mandatory filing might harm U.S. open investment policy as well as overburden U.S. government resources. However, both agencies stated that even though filing with CFIUS is voluntary, it is in the best interest of the parties to an investment transaction to notify the committee because CFIUS retains the right to review any transactions not communicated to the committee, and the review could result in forced divestiture.

While we acknowledge that the number of CFIUS filings has increased, we still question whether CFIUS is capturing—in a timely manner—all relevant acquisitions and mergers, especially those involving small or medium-sized U.S. companies that manufacture or conduct research on sensitive U.S. technologies (including emerging technologies). For instance, one of the 2006 cases we reviewed during our follow-up work involved a small U.S. company that had

been acquired a year earlier without CFIUS review. It is unknown why the U.S. company did not notify CFIUS of the proposed acquisition prior to its completion. The transaction was only brought to CFIUS' attention a year after the acquisition occurred when it was highlighted by the media. Due to national security concerns, the U.S. government ultimately ordered the divestiture of the acquisition which has to be completed by December 2007. While there was no evidence in the case file to suggest national security had been compromised, reviewing such transactions after the fact increases the likelihood of this possibility.

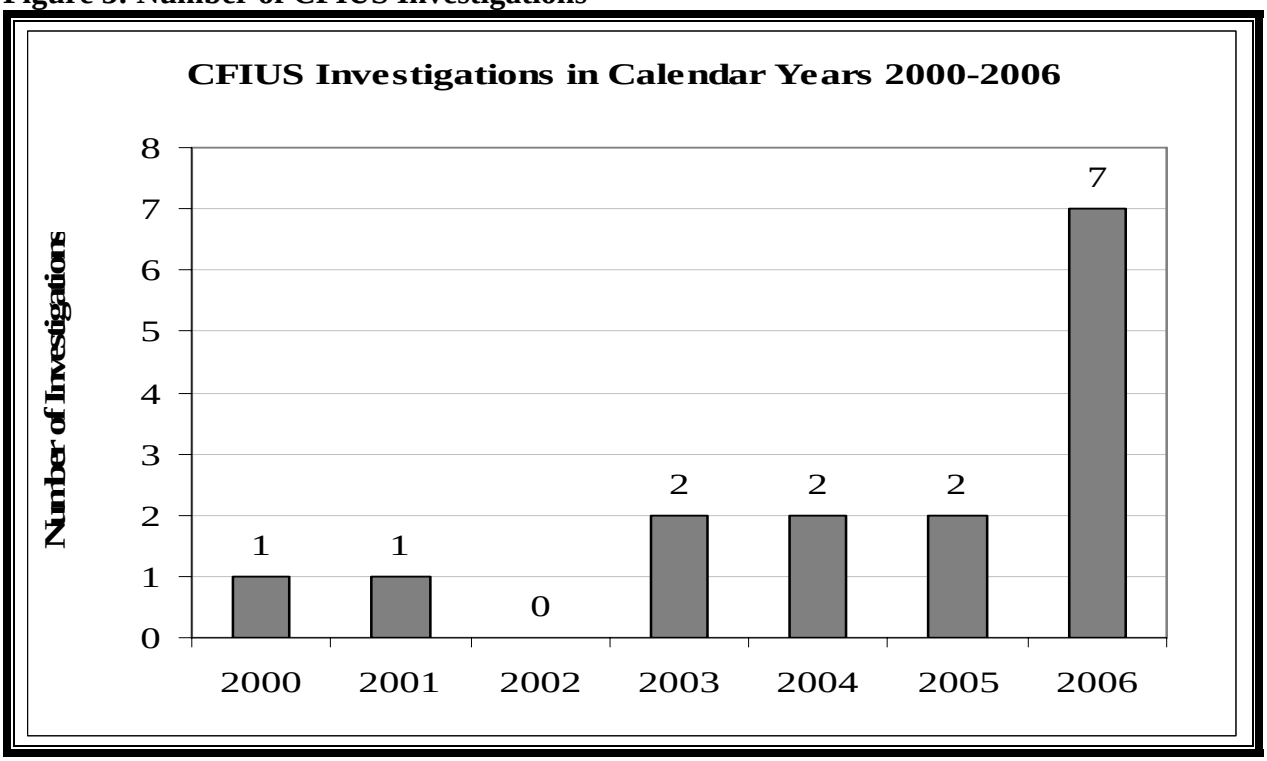
In addition, while CFIUS members are permitted to submit a notice of proposed or completed acquisition for a national security review, this does not happen very often. Specifically, the Department of the Treasury reported that it received six notifications from member agencies in 2006, including four from Commerce.

Low Number of Investigations—*Update*

The number of 45-day investigations has increased since our March 2000 report (see Figure 3). Specifically, the percentage of filings investigated increased from 1 percent in 2000 to 6 percent in 2006. Of the 113 CFIUS filings in 2006, 7 cases were escalated to the investigation phase. However, since the number of filings also increased in this time period, it is hard to determine—based on the statistics alone—what this increase in investigations really means or how significant it is given that (1) a party can withdraw its filing before it is escalated to the investigation phase (although the expectation is that the party will refile the notice if the transaction is to proceed) and (2) CFIUS can enter into a mitigation agreement with a party to deal with any potential national security concerns before being escalated to the investigation phase.

Of the seven cases escalated to investigation in 2006, only two required a presidential decision. In both cases, the President allowed the transaction to go forward. The remaining five cases were withdrawn before the investigation phase concluded and refiled later. CFIUS ultimately approved three of the five refiled transactions. In the fourth case, CFIUS required a divestiture, and the fifth transaction was abandoned by the parties involved.

Figure 3: Number of CFIUS Investigations



Source: Department of the Treasury

Dual Responsibilities of CFIUS Leadership—*Update*

In our March 2000 report, we questioned whether the dual responsibilities of Treasury's Office of International Investment, located in the Office of the Assistant Secretary of International Affairs, were incompatible. That office, which serves as the secretariat for CFIUS, is responsible for promoting foreign direct investment as well as investigating questionable foreign investment. While the lead responsibility for CFIUS continues to remain in this office, both Treasury and Commerce officials reported that CFIUS has been operating on a consensus basis for the past year. As such, any CFIUS member can bring a case to CFIUS for review as well as escalate a case for investigation. In addition, although the law requires CFIUS to provide reports to the Congress only on transactions that receive a presidential decision, Treasury officials informed us that, in the spirit of transparency, it now provides all final CFIUS results to the Congress. Therefore, our original concern about Treasury's leadership of CFIUS—based on its competing interests—appears to be mitigated due to the recent increase of checks and balances on Treasury's decision-making authority.

Conclusion

Even with the possible enactment of the pending CFIUS legislation, we still have concerns about the overall effectiveness of CFIUS' monitoring of foreign investments for national security reasons. Specifically, whether or not it is determined to be feasible to require mandatory reporting to CFIUS, we are concerned that the committee may not be capturing acquisitions and mergers involving small or medium-sized U.S. companies that manufacture or conduct research

on sensitive U.S. technologies, as noted earlier in our report. Also, it is not clear whether companies that withdraw their filings at various stages in the process are adequately monitored by CFIUS to ensure that a merger or acquisition that raises potential national security concerns does not continue without further review. Additionally, there does not appear to be a formal mechanism in place to monitor mitigation agreements that CFIUS members enter into with parties to a merger or acquisition.

Our March 2000 report suggested that an interagency OIG review of the CFIUS process, conducted by the OIGs from the Departments of Commerce, Defense and the Treasury, may be warranted, as a part of our responsibilities under the National Defense Authorization Act for Fiscal Year 2000, as amended. While the Inspectors General of Treasury and Defense concurred with our suggestion, other priorities prevented this review from taking place. Nevertheless, we still believe that such a review is warranted to (1) determine the scope of the problem regarding foreign investment in U.S. companies with sensitive technologies by countries and entities of concern and (2) review the overall effectiveness of CFIUS and recommend improvements, as necessary, to the way the U.S. government monitors foreign investment in these companies.

B. Update on Closed OIG Recommendations Related to Commerce's Role in CFIUS

Placement of CFIUS Responsibility Within the Department—*Update*

When CFIUS was created, the Department's export control functions were performed by ITA. However, in 1987 the Congress decided to split the Department's trade promotion responsibilities from its export control and enforcement functions. Thus, the Bureau of Export Administration (now BIS) was created as an independent Commerce bureau to handle the latter trade administration functions. While ITA's focus remained on trade promotion, it also retained its role as Commerce's representative on CFIUS. With the passage of the Exon-Florio provision in 1988, however, CFIUS's main focus was shifted from monitoring overall foreign investment in the United States to determining the effects on national security of foreign mergers, acquisitions, and takeovers of U.S. companies. Given the main thrust of Exon-Florio is to prevent foreign acquisitions or investments that could threaten national security, our March 2000 report questioned why the lead responsibility for CFIUS within the Department was with ITA and not BIS.

In response to our March 2000 report, ITA stated that it should retain the role as the lead organization in Commerce on CFIUS issues. In addition, it stated that ITA would continue to encourage full involvement and cooperation by all concerned units in the Department and would participate fully in efforts to seek productive ways of improving the effectiveness of CFIUS. BIS' response stated that the current Commerce mechanism for reviewing CFIUS filings is sufficient, but that it would accept the responsibility if it were transferred to it.

We still believe that BIS may be the more appropriate entity to have the lead on CFIUS within Commerce given its national security mission. However, based on our discussions with BIS and ITA officials and our limited case reviews, it appears that the current Commerce process is working well. Both ITA and BIS report that disagreements between the two entities during Commerce's decision-making process are rare. ITA officials attribute this, in part, to the fact

that it defers to BIS on any case that raises specific export control concerns. We only identified one case in which BIS and ITA officially disagreed, but the issues of concern did not involve export controls. Ultimately, the decision on Commerce's position on this case was raised to the Deputy Secretary, who made the final decision.

While we are encouraged by these recent developments, we are concerned that there are no comprehensive, written procedures outlining how the CFIUS process works in Commerce. The director of ITA's Office of Competition and Economic Analysis (OCEA) informed us that he is planning on establishing written CFIUS guidelines in the next month and distributing them to BIS, NIST, and other offices within Commerce that work on CFIUS. We also were informed that, in March 2007, BIS developed written guidance for handling of the CFIUS process within BIS. It is now appropriate that ITA, BIS, and other relevant Commerce offices work together to develop and implement written procedures outlining how the CFIUS process should work in the Department, including the roles and responsibilities of all parties involved in the process.

Recommendation:

We recommend that ITA work with BIS and other relevant Commerce offices to establish written procedures outlining the specific CFIUS roles and responsibilities of Commerce units and how the CFIUS process should work in Commerce to ensure continued coordination and cooperation.

BIS' Internal Review of CFIUS Notifications—*Update*

While our prior work found that the Office of Strategic Industries and Economic Security (OSIES) was conducting a fairly comprehensive review of CFIUS notifications in response to ITA's referrals, our March 2000 report raised concerns that these notifications, and in particular those involving entities from countries of concern, were not always reviewed by Export Administration's and Export Enforcement's licensing and enforcement experts. However, based on our follow-up work, we found that OSIES has greatly increased its collaboration with these components of BIS. OSIES now works more closely with licensing officers on each CFIUS filing: Every notification is sent to the appropriate licensing officer for a technical review and to determine if applicable U.S. technologies and/or commodities involved in the transaction fall under the Export Administration Regulations. The division director of OSIES also reported that in order for licensing officers to better understand what CFIUS is and to ensure that applicable CFIUS transactions are not overlooked during the export licensing process, OSIES is providing training to licensing officers on the CFIUS process.

In addition to working with licensing officers, OSIES is working more closely with export enforcement officials. Specifically, all parties associated with CFIUS filings are reportedly vetted with Export Enforcement to ensure that there are no export enforcement concerns relevant to a CFIUS case under review. We also found, based on two recent CFIUS cases we reviewed, that OSIES refers possible export control violations identified as a part of the CFIUS review process to Export Enforcement's Office of Export Enforcement (OEE). Given the 30-day CFIUS review period, OEE made these referrals a priority and was able to respond back to OSIES in a timely fashion with the recommendation that these cases could move forward in the

CFIUS process. Furthermore, it should be noted that OEE is planning to conduct outreach visits in 2007 with U.S. parties to CFIUS transactions to educate and inform them of their export control responsibilities. The director of OSIES informed us that he and/or his staff plan to accompany OEE on two of the outreach visits scheduled in April 2007.

Additionally, as noted previously, BIS has recently established written procedures that reflect the new CFIUS process within the bureau. The director of OSIES told us that this document was distributed to every analyst who is involved with CFIUS. Also, the Assistant Secretary for Export Administration was recently briefed on the newly created CFIUS written procedures.

Finally, it should be noted that in 2006 and 2007, Commerce, in particular BIS, along with several other CFIUS members, participated in negotiating two mitigation agreements with parties involved in sensitive acquisitions of U.S. companies. BIS will be responsible for monitoring the export control provisions of these agreements when they take effect in the near future. However, BIS does not have any written procedures in place that outline how it should monitor these provisions of the agreements. (As of March 30, 2007, the Director of OSIES told us that his office is currently working on a draft version of the procedures for monitoring provisions of the mitigation agreements.) To better ensure that mitigation agreements are adhered to by the parties involved, BIS should finalize and issue those procedures that will allow it to monitor and enforce the export control provisions of these agreements.

Recommendation:

We recommend that BIS finalize and implement written procedures that outline how it will monitor and enforce the dual-use export control provisions of mitigation agreements entered into by CFIUS.

Appendix C. Department of Defense Report

Report No. D-2007-131 September 28, 2007

Inspector General

United States Department of Defense

Followup Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern

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Acronyms

DDR&E	Director of Defense Research and Engineering
DFARS	Defense Federal Acquisition Regulation Supplement
DTSA	Defense Technology Security Administration
DUSD(TSP&NDP)	Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy
EAR	Export Administration Regulations
USD(AT&L)	Under Secretary of Defense for Acquisition, Technology, and Logistics
USD(P)	Under Secretary of Defense for Policy
USXPORTS	U.S. Exports System

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

September 28, 2007

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS
UNDER SECRETARY OF DEFENSE FOR POLICY
DEPUTY UNDER SECRETARY OF DEFENSE FOR TECHNOLOGY SECURITY POLICY AND NATIONAL DISCLOSURE POLICY
DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
DIRECTOR, DEFENSE TECHNOLOGY SECURITY ADMINISTRATION

SUBJECT: Report on Followup Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern (Report No. D-2007-XXX)

We are providing this report for review and comment. We conducted the audit to comply with Public Law 106-65, "National Defense Authorization Act of Fiscal Year 2000," Section 1402, "Annual Report on Transfers of Militarily Sensitive Technology to Countries and Entities of Concern."

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We considered comments from the Under Secretary of Defense for Acquisition, Technology, and Logistics and from the Defense Technology Security Administration when preparing the final report. Because those comments did not provide concurrence or nonconcurrence with the recommendation, we request that those organizations send comments by October 29, 2007. We did not receive comments on a draft of this report from the Under Secretary of Defense for Policy or the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy; we request that they provide comments by October 29, 2007. Although not requested, Defense Research and Engineering provided comments. We made minor changes to the report in response to comments, the complete text of which is in the Management Comments section.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to AudROS@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Dennis L. Conway (703) 604-9172 (DSN 664-9172) or Mr. Lamar Anderson at (703) 604-9640 (DSN 664-9640). The team members are listed inside the back cover. See Appendix E for the report distribution.

By direction of the Deputy Inspector General for Auditing:

Wanda A. Scott
Assistant Inspector General
Readiness and Operations Support

Department of Defense Office of Inspector General

Report No. D-2007-131 **September 28, 2007**
(Project No. D2006-D000LG-0199.000)

Followup Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern

Executive Summary

Who Should Read This Report and Why? Personnel who are responsible for developing and implementing controls over exports of sensitive technology should read this report. It discusses audit recommendations to strengthen controls over exporting sensitive goods, services, and technologies to foreign countries and persons.

Background. Public Law 106-65, "National Defense Authorization Act for Fiscal Year 2000," requires the Inspectors General of the Departments of Commerce, Defense, Energy, and State to conduct annual reviews of the transfer of militarily sensitive technology to countries of concern. For the annual review due to Congress by March 30, 2007, these Inspectors General were joined by those of the Departments of Homeland Security, Treasury, the U.S. Postal Service, and the Central Intelligence Agency. The Inspectors General decided to follow up on recommendations made from FY 2000 through FY 2006 to improve controls over exports. Each year, the results of the individual agencies' reviews are combined in a report to Congress.

Results. The DoD Inspector General made 39 recommendations during FYs 2000 through 2006 to strengthen controls and reduce risks contributing to the inappropriate export of goods, services, and technologies such as chemicals, toxins, electronics, explosives, sensors, and lasers. As of June 28, 2006, DoD organizations had implemented 25 of the 39 recommendations. During this audit, we found four additional recommendations were implemented for a total of 29 recommendations. Therefore, as of December 21, 2006, DoD organizations still needed to implement 10 recommendations. The 10 remaining recommendations request DoD organizations to develop, implement, or revise guidance to determine whether an export license is required; to prevent unauthorized access to or disclosure of export-controlled technology; and to establish roles and responsibilities for persons involved with export-controlled technology. Also, the recommendations relate to analyzing and documenting analysis of export applications; updating export guidance to reflect current organizational titles, responsibilities, and structure; giving users access to the DoD export application system; and developing effective management controls. Until our recommended actions are implemented, DoD continues to accept avoidable risks of inappropriately exporting sensitive goods, services, and technology that could threaten our national security. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. We issued a draft of this report on March 12, 2007. The Director of Defense Procurement and Acquisition Policy responded for the Under Secretary of Defense for Acquisition, Technology, and Logistics and neither concurred nor nonconcurred with our finding and recommendation. We considered the Director's response related to explaining the process for revising the Defense Federal Acquisition Regulation Supplement; however, we did not see that an explanation of the process was needed to explain the status of our recommendation. We agreed with the Director's comments and revised our report to state that the proposed changes in the Defense Federal Acquisition Regulation Supplement did not meet the intent of our prior recommendation. Also, we considered the Director's comments and deleted our references to the Defense Federal Acquisition Regulation Supplement related to issuing guidance and training DoD personnel. We revised our finding to show that the draft policy issued by the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy

should address our recommendation for issuing guidance and training DoD personnel on procedures for handling exports, if approved and implemented. In addition, we considered and revised our report to reflect the Director's comments concerning the responsibility of the Under Secretary of Defense for Policy for revising and issuing draft DoD Instruction 2040.2. We made no change in response to the Director's comment that no DoD Instruction is numbered 2040.2. A draft of the new DoD Instruction 2040.2 is being coordinated within the Department; this Instruction will replace DoD Directive 2040.2. Finally, we considered the Director's comments that his office's procedures for following up on our recommendation was timely and adequate. However, more timely action by the Director's office is needed to implement our recommendation. We issued our audit report on March 25, 2004, and one recommendation remained outstanding on March 29, 2007. Until changes are made, DoD will be at increased risk of other nations' countering or reproducing our technology. We request that management provide comments on this final report by October 29, 2007.

The Director (Acting) of the Defense Technology Security Administration nonconcurred with our findings related to her office. Specifically, the Director disagreed with our use of the policies in the Export Administration Regulations for evaluating her office's review of applications to export dual-use items. However, we used those export policies and procedures for evaluating the review of license applications after reviewing and considering DoD's directive on management controls. That directive requires organizations to perform functions to comply with applicable laws and management policy. The Export Administration Act is the law that establishes the requirements for processing export license applications and the Export Administration Regulations implement the management policies for processing those applications. DoD should consider those policies in making recommendations to the Department of Commerce on export license applications. Also, the Director disagreed with our finding that her office was required to document reasons for all recommendations made on export applications. We addressed the need to document reasons for all recommendations in our prior report, "Controls Over Exports to China," March 30, 2006. That report cited the Principal Statutory Authority for the Export Administration Regulations, which stated that DoD will make and keep records of its advice, recommendations, or decisions, including the factual and analytical basis, connected with export licenses. We agree with the Director's comment that her office had no statutory or regulatory authority to approve or deny export applications, merely to recommend a course of action to the licensing department. We modified our report to show that her office was only responsible for making recommendations to the Department of Commerce. Further, we considered and agreed with the Director's comment that DoD Instruction 2040.2 cannot be finalized until it has been coordinated with DoD activities and completed by the Under Secretary of Defense for Policy. We request that management provide comments on this final report by October 29, 2007.

We did not receive any written management comments on this report from the Under Secretary of Defense for Policy or from the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy. Therefore, we request that both provide management comments on this final report by October 29, 2007. Although no comments were required, we received and agreed with comments provided by the Director of Defense Laboratory Programs, who responded for the Director, Defense Research and Engineering. The Director commented that our recommendation to complete DoD Instruction 2040.2 should be redirected to the Under Secretary of Defense for Policy; we did so in the draft. Also, the Director asked us to consider revising the report to state that DoD Instruction 2040.2 will provide export procedures, the Defense Federal Acquisition Regulation Supplement will provide specific clauses concerning export procedures, and training on export compliance requirements depend on the content of the yet-to-be-published Defense Federal Acquisition Regulation Supplement and DoD Instruction 2040.2. See the Findings section for a discussion of management comments, and see the Management Comments section for the complete text of the comments.

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Background

Annual Review on Transfers of Technology. In FY 2000, Congress passed Public Law 106-65,[1] which requires an annual review of transfers of sensitive technology to countries of concern. The law required annual reviews to begin in FY 2000 and end in FY 2007. To comply with the law, Inspectors General of affected departments and agencies formed an interagency team to conduct the reviews and produce the annual reports.

Annual Report to Congress. For the annual report due to Congress by March 30, 2007, the Inspectors General decided to review whether recommendations made in previous reports had been implemented. The Inspectors General participating in this year's review include those from the Departments of Commerce, Defense, Energy, Homeland Security, State, and Treasury; the U.S. Postal Service; and the Central Intelligence Agency. This audit report provides the legislatively required 2007 review of DoD controls over exports.

Legislative Controls Over Exports. Several laws give the U.S. Government authority to control the export of commodities and technologies. The primary legislative authority for controlling the export of goods and technologies that have both civilian and military use (dual use) is the Export Administration Act of 1979, as amended (title 50, United States Code, section 2401).[2] The Arms Export Control Act (title 22, United States Code, section 2778) authorizes the President to issue regulations for export of selected:

- defense-related articles (which are models, mockups, or technical data shown on the U.S. Munitions List);
- services, such as assistance provided to foreign persons in the design, development, and production of defense articles; and
- technical data including either classified or unclassified information, other than software, required for the design, development, or production of defense articles.

[1] We performed this audit to comply with Public Law 106-65, "National Defense Authorization Act for Fiscal Year 2000," section 1402, "Annual Report on Transfers of Militarily Sensitive Technology to Countries and Entities of Concern," October 5, 1999.

[2] The Export Administration Act expired in August 1994. However, the President, under the authority of the International Emergency Economic Powers Act (50 U.S.C. 1702), continued the provision of the Export Administration Act through Executive Orders 12924 and 13222, "Continuation of Export Control Regulations," August 19, 1994, and August 17, 2001, respectively. Each year thereafter, and most recently on August 3, 2006, the President issued a notice, "Continuation of Emergency Regarding Export Control Regulations," extending Executive Order 13222.

DoD Export Control Responsibilities. DoD designated the following offices to develop and implement export control policy and to control exports to foreign countries and persons:

- **Under Secretary of Defense for Acquisition, Technology, and Logistics (USD[AT&L]).** The USD(AT&L), in coordination with the Under Secretary of Defense for Policy, is responsible for providing technology assessments that help DoD determine the national security implications of the transfer of technology, goods, services, and munitions.[3] Also, the USD(AT&L) advises the Under Secretary of Defense for Policy on the technological aspects of export control policies and procedures necessary to protect the national security interests of the United States.

- **Under Secretary of Defense for Policy (USD[P]).** The USD(P) is responsible for the formulation of defense policy and for the integration and oversight of DoD policies and plans to achieve national security objectives. Specifically, the USD(P) oversees all aspects of DoD transfers of international technology, including export controls, licensing of dual-use commodities[4] and munitions, and arms cooperation programs. As part of its oversight responsibilities, the USD(P) supervises the Office of the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy.

- **Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy (DUSD[TSP&NDP]).** The DUSD (TSP&NDP) is responsible for developing and implementing DoD technology security policies to control defense-related goods, services, and technology exports. The DUSD(TSP&NDP) also serves as the Director of the Defense Technology Security Administration (DTSA), responsible for coordinating reviews of license applications and reporting decisions made on the basis of those reviews to the Department of Commerce.

Objectives

The overall objective of this audit was to determine whether DoD effectively implemented recommendations made by the DoD Office of Inspector General in our seven previous reports (FY 2000 to FY 2006) on controls over militarily sensitive exports. Management had implemented recommendations from four of the seven reports; therefore, we reviewed the three remaining reports to determine management action. Specifically, we evaluated management actions taken on:

- all recommendations contained in DoD IG Report No. D-2006-067, "Controls Over Exports to China," March 30, 2006;

[3] Munitions include arms and ammunition as well as any material, equipment, or goods used to make military items.

[4] Dual-use commodities can be used for commercial or military purposes.

- Recommendations 1. and 2. in DoD IG Report No. D-2004-061, "Export-Controlled Technology at Contractor, University, and Federally Funded Research and Development Center Facilities," March 25, 2004; and

- Recommendations A.1. and A.2. in DoD IG Report No. D-2000-110, "Export Licensing at DoD Research Facilities," March 24, 2000, which related to controls over exporting sensitive technologies to countries of concern.

See Appendix A for a discussion of the scope and methodology, and Appendix B for prior coverage related to the audit objective.

Extent of Implementation of Recommendations To Improve Export Controls

DoD organizations implemented 29 of 39 (74 percent) of the recommendations made in the 7 reports that we issued from FY 2000 through FY 2006. We made the 39 recommendations to strengthen controls and reduce risks of inappropriate exports of goods, services, and technologies such as chemicals, toxins, electronics, explosives, sensors, and lasers. However, DoD organizations need to take further actions to fully implement the 10 remaining recommendations in 3 of the 7 reports.

DoD organizations did not establish a fully effective process for following up and aggressively implementing the 10 outstanding recommendations as demonstrated by one recommendation that was not implemented for almost 7 years. Until recommended controls are implemented, DoD continues to accept avoidable risks of inappropriately exporting sensitive goods, services, and technology that could threaten our national security.

DoD Guidance on Implementing Audit Recommendations

Guidance on Implementing Recommendations. DoD Directive 7650.3, "Follow-up on General Accounting Office (GAO),[5] DoD Inspector General (DoD IG), and Internal Audit Reports," provides guidance to DoD managers on implementing audit recommendations. The Directive states:

- "The DoD Component managers recognize, support, and use auditors as important elements of DoD management systems.
- Timely decisions and responsive actions shall be taken and documented on audit findings and recommendations to reduce costs, manage risks, and improve management processes.
- Follow-up is an integral part of good management and is a responsibility shared by DoD managers and auditors.
- An effective, credible decision process shall be maintained to resolve disputes on audit findings and recommendations; prevent preemptive actions, such as proceeding with activities questioned in undecided audit reports; and provide prompt and well-documented decisions consistent with statutes and regulations.
- Follow-up systems shall provide for a complete record of action taken on findings and recommendations."

[5] The General Accounting Office was renamed the Government Accountability Office.

Status of Recommendations. We announced the audit on June 28, 2006, to determine whether DoD officials had implemented the recommendations we made from FY 2000 through FY 2006. The results of this audit will be combined with the results of reviews by seven other Inspectors General in a report to Congress. The report will provide an assessment of the extent to which export controls were implemented within the Federal Government from FYs 2000 through 2006.

As of June 28, 2006, DoD organizations had implemented 25 of 39 (64 percent) of the recommendations made in our reports from FYs 2000 through 2006. Those DoD organizations had agreed to implement all 39 recommendations.

During this audit, we found that DoD organizations had implemented four additional recommendations. Therefore, as of December 21, 2006, 29 of 39 (74 percent) of the recommendations were implemented. The table shows the number of recommendations we made and those implemented by DoD organizations.

Status of Recommendations

		Implemented			
		As of June 28, 2006		As of Dec. 12, 2006	
Report Number	Number of Recommendations	Yes	No	Yes	No
D-2006-067	7	0	7	1	6
D-2005-042	1	1	0	1	0
D-2004-061	4	1	3	1	3
D-2003-070	3	3	0	3	0
D-2002-039	4	4	0	4	0
D-2001-088	8	8	0	8	0
D-2000-110	12	8	4	11	1
Total	**39**	**25**	**14**	**29**	**10**

(See Appendix C for a complete list of the recommendations we reviewed.)

Work Needed To Implement Recommendations

As of June 28, 2006, DoD organizations still needed to implement 14 of the recommendations made during FYs 2000 to 2006.[6] One outstanding recommendation was almost 7 years old. Also, as of December 12, 2006, we found that 4 additional recommendations were implemented, which resulted in 10 remaining outstanding.

Five DoD organizations were responsible for implementing the 14 recommendations. We indicate responsibility for and discuss the status (outstanding or closed) of recommendations below, by organization:

- **Under Secretary of Defense for Acquisition, Technology, and Logistics (USD[AT&L]) was responsible for implementing 1 of the 14 recommendations, this recommendation remains outstanding;**

- **Under Secretary of Defense for Policy (USD[P]) was responsible for implementing 2 of the 14 recommendations, 1 of the 2 recommendations remains outstanding;**

- **Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy (DUSD[TSP&NDP]) was responsible for implementing 4 of the 14 recommendations, each of the 4 recommendations remain outstanding;**

- **Director, Defense Research and Engineering (DDR&E) was both responsible for implementing 2 of the 14 recommendations, recommendations were closed and a new recommendation was made in this report to USD(P); and**

- **Director, Defense Technology Security Administration (DTSA) was responsible for implementing 5 of the 14 recommendations, 4 of the 5 recommendations remain outstanding.**

Under Secretary of Defense for Acquisition, Technology, and Logistics (USD[AT&L]). The USD(AT&L) did not implement one of the recommendations in Report No. D-2004-061, "Export Controlled Technology at Contractor, University, and Federally Funded Research and Development Center Facilities." We issued the report on March 25, 2004, and recommended that the USD(AT&L) develop and insert a clause in the Defense Federal Acquisition Regulation Supplement (DFARS) requiring contractors to:

> Comply with Federal export regulations and DoD guidance for export-controlled technology and technical data by obtaining an export license, other authorized approval or exemption, and preventing unauthorized disclosure to foreign nationals.

[6] As previously noted, we determined during this audit that 4 of the 14 recommendations were implemented, as of December 12, 2006.

> Incorporate the terms of the clause in all subcontracts that involve export-controlled technology.
>
> Conduct initial and periodic training on export compliance controls for those employees who have access to export-controlled technology.
>
> Perform periodic self-assessments to ensure compliance with Federal export laws and regulations.

Although the USD(AT&L) concurred with our recommendation in July 2004, the office had not implemented it as of December 21, 2006. However, USD(AT&L) did publish a draft of the proposed clause in the Federal Register dated August 14, 2006. USD(AT&L) officials stated that they received comments from the public in November 2006. However, as of February 5, 2007, USD(AT&L) had not completed the clause in the DFARS because those officials had not obtained the agreement from the Defense Acquisition Regulatory Council on the wording of the clause or the approval of the Office of Management and Budget's Office of Information and Regulatory Affairs.

We examined the proposed clause; it did not require contractors to conduct initial and periodic training or to perform periodic self-assessments on compliance with the Federal export laws and regulations. Therefore, we concluded that the clause did not meet the intent of the recommendation, which will remain outstanding (open) until the clause is revised to address the requirements of the recommendation and is published in the DFARS.

Under Secretary of Defense for Policy (USD[P]). The Office of the USD(P) implemented one of the two recommendations we made in Report No. D-2000-110, "Export Licensing at DoD Research Facilities," on March 24, 2000.

Specifically, we recommended that the USD(P):

> Coordinate with Commerce and State to develop guidance regarding when a visit or assignment of a foreign national to a Defense facility requires a deemed export license.[7]
>
> Revise DoD Directive 2040.2, "International Transfers of Technology, Goods, Services, and Munitions," to clearly state policies, procedures, and responsibilities of DoD and Military Department hosts for determining whether a deemed export license is required when a foreign national visits a Defense facility.

Guidance on When To Obtain a Deemed Export License. On March 24, 2000, the USD(P) agreed with the first recommendation to coordinate with the Departments of Commerce and State to develop guidance for when a visit or assignment of a foreign national to a DoD facility requires a deemed export

[7] A deemed export is defined by Export Administration Regulations (EAR) as a release of technology to a foreign national in the United States through such means as visual inspection, oral exchanges, or application of personal knowledge or technical experience acquired in the United States.

license. Also, on March 24, 2000, the USD(P) stated that DoD Directive 5230.20, "Visits, Assignments, and Exchanges of Foreign Nationals," would be revised to include DoD policies for licenses of deemed exports. During this audit, we examined the revised directive and determined that it includes guidance that satisfies our recommendation; therefore, we consider the recommendation closed.

Revision of DoD Directive. For the second recommendation—to revise guidance by clearly stating how Departmental hosts[8] should determine whether a deemed export license is required when a foreign national visits a Defense facility—DoD took several actions. Specifically, DTSA, an office under the USD(P):

- issued guidance in November 2002 and June 2003 that restricted the access of foreign nationals to export-controlled technologies at DoD facilities, and

- continued to review DoD Directive 2040.2, "International Transfers of Technology, Goods, Services, and Munitions,"[9] as of February 2005.

During this audit, a DUSD(TSP&NDP) official assigned to the USD(P) provided a draft memorandum, "Interim Guidance on Export Controls for Biological Agents," dated August 14, 2004. We determined that the proposed memorandum would fulfill our recommendation and clearly defines the policies, procedures, and responsibilities of DoD and Military Department hosts for determining whether a deemed export license is required when a foreign national visits a DoD facility. A USD(P) official stated that the guidance will be included in the revised DoD Instruction 2040.2; however, the Instruction remains in draft, and the USD(P) official could not provide an estimated completion date. Therefore, this recommendation remains open until the guidance is published in DoD Instruction 2040.2.

Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy (DUSD[TSP&NDP]).

DUSD(TSP&NDP)[10] did not implement two recommendations from FY 2004 and the two from FY 2006. In FY 2004, we issued Report No. D-2004-061, "Export Controlled Technology at Contractor, University, and Federally Funded Research and Development Center Facilities." We issued the report on March 25, 2004, and recommended that the DUSD(TSP&NDP):

> Expand "Interim Guidance on Export Controls for Biological Agents," November 7, 2002 to:
>
> > Encompass all export-controlled technology.

[8] A host is a designated individual or organization that is responsible for coordinating foreign national visits to sensitive and nonsensitive U.S. Government facilities.

[9] DoD Directive 2040.2, "International Transfers of Technology, Goods, Services, and Munitions," is now in draft as DoD Instruction 2040.2, "International Transfers of Technology, Goods, and Services."

[10] DUSD(TSP&NDP) was formerly titled the Deputy Under Secretary of Defense for Technology Security Policy and Counter Proliferation.

> Require program managers, in coordination with counterintelligence, security, and foreign disclosure personnel to:
>
> - identify export-controlled technology, foreign national restrictions, and licensing requirements.
> - identify threats by foreign countries that are targeting the specific technologies.
> - identify vulnerabilities and countermeasures to protect the export-controlled technology.
>
> Require program managers and contracting officers to ensure that contracts identify the export-controlled technology and contain requirements to maintain an access control plan, including unique badging technology; perform export compliance training; conduct annual self-assessments; and comply with Federal export laws by obtaining an export license, other authorized approval or exemption, or by safeguarding the technology when contracts involve export-controlled technology or information.

Expanding Interim Guidance. The DUSD(TSP&NDP) generally concurred with this recommendation on February 17, 2004, and later stated that follow-on draft guidance was issued in August 2004. We examined the draft interim guidance and found the guidance did address a portion of the recommendation; however, the guidance did not include procedures that require program managers, in coordination with counterintelligence, security, and foreign disclosure personnel, to identify:

- export-controlled technology, foreign national restrictions, and licensing requirements;
- threats by foreign countries that are targeting the specific technologies; and
- vulnerabilities and countermeasures to protect the export-controlled technology.

In addition, the interim guidance was not expanded to require program managers and contracting officers to conduct annual self-assessments.

On January 17, 2007, a DUSD(TSP&NDP) official stated that his office was working to include these procedures in the draft interim guidance. On February 2, 2007, a DUSD(TSP&NDP) official told us that the draft interim guidance will not be issued as a separate memorandum because the guidance will be published in DoD Instruction 2040.2. However, our recommendation was not incorporated in either the interim guidance or the Instruction; therefore, we consider this recommendation open. Further, in this report, we issued a new recommendation that requests the USD(P) to complete and publish DoD Instruction 2040.2, because the USD(P) has the responsibility for updating and publishing this Instruction.

Incorporating Interim Guidance in a DoD Directive. For the second recommendation, we requested the DUSD(TSP&NDP):

> Incorporate the interim guidance into the revision of DoD Directive 2040.2, "International Transfers of Technology, Goods, Services, and Munitions," January 1984, to include the roles and responsibilities of the program managers, counterintelligence, security, and foreign disclosure personnel.

The DUSD(TSP&NDP) generally concurred with this recommendation on March 25, 2004, and planned to include the interim guidance in DoD Instruction 2040.2. In August 2004, the DUSD(TSP&NDP) issued interim guidance.

During this audit, we reviewed the interim guidance and the DoD Instruction; neither addressed the roles and responsibilities of counterintelligence and foreign disclosure personnel for controlling the release of technology and technical data. Also during the audit, a DUSD(TSP&NDP) official reiterated to us on February 2, 2007, that the interim guidance will not be re-issued as a separate memorandum because the guidance will be published in the revised DoD Instruction. Regardless, the DoD Instruction did not fully address our recommendation and remains in draft without a planned completion date. Therefore, this recommendation remains open.

Gaining Access to USXPORTS. In addition to the recommendations we made in FY 2004 to the USD(TSP&NDP), we examined the following two recommendations addressed to the USD(TSP&NDP) in Report No. D-2006-067, "Controls Over Exports to China." Specifically, we recommended on March 30, 2006, that the DUSD(TSP&NDP):

> Grant access privileges to the four DoD organizations currently without access to USXPORTS to facilitate reviews of export applications.
>
> Update the guidance for the export review process to reflect current organizations and responsibilities.

Audit Report No. D-2006-067 identified that 4 of the 18 DoD organizations responsible for reviewing export applications were disconnected from USXPORTS (USXPORTS is an automated system used by DoD to process electronic export license data). The audit report recommended that the four organizations' access to this system be restored. The DUSD(TSP&NDP) agreed with our recommendation on March 29, 2006, and stated she would inform users of USXPORTS, within 60 days of becoming disconnected from the system, of the need to maintain access.

As of December 21, 2006, we found that DUSD(TSP&NDP) did not inform the four organizations' users of the need to maintain access to USXPORTS. A DTSA official, who reports to the Office of the DUSD(TSP&NDP), suggested we coordinate with the USD(P) regarding users' access to USXPORTS. (The USD[P] is responsible for developing, maintaining, and operating USXPORTS.)

We asked a USD(P) official why users at the four organizations were not informed of the need to maintain access to USXPORTS. The USD(P) official was unable to provide a reason. He told us that his office did not coordinate with DTSA when users were dropped from USXPORTS. Therefore, DTSA would not have known when users of USXPORTS were dropped from the system.

As a result of our discussions with the USD(P) official, we again asked the DTSA official why users of USXPORTS were not notified of the need to maintain access to USXPORTS. The DTSA official told us that the organizations were notified, but he could not provide documentation to show that they were notified. Also, the DTSA official told us that DTSA could not require organizations to use USXPORTS. In addition, the DTSA official stated that there were plans to transfer responsibility for USXPORTS from USD(P) to DTSA; however, he could not provide the date of transfer. Although the DTSA official could not provide a date when DTSA would assume the responsibilities for USXPORTS, he told us that when the transfer occurs his office will modify DoD Instruction 2040.2 to require users of USXPORTS to maintain access to USXPORTS. As a result, the recommendation remains open.

Updating Guidance on the Export Review Process. Our second recommendation asked DUSD(TSP&NDP) to update guidance on the export review process to reflect current organizations and responsibilities. DUSD(TSP&NDP) agreed with this recommendation on March 29, 2006, and stated that organizational changes would be accurately reflected in the guidance on the export review process.

We determined that DUSD(TSP&NDP) established draft guidance, but the guidance was not updated to reflect current DoD organizations and responsibilities. On November 14, 2006, a DUSD(TSP&NDP) official stated that the guidance is a draft and the current organizations and responsibilities cannot be completely determined until the Office of the Secretary of Defense completes its reorganization. As a result, the recommendation remains open.

Director, Defense Research and Engineering (DDR&E). The following two recommendations to DDR&E are in Report No. D-2000-110, "Export Licensing at DoD Research Facilities," March 24, 2000.

> Develop an export control program document containing procedures for determining if technology or commodities at Defense research facilities can be exported, with or without a license, including circumstances that may constitute exemptions from requirements of the Export Administration Regulations or International Traffic in Arms Regulations.
>
> Mandate training requirements for personnel at Defense research facilities on the deemed export licensing requirements of the Export Administration Regulations and International Traffic in Arms Regulations.

Guidance on Restricted Technology. DDR&E officials stated that the DUSD(TSP&NDP) issued a memorandum on August 14, 2004, that included a revised draft policy memorandum and a guide, "Managing Foreign Access: Implementing DoD Guidance on Restricted Technology." During this audit, we found the guide contained procedures for determining whether goods, services, and technology at DoD research facilities were exportable with or without a license. In addition, we determined that this guidance is in draft and will be included in DoD Instruction 2040.2, which will be completed by USD(P) because the USD(P) has the responsibility for updating and publishing this Instruction. Therefore, we decided to close our recommendation to the DDR&E and issue a new recommendation requesting that USD(P) complete and publish DoD Instruction 2040.2. The new recommendation requests that USD(P) merge procedures for determining whether goods, services, and technology at DoD research facilities were exportable with or without a license—procedures already contained in the draft policy guide, "Managing Foreign Access: Implementing DoD Guidance on Restricted Technology"—into the DoD Instruction.

Training Requirements for Defense Research Personnel. For the second recommendation, a DDR&E official informed us that the training requirements for personnel at DoD research facilities depend on the content of yet-to-be-published revisions of the DFARS and DoD Instruction 2040.2. In addition, DDR&E officials told us that they trained program managers, laboratory personnel, and security managers on deemed export licensing requirements of the Export Administration Regulations and the International Traffic in Arms Regulations.

Our review of the proposed revisions to DFARS and DoD Instruction 2040.2 determined that neither document included a mandate for training personnel at DoD research facilities on deemed export licensing requirements. As previously stated, DDR&E officials stated that the DUSD(TSP&NDP) issued a memorandum on August 14, 2004, that included a revised draft policy memorandum and a guide, "Managing Foreign Access: Implementing DoD Guidance on Restricted Technology."

We found the guide prescribed training for personnel at DoD research facilities on export licensing requirements. However, on February 2, 2007, a DUSD(TSP&NDP) official reiterated to us that the interim guidance will not be issued as a separate memorandum because the guidance will be published in DoD Instruction 2040.2. As such, our recommendation was not included in the pending revisions to the DFARS and the Instruction.

Further, we issued a new recommendation that requests the USD(P) to complete and publish DoD Instruction 2040.2 because, as previously stated, the USD(P) has the responsibility for updating and publishing this Instruction. Therefore, we decided to close our recommendation to DDR&E and issue a new recommendation that requests USD(P) to complete and publish the DoD Instruction. Completing the Instruction will involve the insertion of a mandate contained in the draft policy guide, "Managing Foreign Access: Implementing DoD Guidance on Restricted Technology" for training personnel at DoD research facilities on deemed export licensing requirements.

Director, Defense Technology Security Administration (DTSA). The DTSA implemented one recommendation but not four others made in Report No. D-2006-067, "Controls Over Exports to China," March 30, 2006. During this audit, we examined DTSA actions to implement the following five recommendations:

> Prepare written analyses to support decisions on export applications and maintain documents in USXPORTS to support those decisions.
>
> Elevate decisions to the extent possible when the appeal process does not produce a decision that supports the national security posture.
>
> Provide written responsibilities to the senior management control official for administering the management control program.
>
> Maintain documentation of training that managers of operating and assessable units receive.
>
> Adjust the internal management control program to more effectively assess internal controls for recording analyses and documentation in USXPORTS.

Documentation for Decisions on Export Applications. In response to the first recommendation, on May 19, 2006, the Acting DUSD(TSP&NDP) replied for DTSA:

> We are in general agreement with the proposition that complete analysis is a necessary and vital part of the licensing process. However, we disagree that inclusion of *every* facet of analysis considered in making a licensing determination is required-or even necessary-in *every* individual case. This is particularly true since implementation of a newer, automated license system, USXPORTS.
>
> All cases that were reviewed for this Report occurred prior to USXPORTS deployment. Significant changes have been made to the automated license database including:
>
> - USXPORTS maintains thorough data for each case, e.g., support documents, technical specification, end-user information, etc;
> - USXPORTS provides an easy way for licensing experts to search for precedent decisions, e.g., cases that involve the same item to the same destination, or the same end user or an item of similar capability to the same country; and
> - USXPORTS now contains complete analytic information for all cases escalated to the Operating Committee, the interagency committee that is the first line of escalation for disputed cases and where most are resolved.

To determine whether the recommendation was implemented, we requested and received the files supporting 1,609 and 1,880 applications to export to China for calendar years 2005 and 2006, respectively. We found that DTSA made recommendations (with conditions) to approve 2,953 export applications and to disapprove 385 applications. Those 3,338 applications represented 96 percent of the 3,489 applications processed for exports to China in calendar years 2005 and 2006.[11] According to DTSA officials, the 3,489 applications contained complete and timely data.

Selection Process for Application Review. We judgmentally selected and reviewed 40 of the 3,489 applications that contained requests to export sensitive goods, services, and technology such as chemicals and toxins, electronics, explosives, sensors, and lasers. The sample of 40 applications had closing dates[12] from January 7, 2005, to December 29, 2006. We selected these applications because of the potential adverse impact the prospective exports would have on regional stability, proliferation of nuclear weapons, use of chemical and biological weapons, and national security, if sent to China.

Results of Application Review. The review of the application files showed that 29 of the 40 files did not contain adequate analysis. In addition, 39 of the 40 did not have adequate supporting documentation.

For example, one file contained an application that recommended approval with conditions to export a pulse neutron generator to China. For this item, the Export Administration Regulations state that eight factors should be considered when determining whether to recommend approval of an application. Those factors were:

- whether the items to be transferred are appropriate for the stated end use and whether that stated end use is appropriate for the end user,
- the significance for nuclear purposes of the particular item,
- whether the item can be used in a nuclear reprocessing or enrichment facility,
- the types of assurances given that the item will not be used for nuclear explosive purposes or proliferation,
- whether any party to the transaction has been engaged in clandestine or illegal procurement activities,
- whether an application has previously been denied, or whether the end user has previously diverted items,

[11] The remaining applications were either approved, returned to the applicant without action, or partially approved.

[12] DTSA defined "closing date" as the date when it completed work on an application, developed its final recommendation for the application, and returned the application to the Department of Commerce.

- whether the export or re-export would present an unacceptable risk of diversion to a nuclear explosive activity or a nuclear fuel-cycle activity, and

- the nonproliferation credential of the importing country.

A review of this application file determined that the analysis and documentation were inadequate to justify the decision made by DTSA to recommend approval of this application. Specifically, the file did not include adequate analysis or documentation for any of the eight factors. Therefore, the file did not support the recommendation to approve the application. Because 29 of 40 files did not contain adequate analysis and 39 of 40 lacked documentation, our recommendation remains open. See Appendix D for the results of our analysis of the 40 application files we selected for review.

Decisions To Elevate Recommendations. For our second recommendation, we suggested that DTSA elevate its recommendations to the extent possible in the export application appeal process, if the majority of the representatives from the Departments of Commerce, Energy, and State did not agree with a DTSA recommendation (DTSA is responsible for recommending whether to approve export applications for DoD). We selected 11 applications that DTSA disapproved. One of the 11 was approved (with conditions) by all the other Departmental representatives. Thus, the majority of the Departments opposed the DTSA recommendation. Therefore, DTSA had the opportunity to appeal, but instead changed its recommendation and decided to approve the application with conditions.

Export Administration Regulations do not require a Department to appeal if the majority of the other Departments disagree with its recommendation. Also, Export Administration Regulations allow a Department to add conditions that it considers appropriate to offset the risk associated with approval of an application. As a result, our sample did not detect any instances in which DTSA did not use the appeal process to the extent it considered possible. Therefore, we consider this recommendation closed.

Management Control Plan. For the remaining three recommendations, which pertain to management controls, DTSA agreed with the recommendations on March 29, 2006, and stated it had adjusted its management control plan to:

- provide written responsibilities to the senior management control official,

- maintain training documentation for managers of operating and assessable units, and

- more effectively assess internal controls for recording analyses and maintaining documentation in USXPORTS.

DTSA provided a draft management control plan that did not meet the intent of the recommendations. On November 16, 2006, a DTSA official stated that

controls were in place but not written into the draft management control plan because of significant personnel turnover. Although he stated that the plan would be updated by December 31, 2006, we were unable to obtain this plan before we completed the audit. The three recommendations cited above will remain open until DTSA updates and approves the management control plan, including the requirements of our recommendations.

Effective Process for Following Up on Prior Recommendations

While the five DoD organizations responsible for managing export activities implemented most of the recommendations, they did not establish a fully effective process for following up on and implementing all of our recommendations. Those organizations had agreed to implement each of our 39 recommendations; however, 1 recommendation remained open for almost 7 years.

DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006, states that the Managers' Internal Control Program should identify and promptly correct ineffective internal controls. Also, the Instruction requires DoD managers to track corrective actions taken to expedite prompt resolution of control deficiencies. In addition, the Instruction states that the deficiencies identified, whether through internal review or by an external audit, should be evaluated and corrected.

Office of Management and Budget Circular No. A-123, "Management's Responsibility for Internal Control," December 21, 2004, requires DoD Component managers to take prompt and effective actions to correct weaknesses in their internal control processes. The Circular states that management must make a decision regarding Inspector General audit recommendations within a 6-month period and complete implementation of management's decision within 1 year, to the extent practicable.

The audit showed that four DoD organizations were not prompt in implementing 10 of the recommendations. While DoD organizations made improvements in export controls and implemented 74 percent of the recommendations, they told us that implementation of the remaining recommendations was restricted, in part, by the ongoing DoD reorganization, personnel turnover, insufficient numbers of personnel, and the formal process for updating the DFARS. However, we contend that DoD managers are constantly confronted with constraints on resources and with organizational changes and must take action to implement audit recommendations to manage risks and improve management processes.

Risks of Not Implementing Export Controls

Until the recommended controls are implemented, DoD continues to accept avoidable risks of exporting sensitive goods, services, and technology that could threaten our national security. During this audit, we found that 10 recommendations remain open. We made 1 of the 10 recommendations in FY 2000, 3 in FY 2004, and 6 in FY 2006.

Controls Recommended in FY 2000. Our review in FY 2000 recommended that the USD(P) revise DoD Directive 2040.2 to clearly state policies, procedures, and responsibilities of DoD and Military Department hosts for determining whether a deemed export license was required when a foreign national visits a Defense facility. Such a revision is important because, during the review in FY 2000, we found that more than 11,000 foreign nationals visited 6 research facilities within only 2 fiscal years.

Controls Recommended in FY 2004. Our review in FY 2004 recommended that DUSD(TSP&NDP) expand interim guidance on export controls for biological agents and include the interim guidance in the DoD Directive. The guidance should include the roles and responsibilities of program managers and of counterintelligence, security, and foreign disclosure personnel.

Also, we recommended the USD(AT&L):

- develop and include in the DFARS an export clause that requires a contractor to comply with Federal export regulations and DoD guidance,
- include an export-controlled technology clause in all subcontracts, and
- conduct training and self-assessments.

However, until DoD program managers are held accountable for identifying export-controlled technology and have controls in place to protect the export-controlled technology, DoD will be at increased risk of other nations' countering or reproducing our technology.

Controls Recommended in FY 2006. Most recently, in FY 2006, we recommended that DTSA:

- record its analyses and insert documentation in the USXPORTS database to support recommendations made on export applications;
- update export guidance to reflect current organizational titles, responsibilities, and structure;
- grant DoD organizations without access to USXPORTS the access needed to facilitate reviews of export applications; and
- develop effective management controls.

Our recommendations were intended to help reduce the risk of allowing unjustified exports to China and to strengthen U.S. actions to maintain regional stability; hinder proliferation of nuclear, chemical, and biological weapons; and offset adverse effects on our national security. Until management fully implements the 10 recommendations, DoD will continue to accept avoidable risks in exporting sensitive goods, services, and technology that could threaten our national security.

Conclusion

DoD organizations did implement 74 percent of the recommendations in seven reports issued from FY 2000 through FY 2006. However, these organizations need to continue taking actions to fully implement the 10 remaining recommendations.

Normally, we request DoD organizations to comment on each recommendation, but we received those comments during the audit. Therefore, additional comments are not necessary on the prior recommendations. As a result of this audit, we are making new recommendations and asking management to comment on them.

We will ask our Report Followup Division to continue to track the status of actions taken on the unimplemented recommendations during its periodic reviews. The division will monitor the status of the 10 unimplemented recommendations shown in Appendix C of this report.

Management Comments on the Finding and Audit Response

USD(AT&L) Comments on the Finding. We issued a draft of this report on March 12, 2007. The Director of Defense Procurement and Acquisition Policy responded for the Under Secretary of Defense for Acquisition, Technology, and Logistics and neither concurred nor nonconcurred with our finding and recommendations, but provided comments. For the full text of the comments, see the Management Comments section of the report.

The Director suggested that we edit and augment the finding to reflect the procedures involved with updating the Defense Federal Acquisition Regulation Supplement (DFARS). In addition, the Director requested clarification on the issuance of export guidance, training requirements for DoD research personnel, and responsibility for DoD Instruction 2040.2. For full text of the comments, see the Management Comments section of the report.

Audit Response. We considered the Director's comments related to the process for updating the DFARS. In consideration of the Director's comments, we did not see that the addition of an explanation of the process for coordinating changes to the Supplement was needed to explain the current status of our recommendations. However, we revised the report to clarify our position that the proposed clause in the DFARS did not meet the intent of our prior recommendation, which requires contractors to conduct initial and periodic training and to perform periodic self-assessments on their compliance with Federal export laws and regulations. Therefore, the recommendation remains open until the clause is revised and published in the DFARS to address our recommendation.

Also, we considered the Director's comments on the proposed revision to the DFARS, related to issuing export guidance to and training of DoD personnel. As a result of reviewing those comments, we revised our finding to show that the draft policy guide issued by the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy, "Managing Foreign Access: Implementing DoD Guidance on Restricted Technology," should address our recommendations on issuing export guidance and training DoD personnel. However, the guide is a draft and the policies listed in the guide must be included in the revised DoD Instruction 2040.2 and published by USD(P). The recommendation remains open until the requirements are addressed in formal policy documents.

In addition, we considered the Director's comments concerning the responsibility for revising DoD Instruction 2040.2. We revised our report and requested that the Under Secretary of Defense for Policy complete the revisions and issue the Instruction (the Under Secretary of Defense for Policy is responsible for issuing DoD Instructions related to international transfers of technology, goods, services, and munitions). We acknowledge, but made no change in response to, the Director's comments that no DoD Instruction is numbered 2040.2. The draft DoD Instruction 2040.2, "International Transfers of Technology, Goods, and Services,"

is replacing DoD Directive 2040.2, "International Transfers of Technology, Goods, Services, and Munitions."

Finally, we considered the Director's comments related to responsiveness in implementing recommendations. The Director stated that he believed his office's procedures for following up on our recommendations were adequate to ensure timely and responsive actions. However, management actions are still needed to implement our recommendations in a timely manner since we issued our audit report on March 25, 2004, and the recommendations remained outstanding as of March 29, 2007. Until the recommendations are implemented, some DoD program managers will not be held accountable for identifying and protecting export-controlled technology, and we will be at increased risk of other nations' countering or reproducing our technology.

DTSA Comments on the Finding. The Director (Acting) of the Defense Technology Security Administration nonconcurred with our findings related to her office. Specifically, the Director disagreed with our use of the policies in the Export Administration Regulations (EAR) for evaluating her office's review of applications to export dual-use (military or civilian use) goods, services, and technologies. The Director stated that it is the responsibility of the Department of Commerce, not DoD, to use the EAR as a basis for evaluating export license applications. Also, the Director disagreed with our finding that her office was required to document reasons for all recommendations made on export applications. She commented that a statement of reasons was required only for recommendations to deny export licenses. In addition, the Director commented that her office had no statutory or regulatory authority to approve or deny export applications, merely to recommend a course of action to the licensing department.

Further, she commented that DoD Instruction 2040.2 could not be finalized until the process for coordinating it within the Department was complete. Also, she stated that our audit did not consider the steps taken by her office to incorporate prior audit recommendations, many of which are included in the upcoming revision of DoD Instruction 2040.2, which has been in process for many months. For the full text, see DTSA Management Comments on page 37 of this report.

Audit Response. The Director disagreed with our use of the policies identified in the EAR. However, DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, states that each DoD field activity (the Defense Technology Security Administration is a field activity) must implement management controls that provide reasonable assurance that programs, as well as administrative and operating functions, are efficiently and effectively carried out in accordance with applicable laws and management policy, such as the Export Administration Act (EAA) and the EAR.

The EAA authorizes the Secretary of Commerce to issue policies and procedures for exporting dual-use items. The Secretary issued those policies and procedures in EAR for use in controlling and overseeing the export of dual-use items. Those export policies and procedures are applicable to agencies involved in overseeing, evaluating, recommending, and approving the requests for exports of sensitive technologies to countries of concern. Although the EAR does not require the

federal agencies involved in the export license process to review all export license applications submitted for consideration, those agencies responsible for making recommendations on exports of dual-use items, including DoD, are subject to addressing the requirements of the EAA and applicable regulations for those applications reviewed. Accordingly, it would be prudent for DTSA to follow those requirements when assessing export license applications because DTSA is the DoD activity responsible for reviewing, evaluating, and making recommendations to the Department of Commerce on such requests for dual-use items. The requirements of the EAR may help reduce the risk of allowing unjustified exports to China and to strengthen U.S. actions to maintain regional stability; hinder proliferation of nuclear, chemical, and biological weapons; and offset adverse effects on our national security. Although, our review was limited to evaluating export license applications to China, it would be prudent for DTSA to consider those factors in the EAR for all export license applications.

Also, the Director disagreed with our finding that her office was required to document reasons for all recommendations made on export applications. She commented that a statement of reasons was required only for recommendations to deny export licenses. We addressed the need to document reasons for all recommendations in our report, "Controls Over Exports to China," March 30, 2006. That report cited the Principal Statutory Authority (Export Administration Act) for the EAR, which states that DoD will make and keep records of its advice, recommendations, or decisions, including the factual and analytical basis, connected with export licenses.

In addition, that report cited the Government Accountability Office's "Standards for Internal Control in the Federal Government," November 1999, which stated, "Control activities occur at all levels and functions of the entity." Those control activities include "approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation." Furthermore, as demonstrated by our audit, DTSA did not maintain appropriate documentation to show the factual and analytical basis for recommending to the Department of Commerce their position on export license applications.

We agree with the Director's comment that her office had no statutory or regulatory authority to approve or deny export applications. We modified our report to show that her office was responsible only for recommending approval or denial of export applications to the Department of Commerce. Further, we agreed with the Director's comment that DoD Instruction 2040.2 cannot be finalized until the coordination process is completed. We acknowledged this fact in our draft report; therefore, no change was made in this final report.

DDR&E Comments on the Finding. Although not required to comment, the Director of Defense Laboratory Programs, responding for the Director, Defense Research and Engineering, pointed out that our recommendation to complete DoD Instruction 2040.2 should be redirected to the Under Secretary of Defense for Policy. For the full text of the comments, see the Management Comments section of the report.

Audit Response. We agree with the comment by the Director of Defense Laboratory Programs about redirecting the responsibility for completing the draft DoD Instruction 2040.2 to the Under Secretary of Defense for Policy and adjusted the draft of this report accordingly. Also, we made the other changes that the Director requested to clarify statements he made during the audit. For instance, we adjusted this final report to show that training requirements for personnel at Defense research facilities depend on the content of yet-to-be-published revisions of the DFARS and DoD Instruction 2040.2. We also adjusted this final report to reflect the comments made regarding procedures included in the DFARS and DoD Instruction 2040.2.

Recommendations, Management Comments, and Audit Response

For clarity of presentation, we split a single recommendation (Recommendation 1. in our draft report) addressed to four organizations with open recommendations into four distinct recommendations below (Recommendations 1. through 4.). This format highlights each organization's management comments. Also, we renumbered draft Recommendation 2. as Recommendation 2.b.

1. We recommend that the Under Secretary of Defense for Acquisition, Technology, and Logistics establish followup procedures to ensure that timely and responsive actions are taken to implement all audit recommendations.

Management Comments. The Director of Defense Procurement and Acquisition responded for the Under Secretary of Defense for Acquisition, Technology, and Logistics and neither concurred nor nonconcurred with our finding and recommendation, but provided comments. Specifically, the Director commented that his office's followup procedures are adequate to ensure timely and responsive actions to implement our recommendations. The Director also stated implementation will be complete upon publication of the final DFARS rule.

Audit Response. The Director's comments were not fully responsive. Timely implementation of this recommendation is still needed. We issued our audit report on March 25, 2004, and the recommendation remained outstanding on March 29, 2007. Therefore, the potential risks we mentioned in our report on March 25, 2004, remain. That is, until DoD program managers are held accountable for identifying export-controlled technology and have controls in place to protect the export-controlled technology, DoD will be at increased risk of other nations' countering or reproducing our technology. In accordance with DoD Directive 7650.3, we request that USD(AT&L) reconsider his response and send comments by October 29, 2007.

2. We recommend that the Under Secretary of Defense for Policy:

a. Establish followup procedures to ensure that timely and responsive actions are taken to implement all audit recommendations.

b. Complete and publish DoD Instruction 2040.2, "International Transfers of Technology, Goods, and Services."

Management Comments Required. The Under Secretary of Defense for Policy did not comment on a draft of this report. We request that the Under Secretary of Defense for Policy provide comments on the final report.

3. We recommend that the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy establish followup procedures to ensure that timely and responsive actions are taken to implement all audit recommendations.

Management Comments Required. The Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy did not comment on a draft of this report. We request that the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy provide comments on the final report by October 29, 2007.

4. We recommend that the Director, Defense Technology Security Administration establish followup procedures to ensure that timely and responsive actions are taken to implement all audit recommendations.

Management Comments Required. The Director, Defense Technology Security Administration did not comment on the recommendation. We request that the Director, Defense Technology Security Administration provide comments on the recommendation for the final report by October 29, 2007.

Appendix A. Scope and Methodology

We conducted this performance audit from June 28, 2006, through March 12, 2007, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We reviewed documents such as Executive Orders, Federal laws, and regulations, including the Export Administration Act and the associated Export Administration Regulations. In addition, we evaluated the adequacy of DoD directives, policies, and regulations related to the transfer of militarily sensitive technology to countries of concern.

We interviewed personnel in the following organizations:

- Department of Commerce;
- Under Secretary of Defense for Acquisition, Technology, and Logistics;
- Office of the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy;
- Director, Defense Research and Engineering; and
- Defense Technology Security Administration.

Our contacts with personnel in these organizations included discussions on the implementation of recommendations in the previously issued audit reports.

We limited our review to open recommendations in audit reports we issued to comply with Public Law 106-65. Only DoD IG Reports No. D-2006-067, D-2004-061, and D-2000-0110 contained open recommendations.

To complete this review, we judgmentally selected a sample of 40 export license applications from 3,489 export license applications processed in calendar years 2005 and 2006. We obtained the complete USXPORTS file on each of the 40 selected applications to determine whether DTSA analysis, documentation, and elevation procedures achieved the recommended actions made in DoD IG Report No. D-2006-067.

Use of Computer-Processed Data. USXPORTS is the automated system that DTSA uses for processing export applications. We used computer-processed data from USXPORTS to identify export license applications for China. Testing the reliability of the computer-processed data was not the purpose of this audit; the data were used strictly as source documentation. We thoroughly compared the contents of each selected export license application with supporting

documentation. Nothing came to our attention as a result of the testing that caused us to doubt the reliability of the computer-processed data.

Use of Technical Assistance. We received technical assistance from the DoD Office of Inspector General's Quantitative Methods Division, which advised us on the selection of the sample size.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in the Department of Defense. This report does not cover any DoD high-risk areas, but this report does address the Government Accountability Office's newly designated Federal Government-wide high-risk area of "Ensuring the Effective Protection of Technologies Critical to U.S. National Security Interests."[13]

[13] The Government Accountability Office designated this area as being high-risk in January 2007.

Appendix B. Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and the Department of Defense Inspector General (DoD IG) have conducted multiple reviews regarding the adequacy of export controls. Unrestricted GAO reports can be accessed over the Internet at http://www.gao.gov. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports. The following previous reports are of particular relevance to the subject matter in this report.

GAO

GAO Report No. GAO-01-528, "Export Controls: State and Commerce Department License Review Times are Similar," June 1, 2001

DoD IG

DoD IG Report No. D-2006-067, "Controls Over Exports to China," March 30, 2006

DoD IG Report No. D-2005-042, "Controls Over the Export Licensing Process for Chemical and Biological Items," March 30, 2005

DoD IG Report No. D-2004-061, "Export Controls: Export-Controlled Technology at Contractor, University, and Federally Funded Research and Development Center Facilities," March 25, 2004

DoD IG Report No. D-2003-070, "Export Controls: DoD Involvement in Export Enforcement Activities," March 28, 2003

DoD IG Report No. D-2002-039, "Automation of the DoD Export License Application Review Process," January 15, 2002

DoD IG Report No. D-2001-088, "DoD Involvement in the Review and Revision of the Commerce Control List and the U.S. Munitions List," March 23, 2001

DoD IG Report No. D-2000-0110, "Export Licensing at DoD Research Facilities," March 24, 2000

Interagency Reviews

Inspectors General of the Departments of Commerce, Defense, Energy, State, Homeland Security, Agriculture, and the Central Intelligence Agency Report No. D-2005-043, "Interagency Review of the Export Licensing Process for Chemical and Biological Commodities," June 10, 2005

Inspectors General of the Department of Commerce, Defense, Energy, Homeland Security, and State and the Central Intelligence Agency Report No. D-2004-061, "Interagency Review of Foreign National Access to Export Controlled Technology in the United States," April 16, 2004

Offices of Inspector General Department of Commerce, Defense, State, and the Treasury; the Central Intelligence Agency; and the U.S. Postal Service Report No. D-2003-060, "Interagency Review of Federal Export Enforcement Efforts," April 18, 2003

Inspectors General of the Departments of Commerce, Defense, Energy, State, and the Treasury Report No. D-2002-074, "Interagency Review of Federal Automated Export Licensing Systems," March 29, 2002

Inspectors General of the Departments of Commerce, Defense, Energy, and State Report No. D-2001-092, "Interagency Review of the Commerce Control List and the U.S. Munitions List," March 23, 2001

Office of the Inspector General Department of Defense, Office of Intelligence Review, Report No. 00-OIR-05, "Measures to Protect Against the Illicit Transfer of Sensitive Technology," March 27, 2000

Offices of the Inspectors General Departments of Commerce, Defense, Energy, and State Report No. D-2000-109, "Interagency Review of the Export Licensing Process for Foreign National Visitors," March 24, 2000

Appendix C. Status of Prior Recommendations

Implementation of Recommendations					
		Status of Recommendations			
		As of June 28, 2006		As of December 21, 2006	
Report	Recommendation Number	Implemented	Not Implemented	Implemented	Not Implemented
D-2006-0067-D000LS-0001	1.a	0	1	0	1
D-2006-0067-D000LS-0001	1.b	0	1	0	1
D-2006-0067-D000LS-0001	2.a	0	1	0	1
D-2006-0067-D000LS-0001	2.b	0	1	1	0
D-2006-0067-D000LS-0001	2.c	0	1	0	1
D-2006-0067-D000LS-0001	2.d	0	1	0	1
D-2006-0067-D000LS-0001	2.e	0	1	0	1
D-2005-0042-D000LG-0002	1	1	0	1	0
D-2004-0061-D000LG-0001	1.a	0	1	0	1
D-2004-0061-D000LG-0001	1.b	0	1	0	1
D-2004-0061-D000LG-0001	2.a	0	1	0	1
D-2004-0061-D000LG-0001	2.b	1	0	1	0
D-2003-0070-D000LG-0001	A.1	1	0	1	0
D-2003-0070-D000LG-0001	A.2	1	0	1	0
D-2003-0070-D000LG-0001	A.3	1	0	1	0
D-2002-0039-D000LG-0001	1	1	0	1	0
D-2002-0039-D000LG-0001	2	1	0	1	0
D-2002-0039-D000LG-0001	3	1	0	1	0
D-2002-0039-D000LG-0001	4	1	0	1	0
D-2001-0088-D000LG-0001	A.1	1	0	1	0
D-2001-0088-D000LG-0001	A.2	1	0	1	0
D-2001-0088-D000LG-0001	A.3	1	0	1	0
D-2001-0088-D000LG-0002	B.2.a	1	0	1	0
D-2001-0088-D000LG-0002	B.2.b	1	0	1	0
D-2001-0088-D000LG-0002	C.2	1	0	1	0
D-2001-0088-D000LG-0003	B.1	1	0	1	0
D-2001-0088-D000LG-0003	C.1	1	0	1	0
D-2000-0110-D000LA-0001	A.1.a	0	1	1	0
D-2000-0110-D000LA-0001	A.1.b	0	1	0	1
D-2000-0110-D000LA-0001	A.1.c	1	0	1	0
D-2000-0110-D000LA-0001	A.2.a	1	0	1	0
D-2000-0110-D000LA-0001	A.2.b	1	0	1	0
D-2000-0110-D000LA-0001	A.2.c	0	1	1	0
D-2000-0110-D000LA-0001	A.2.d	0	1	1	0
D-2000-0110-D000LA-0002	B.1.a	1	0	1	0
D-2000-0110-D000LA-0002	B.1.b	1	0	1	0
D-2000-0110-D000LA-0002	B.2	1	0	1	0
D-2000-0110-D000LA-0002	B.3	1	0	1	0
D-2000-0110-D000LA-0002	B.4	1	0	1	0
Total		25	14	29	10

Appendix D. Assessment of Export Applications

CY 2005 and CY 2006 Assessment of DTSA Applications for Making Exports to China					
Sample Number	USXPORTS File Number	Export Control Classification Number	Adequate Analysis	Adequate Documentation	DTSA Recommendation
1	D347546	2A983	No	No	AWC
2	D337344	1C350	No	No	AWC
3	D344327	3A231	No	No	AWC
4	D340340	6A003	No	No	AWC
5	D333544	1C350	No	No	AWC
6	D333545	1C350	No	No	AWC
7	D329056	6A003	No	No	AWC
8	D337063	1C350	No	No	AWC
9	D342226	6A003	No	No	AWC
10	D331360	6A003	No	No	AWC
11	D322475	6A003	No	No	AWC
12	D340947	1C350	No	No	AWC
13	D348973	2A983	No	No	AWC
14	D332675	6A003	Yes	No	AWC
15	D344183	6A003	No	No	AWC
16	D343704	1C350	No	No	AWC
17	D347548	2A983	No	No	AWC
18	D336673	1C350	No	No	AWC
19	D336321	1C350	No	No	AWC
20	D332824	2A983	No	No	AWC
21	D326299	1C350	No	No	Disapproved
22	D332399	6A003	No	No	Disapproved
23	D332835	6A003	No	No	Disapproved
24	D335081	6A003	Yes	No	Disapproved
25	D335082	6A003	Yes	No	Disapproved
26	D340344	6A003	Yes	No	Disapproved
27	D342044	6A003	Yes	No	Disapproved
28	D345271	6A003	Yes	No	Disapproved
29	D349729	6A003	Yes	No	Disapproved
30	D346795	6A003	Yes	No	Disapproved
31	D363862	1C350	No	No	AWC
32	D359155	1C350	No	No	AWC
33	D357867	1C350	No	No	AWC
34	D367495	2A983	No	No	AWC
35	D361730	2A983	No	No	AWC
36	D368316	2A983	No	No	AWC
37	D364144	3A231	No	No	AWC
38	D360724	3A231	Yes	No	AWC
39	D355231	6A003	N/A	N/A	RWA
40	D364201	6A003	Yes	No	Disapproved

(The first 30 applications represent Calendar Year (CY) 2005 and the remaining 10 represent CY 2006 applications.) 6A003–Sensors and Lasers; 1C350–Chemicals and Toxins; 2A983–Explosives; 3A231–Electronics; AWC-Approved With Conditions; RWA-Returned Without Action; and N/A-Not Applicable.

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
- Director, Defense Research and Engineering
- Deputy Under Secretary of Defense (Science and Technology)

Under Secretary of Defense for Policy
- Deputy Under Secretary of Defense (Technology Security Policy and National Disclosure Policy)

Under Secretary of Defense (Comptroller)/Chief Financial Officer
- Deputy Chief Financial Officer
- Deputy Comptroller (Program/Budget)

Under Secretary of Defense for Intelligence

Assistant to the Secretary of Defense (Nuclear and Chemical and Biological Defense Programs)

Director, Program Analysis and Evaluation

Joint Staff

Director, Joint Staff
- Director, Plans and Policy Directorate (J-5), Joint Staff
- Director, Force Structure, Resources, and Assessment Directorate (J-8), Joint Staff

Department of the Army

Inspector General, Department of the Army

Director, Joint Program Executive Office (Chemical and Biological Defense)

Department of the Navy

Naval Inspector General

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

Director, Defense Intelligence Agency
Director, Defense Logistics Agency
Director, Defense Security Service
Director, Defense Technology Security Administration
Director, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
Inspector General, Department of Agriculture
Inspector General, Department of Commerce
Inspector General, Department of Energy
Inspector General, Department of Health and Human Services
Inspector General, Department of Homeland Security
Inspector General, Department of State
Inspector General, Department of Treasury
Inspector General, Central Intelligence Agency
Inspector General, U.S. Postal Service
U.S.-China Economic and Security Review Commission

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
Senate Select Committee on Intelligence
Senate Committee on Foreign Relations
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform
House Subcommittee on National Security, and Foreign Affairs, Committee on Oversight and Government Reform
House Subcommittee on Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform
House Subcommittee on Terrorism, Nonproliferation, and Trade, Committee on Foreign Affairs
House Permanent Select Committee on Intelligence
House Subcommittee on Oversight and Investigations
House Committee on Homeland Security

Under Secretary of Defense for Acquisition, Technology, and Logistics Comments

Final Report Reference

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION, TECHNOLOGY AND LOGISTICS

MAR 26 2007

MEMORANDUM FOR PROGRAM DIRECTOR, READINESS AND OPERATIONS SUPPORT, OFFICE OF THE INSPECTOR GENERAL

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS 2/27/07

SUBJECT: Followup Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern (Project No. D2006-D000LG-0199.000) (Your Memo dated March 12, 2007)

As requested, we have reviewed the draft report and offer the following comments.

1. The Office of Defense Procurement and Acquisition Policy (DPAP) has responsibility for Recommendations 2.a. and 2.b. in Report D-2006-061 dated 25 March 2004.
   a. The finding (on page 6 of the draft report) regarding the status of OUSD(AT&L) DPAP action on these recommendations should be edited and augmented to reflect that (1) completing the action to implement Recommendations 2.a. and 2.b. requires compliance with the formal rulemaking process that applies to the DoD Federal Acquisition Regulation Supplement (DFARS), (2) the implementing action is not limited to publication of a single clause but involves publication of a DFARS rule that includes contract clauses for use in particular circumstances, (3) DoD published a proposed rule on 12 July 2005, and based on public comments received by the October 2005 deadline, made substantial revisions to it; (4) DoD published the *second* proposed rule on 14 August 2006, and received public comments from 167 persons or organizations by the deadline of 2 November 2006; (5) the DAR Council has agreed upon a draft final rule based on consideration of public comments received on the second proposed rule, and the draft final rule is now in the last stages of the formal rulemaking process. Publication of the final rule is expected within about 90 days.
   b. A clarification is needed on page 11under "Issuance of Guidance". The DFARS rule does not contain procedures for determining whether goods, services, and technology at Defense research facilities are exportable with or without a license. What the DFARS rule does is to assign responsibility to requiring activities for determining if, during performance of a contemplated contract, the contractor will generate or require access to export-controlled information or technology. — Revised
   c. A correction is needed on pages 11-12 under "Training Requirements for Defense Research Personnel". There are no training requirements in the DFARS rule. Although the DFARS rule does not mandate training, the — Revised

Final Report Reference

DFARS R&D Committee, the DAR Council, DPAP, DDRE, and DTSA recognize the importance of training for contracting officers and requiring activity officials who will implement the new DFARS rule. DDRE will lead the effort to ensure appropriate training is available to requiring activities and DPAP will lead the effort to ensure appropriate training is available for contracting officers. The two training efforts will be coordinated since the requiring activities and the contracting officers work interactively. The content of contracting officer training is dependent upon the specifics of the DFARS rule. The content of the requiring activity training is dependent upon the specifics of both the DFARS rule and the revised DoDD 2040.2. Therefore a comprehensive training syllabus cannot be designed until the rule and directive are complete.

Revised

2. DPAP does not have responsibility for DoD Directive 2040.2. There is a suggestion in the draft report that there is a linkage between publication of the DFARS rule, for which DPAP has responsibility, and publication of a new 2040.2. There is no such linkage. (Incidentally, references in the report to DoDI 2040.2 should be changed to DoDD 2040.2. There is not DoD Instruction numbered 2040.2.)

Page 22

Deleted

3. The draft report's references to USD(AT&L) being responsible for DoDD 2040.2 are confusing, especially since the summary regarding previous recommendations directed to USD(P) (at the top of page 7) and Recommendation 2 (on page 18) of this draft report recognize that responsibility for publishing 2040.2 rests with the USD(P). For example, the statements on pages 11 and 12 of the draft report that a USD(AT&L) official "could not provide a planned completion date for DoDI 2040.2, which remains in draft" are irrelevant since USD(AT&L) is responsible for neither the draft nor the final document. We suggest that the report be clarified in this regard.

Page 22

4. DPAP defers to OUSD(AT&L) ARA with regard to Recommendation 1 on page 18 of the draft report. From DPAP's perspective, OUSD(AT&L) follow-up procedures are adequate to ensure timely and responsive actions are taken to implement the IG recommendation assigned to DPAP. DPAP has provided periodic follow-up status reports on actions taken to implement Recommendations 2.a. and 2.b. of OIG Report D-2004-061. Implementation will be complete upon publication of the final DFARS rule.

If you require further information, please contact Barbara Glotfelty at 703-697-9351 or barbara.glotfelty@osd.mil.

for Richard Ginman

Shay D. Assad
Director, Defense Procurement
and Acquisition Policy

Defense Research and Engineering Comments

Final Report Reference

OFFICE OF THE DIRECTOR OF
DEFENSE RESEARCH AND ENGINEERING
3040 DEFENSE PENTAGON
WASHINGTON, DC 20301-3040

MAR 26 2007

MEMORANDUM FOR PROGRAM DIRECTOR, READINESS AND OPERATIONS SUPPORT, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Follow-up Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern, Project No. D2006-D000LG-0199.000 (Draft of a Proposed Report dated March 12, 2007)

As requested, I have reviewed the draft report. The draft report is generally well written. The findings germane to DDR&E are commendable. A few statements within the report contain errors, and while the errors do not lead to incorrect findings, the errors should be corrected to increase the overall accuracy and credibility of the report, its findings, and recommendations.

1. The Director, Defense Research and Engineering (DDR&E) has responsibility for two recommendations in Report D-2000-110 dated March 24, 2000. I do not repeat those recommendation. They appear on page 11 of the draft report.

   a. The statement in the Issuance of Guidance section (page 11) "…the Defense Federal Acquisition Regulation Supplement (DFARS), together with DoDI 2040.2 will include these procedures." is not precisely correct. The DDR&E official should have said "…the pending DoDI 2040.2 will provide procedures and the pending Defense Federal Acquisition Regulation Supplement (DFARS) rule will provide specific contract clauses to use in particular circumstances." — Revised

   b. The first sentence in the next paragraph should be changed. It says USD(AT&L) is responsible for finalizing DoDI 2040.2. That is incorrect. The last sentence in the same paragraph is correct. USD(P) is responsible for DoDI 2040.2. Change the first sentence to read "a DDR&E official told us that the USD(AT&L) is responsible for finalizing the DFARS rule and the USD(P) is responsible for finalizing DoDI 2040.2." — Revised

   c. The statement in the Training Requirements for Defense Research Personnel section (pages 11 & 12) "…a DDR&E official informed — Revised

Final Report Reference

us that the training requirements for personnel at Defense research facilities are in a proposed revision of the DFARS and a draft revision of DoDI 2040.2" is not precisely correct. The DDR&E official should have enabled you to write "…a DDR&E official informed us that the training requirements for personnel at Defense research facilities are dependent upon the content yet to be published in a revision of the DFARS rule and a revision of DoDI 2040.2."

Deleted Page 11

d. The last sentence in the next paragraph (page 12) should say "Further, DDR&E officials told us that the USD(AT&L) is responsible for finalizing the DFARS and USD(P) is responsible for finalizing DoDI 2040.2."

If you require further information, please contact Jon Porter at 703-588-1415 or jonathan.porter@osd.mil.

James M Short

James M. Short
Director, Defense Laboratory Programs

Defense Technology Security Administration Comments

Final Report Reference

DEFENSE TECHNOLOGY SECURITY ADMINISTRATION
2900 DEFENSE PENTAGON
WASHINGTON, DC 20301-2900

APR 27 2007

Mr. Dennis L. Conway
Program Director
Readiness and Operations Support
Office of the Inspector General
Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202

Dear Mr. Conway:

My staff has reviewed your draft report entitled: "Followup Audit on Recommendations for Controls Over Exporting Sensitive Technologies to Countries of Concern" (Project No. D2006-D000LG-0199.000). While I appreciate the effort your staff expended on this project, I am concerned that it does not accurately portray the actions DTSA has undertaken based upon your earlier findings. In fact, I am compelled to non-concur in several areas that we feel are inaccurate or misleading. The two recommendations I am referring to follow:

1. IG Recommendation: Documentation of Decisions on Export Applications

DTSA does not concur with the IG finding and recommendation. This non-concurrence is based upon the fact that the IG audit was based upon several erroneous assumptions:

First, the IG selected the Export Administration Regulation (EAR) as the standard for analysis. Though DTSA does not disagree that these are important policies to be confirmed prior to approval of a license, they are the responsibility of the Department of Commerce (DoC), not the DoD. EO 12981 grants DoD the authority to review any license received by the DoC and permits DoD to notify DoC of any application it does not wish to review. However, the EO prescribes no standard to be used by DoD to either request or defer review. It should therefore be assumed that the standard for analysis likewise rests with DoD, not DoC and its policies in the EAR. DTSA has provided copies of numerous standard operating procedures and identified policies which form the basis of DoD analysis. These, not the EAR standards, should be considered controlling in this case. For DoD to concentrate its review solely on the DoC policies would be both redundant and could indeed jeopardize review of DoD equities.

Revised

Second, when using the EAR as a standard for review, the auditors' findings state that the analysis and documentation were inadequate to justify the decision by DTSA to "approve" license applications. We believe this is incorrect on several levels. DTSA

DTSA

Final Report Reference

has no statutory or regulatory authority to approve or deny license applications, merely to recommend a course of action to the licensing department. More importantly, the EO requires that only recommendations to deny a license "include a statement of the reasons for such recommendation that are consistent with" the EAR. No such requirement exists for other recommendations. Finally, the EO further states that if no recommendation is received within 30 days of referral, the referral department will "be deemed to have no objection to the decision" by the Secretary of Commerce. Devoting resources to document analysis and recommendations that DoD has determined to have no national security implications would not be a prudent use DoD assets and could potentially jeopardize DoD's ability to provide the documentation and analysis required to stop exports of national security concern.

Third, despite many discussions, reviews, and instruction by the DTSA staff, we believe that the auditors did not fully take into account the extensive information that was available in the USXports database, the relationship between the requirements of the procedures in place and the entries made therein, nor the significance of the decision to the overall process. The procedures in place require that the analyst review the end user, the end use and the technology to determine if there are concerns raised by the application in these areas. At each level of review, whether by the "tiger team" on receipt or after staffing, the analyst is required to analyze these areas and determine if there is a national security concern generated by any of these elements of the prospective export using these guidelines. The releasing official is certifying, in the case of a recommendation of approval, that no national security concern exists or, in the case of an approval with conditions, that these concerns have been adequately addressed in the conditions. Ergo, the entire case, the procedural requirements and final determination constitute the documentation that these issues have been addressed. The auditors seem to require that a "checklist" or other summary, redundantly documenting these requirements were met, be appended to each case record. The IG comments included a recommendation that reference to a precedent case in the USXports database, by case number, was insufficient documentation to support its use as a precedent, but rather the entire case would have to be copied into the case at the tool bar. The cost in analysts' time and resources would be extraordinary and would probably not be considered a wise use of resources, unsupported by risk involved.

Given the facts above, DTSA will take no further action on this recommendation.

2. Recommendation: Implementation of prior recommendations in 2040.2

Revised

DTSA does not concur with the IG finding and recommendation. This non-concurrence is based upon the fact that the IG audit did not take into account the steps taken by DTSA in incorporating their prior suggestions.

2

DTSA personnel have on many occasions explained and demonstrated to the Audit team that their recommendations are incorporated into the revised version of 2040.2 that has been in the staffing process for many months and is now approaching approval. Unfortunately, as my staff explained to the IG team, 2040.2 cannot be finalized until the coordination process is complete.

My point of contact for IG matters is Dr. Peter Leitner, peter.leitner@osd.mil, or 703-325-4080.

Beth M. McCormick

Beth M. McCormick
Director (Acting),
Defense Technology
Security Administration

3

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Readiness and Operations Support prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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Inspector General
Department of Defense

Appendix D. Department of Energy Report

U.S. Department of Energy
Office of Inspector General
Office of Inspections and Special Inquiries

Inspection Report

Review of Status of Prior Export Control Recommendations at the Department of Energy

INS-O-07-01 **May 2007**

Department of Energy

Washington, DC 20585

May 22, 2007

MEMORANDUM FOR THE DEPUTY ADMINISTRATOR, DEFENSE NUCLEAR NONPROLIFERATION
CHIEF HEALTH, SAFETY AND SECURITY OFFICER

FROM: Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Inspection Report on "Review of Status of Prior Export Control Recommendations at the Department of Energy"

BACKGROUND

The National Defense Authorization Act for Fiscal Year 2000 provided that beginning in the year 2000 and ending in the year 2007, the President shall annually submit to Congress a report by the Inspectors General of the Departments of Energy, Commerce, Defense, and State of the policies and procedures of the United States Government with respect to the export of technologies and technical information with potential military application to countries and entities of concern. Prior to the review which is the subject of this report, the Energy Office of Inspector General had issued seven reports under this requirement and had made 17 recommendations to Energy, including the National Nuclear Security Administration (NNSA), designed to improve the Department of Energy's export control efforts. The objective of this inspection was to determine the status of all 17 prior export control recommendations. Details on the prior recommendations are provided in Appendix C.

RESULTS OF INSPECTION

We concluded that the actions taken by Energy regarding the 14 closed recommendations appeared to be responsive and that these recommendations should remain closed. We also concluded that two of the three remaining open recommendations should be closed. Finally, we made two additional recommendations based upon this review. Regarding the three open recommendations, we determined that:

- The two recommendations pertaining to NNSA and Commerce's Export Control Automated Support System should be closed because NNSA has found alternate ways to access the necessary data; and

- The remaining recommendation to ensure that export control guidance is disseminated and implemented throughout the complex should remain open because it was incomplete.

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Regarding the two additional recommendations resulting from this review, we determined that:

- NNSA management should expedite action, such as issuing a directive or modifying the Department of Energy Acquisition Regulation, to fully implement the open recommendation; and,

- Energy Order 142.3, "Unclassified Foreign Visits and Assignments," should be revised to reflect the current Energy process for reviewing foreign national visitors and assignees from state sponsors of terrorism.

In addition to this inspection, the Office of Inspector General is conducting a separate review of Energy's audit resolution and follow-up process. The latter review covers corrective actions taken by management to address identified control weaknesses in other Department of Energy programs and administrative activities.

MANAGEMENT REACTION

Management of NNSA and the Chief Health, Safety and Security Officer agreed with our recommendations. Management's comments are provided in their entirety in Appendix D of the report.

Attachment

cc: Chief of Staff
Director, Office of Intelligence and Counterintelligence
Director, Office of Internal Review (CF-1.2)
Director, Policy and Internal Controls Management (NA-66)

REVIEW OF STATUS OF PRIOR EXPORT CONTROL RECOMMENDATIONS AT THE DEPARTMENT OF ENERGY

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Overview

INTRODUCTION AND OBJECTIVES

The National Defense Authorization Act (NDAA) for Fiscal Year 2000 provided that beginning in the year 2000 and ending in the year 2007, the President shall annually submit to Congress a report by the Inspectors General of, at a minimum, the Departments of Energy (Energy), Commerce (Commerce), Defense (Defense), and State (State) of the policies and procedures of the United States Government with respect to the export of technologies and technical information with potential military application to countries and entities of concern. To date, the Energy Office of Inspector General (OIG) has issued 7 reports under this requirement and has made 17 recommendations to Energy, including the National Nuclear Security Administration (NNSA), towards improving Energy's export control efforts. A listing of these and other export related reports is contained in Appendix B.

The objective of this inspection was to determine the status of all 17 prior export control recommendations. Details on the recommendations and managements' responses are provided in Appendix C.

OBSERVATIONS AND CONCLUSIONS

We concluded that the actions taken by Energy regarding the 14 closed recommendations appeared to be responsive and that these recommendations should remain closed. We also concluded that two of the three remaining open recommendations should be closed. Finally, we made two additional recommendations based upon this review. Regarding the three open recommendations, we determined that:

- The two recommendations pertaining to NNSA and Commerce's Export Control Automated Support System should be closed because NNSA has found alternate ways to access the necessary data; and

- The one recommendation to ensure that export control guidance is disseminated and implemented throughout the complex should remain open because it is incomplete.

Regarding the two additional recommendations, we determined that:

- NNSA management should expedite action, such as issuing a directive or modifying the Department of Energy Acquisition Regulation (DEAR), to fully implement the open recommendation; and

- Energy Order 142.3, "Unclassified Foreign Visits and Assignments," should be revised to reflect the current Energy process for reviewing foreign national visitors and assignees from state sponsors of terrorism.

Presently, the OIG is conducting an audit of the Department's unclassified foreign visits and assignments program, which includes issues that were covered in our previous reports and recommendations. The OIG is also conducting an inspection of foreign national access to computers, which also relates to foreign visits and assignment activities. Although our office has conducted several reviews on foreign visitor-related topics, the reviews above may identify additional areas for improvement.

Details of Findings

BACKGROUND

The principal legislative authorities governing the export control of nuclear-related, dual-use[1] items are the Export Administration Act of 1979 and the Nuclear Non-Proliferation Act of 1978. The provisions of the Export Administration Act have been updated by Executive Order, most recently by Executive Order 12981, which grants the Secretary of Commerce the authority to refer export license applications to other agencies for review and gives agencies such as Energy the authority to look at any export license application submitted to Commerce.

Energy's export control efforts, as coordinated by NNSA's Office of International Regimes and Agreements (OIRA), includes the review of export license applications for nuclear, chemical, biological, and missile-related commodities. In addition to reviewing licenses, OIRA participates in working level groups with other Federal agencies for licensing and nonproliferation activities. Also, Energy's Office of Foreign Visits and Assignments establishes Energy policies for the review and processing of visits and assignments by foreign nationals to Energy and NNSA facilities. Reviews of foreign visits and assignments are relevant to Energy's export control efforts because any release of technology or software subject to U.S. Export Administration Regulations to a foreign national is "deemed to be an export" to the foreign national's home country.

ACCESS TO THE COMMERCE EXPORT LICENSE DATABASE

We determined that the two recommendations pertaining to NNSA and Commerce's Export Control Automated Support System should be closed because NNSA has found alternate ways to access the necessary data.

During March 2005, we issued a report entitled "The Department of Energy's Review of Chemical and Biological Export License Applications," DOE/IG-0682, which had two recommendations regarding access to and training on Commerce's Export Control Automated Support System (ECASS). We had determined that although information from ECASS was obtained by officials at the Los Alamos National Laboratory for Energy's export license reviews, only one OIRA Headquarters official had access to ECASS and no OIRA Headquarters officials were trained in ECASS. We were advised by OIRA officials during 2005 that a lack of direct access to and training in ECASS was a problem for the timely and

[1] Some controlled commodities are designated as "dual-use," that is, goods and technologies that have both civilian and military uses. The U.S. Government designates some dual-use commodities as "nuclear dual-use" items, which are controlled for nuclear nonproliferation purposes.

efficient review of export licenses by OIRA Headquarters officials. Accordingly, we made the ECASS recommendations. Both recommendations remained open when we initiated this review.

Since these two recommendations were made, OIRA Headquarters officials have made continual efforts to receive access to and training on ECASS. Although Commerce has provided access to ECASS, access has not been effective because of recurring problems in maintaining connectivity with ECASS by OIRA Headquarters. We were advised by OIRA officials that these connectivity problems resulted from computer system changes at Commerce. OIRA officials further advised that they have not received ECASS training; however, due to the lack of connectivity, the training was not currently a concern. Because of these connectivity problems, OIRA Headquarters officials employed other means to obtain the information needed to conduct timely and effective export license reviews. Specifically, OIRA Headquarters officials obtained initial export license application information through the link to ECASS at the Los Alamos National Laboratory and obtained any further export license information on specific cases through formal and informal means, such as through its participation in various interagency groups and periodic contact with Commerce officials.

Accordingly, OIRA Headquarters officials have been able to obtain the information necessary for them to conduct their required reviews in a timely and effective manner without having access to and training on ECASS. OIRA officials advised us that they will continue to pursue ECASS connectivity and training. However, as discussed above, the recommendations requiring access to and training on ECASS have become of limited additional value to OIRA's export license review process. Based upon our current review, we closed these two open recommendations.

EXPORT CONTROL GUIDANCE

We determined that the one recommendation to ensure that export control guidance is disseminated and implemented throughout the complex should remain open because it is incomplete.

During April 2004, we issued a report entitled "Contractor Compliance with Deemed Export Controls," DOE/IG-0645, which recommended that NNSA ensured that export control guidance, including deemed export guidance, was disseminated and consistently implemented throughout Energy. Although NNSA management had taken some action regarding this

recommendation, it had not been fully implemented when we initiated this review.

IMPLEMENTATION OF RECOMMENDATION

We determined that NNSA management should expedite action, such as issuing a directive or modifying the DEAR, to fully implement the open recommendation to ensure that export control guidance is disseminated and consistently implemented throughout the Energy complex.

Based upon our prior recommendation, OIRA initiated several export control site reviews and determined that some contractors lacked funds and staff to consistently implement the existing informal guidance that had been prepared by OIRA in 1999. Also based upon this recommendation, OIRA revised existing informal export control guidance for dissemination throughout the Energy complex. However, Energy and NNSA General Counsel officials informed OIRA that issuing revised informal guidance would not be the most effective way to ensure consistent export control compliance across the Energy complex. OIRA was informed that a formal order or possible modification to the DEAR would be more effective ways to ensure compliance with export control requirements by all Energy and NNSA contractors.

OIRA prepared a justification for issuing a formal order on export controls, which is currently under NNSA management review. NNSA is also considering a modification to the DEAR as an alternative to issuing an order. We believe that a directive or modification to the DEAR would be effective ways to implement our recommendation. We, therefore, recommend that NNSA management expedite action, such as issuing a directive or modifying the DEAR, to implement our prior recommendation.

REVISION TO ORDER 142.3

We determined that Energy Order 142.3, "Unclassified Foreign Visits and Assignments," should be revised to reflect the current Energy process for reviewing foreign national visitors and assignees from state sponsors of terrorism. Our prior recommendations concerning Energy policy for unclassified foreign visits and assignments were closed as a result of the issuance of Order 142.3 and will remain closed. However, the process listed in Order 142.3 states that all access requests for nationals of countries designated as state sponsors of terrorism to unclassified Energy programs, information and technology be reviewed by a Headquarters Management Panel. The Panel consisted of the Directors of the Energy Offices of Security, Counterintelligence, and Intelligence, and representatives designated

by the Under Secretary of Energy, Science and Environment and the Under Secretary for Nuclear Security/Administrator for the NNSA. Since the issuance of this order, Energy reorganized and has a structure with three Under Secretaries: the Under Secretary for Energy; the Under Secretary for Science; and the Under Secretary for Nuclear Security/Administrator for the NNSA. Additionally, the Offices of Intelligence and Counterintelligence were consolidated into a single Office of Intelligence and Counterintelligence. Consolidation of these offices has not substantively affected the review process; however, based upon an administrative change to existing Order 142.3, representatives of all three Under Secretaries are now part of the panel.

An Office of Foreign Visits and Assignments official advised that the parties involved in the review process determined that it was of little value for representatives of all three Under Secretaries to participate in every panel review. The official advised that, instead, the current practice is to have access requests reviewed by the Office of Security, the Office of Intelligence and Counterintelligence, and the Under Secretary with cognizance over the program requesting access. The official advised that Order 142.3 should be revised to reflect the current practice of involving only the cognizant Under Secretary in a panel review. Based on the above, we recommend that Order 142.3 be revised to reflect Energy's actual practice.

RECOMMENDATIONS

We recommend that the Deputy Administrator, Defense Nuclear Nonproliferation:

1. Expedite actions, such as issuing a directive or modifying the DEAR, to ensure compliance with export control requirements throughout the Energy complex.

We recommend that the Chief Health, Safety and Security Officer:

2. Revise Order 142.3 to reflect the actual process for reviewing access requests for nationals of state sponsors of terrorism.

MANAGEMENT COMMENTS

In comments on our draft report, management agreed with our recommendations and identified timelines for completing corrective actions. The comments from both organizations are included in their entirety at Appendix D.

INSPECTOR COMMENTS

We found management's comments to be responsive to our report recommendations.

Appendix A

SCOPE AND METHODOLOGY

We conducted fieldwork for this review in January and February 2007. We interviewed Federal and contractor Energy officials, including NNSA employees and contractors. We also reviewed relevant export control regulations and Energy policies relevant to export controls. As part of our review, we evaluated Energy's implementation of the "Government Performance Results Act of 1993."

This inspection was conducted in accordance with the "Quality Standards for Inspections" issued by the President's Council on Integrity and Efficiency.

Appendix B

PRIOR EXPORT CONTROL RELATED REPORTS

- "The Department of Energy's Review of Export License Applications for China," DOE/IG-0723, April 2006;
- "The Department of Energy's Review of Chemical and Biological Export License Applications," DOE/IG-0682, March 2005;
- "Contractor Compliance with Deemed Export Controls," DOE/IG-0645, April 2004;
- "Safeguards Over Sensitive Technology," DOE/IG-0635, January 2004;
- "Inspection of Status of Recommendations from the Office of Inspector General's March 2000 and December 2001 Export Control Reviews," INS-L-03-07, May 2003;
- "The Department's Unclassified Foreign Visits and Assignments Program," DOE/IG-0579, December 2002;
- "Follow-up Inspection of the Department of Energy's Export Licensing Process for Foreign National Visits and Assignments," INS-L-02-06, June 2002;
- "Inspection of the Department of Energy's Automated Export Control System," DOE/IG-0533, December 2001;
- "Inspection of the Department of Energy's Role in the Commerce Control List and the U.S. Munitions List," INS-O-01-03, March 2001;
- "Inspection of the Department of Energy's Export License Process for Foreign National Visits and Assignments," DOE/IG-0465, March 2000;
- "The Department of Energy's Export Licensing Process for Dual-Use and Munitions Commodities," DOE/IG-0445, May 1999; and
- "Report on Inspection of the Department's Export Licensing Process for Dual-Use and Munitions Commodities," DOE/IG-0331, August 1993.

STATUS OF RECOMMENDATIONS FROM PRIOR
NATIONAL DEFENSE AUTHORIZATION ACT REPORTS

Section 1204 of the National Defense Authorization Act (NDAA) for Fiscal Year 2001 amended Section 1402(b) of the NDAA for Fiscal Year 2000 to require the specified Office of Inspectors General (OIGs) to include in each annual report the status of the implementation or other disposition of recommendations that have been set forth in previous annual reports under Section 1402(b). To date, seven reports have been completed by the Energy OIG under this requirement. Two reports: "Inspection of Status of Recommendations from the Office of Inspector General's March 2000 and December 2001 Export Control Reviews," INS-L-03-07, May 2003, and "Inspection of the Department of Energy's Role in the Commerce Control List and the U.S. Munitions List," INS-O-01-03, March 2001, did not contain recommendations. The following is the status of the recommendations from the other five reports. Of 17 total recommendations, 14 have already been closed and the remaining 3 are to be closed as a result of this current report.

"The Department of Energy's Review of Export License Applications for China," DOE/IG-0723, April 2006

Recommendation 1. We recommended that the Deputy Administrator, Defense Nuclear Nonproliferation expedite the development and implementation of the new Lawrence Livermore National Laboratory database for processing end-user reviews.

Energy management stated that the end-user database at the Lawrence Livermore National Laboratory is up and running to support all new incoming export license applications received from Commerce. This database is being enhanced to help ensure a complete search capability for entities by incorporating standard names for the facilities names. The Energy OIG agreed to close this recommendation.

Recommendation 2. We recommended that the Deputy Administrator, Defense Nuclear Nonproliferation coordinate with the Director, Office of Intelligence and Counterintelligence ensure personnel affiliated with the Office of Defense Nuclear Nonproliferation who conduct export license reviews have continual access to Sensitive Compartmented Information computers and be able to hand carry Sensitive Compartmented Information documents.

Energy management stated that both offices have met and coordinated regarding this recommendation. Access has subsequently been granted to contractor staff affiliated with the Office of Defense Nuclear Nonproliferation to use Sensitive Compartmented Information computers and hand carry Sensitive Compartmented Information. The Energy OIG agreed to close this recommendation.

"The Department of Energy's Review of Chemical and Biological Export License Applications," DOE/IG-0682, March 2005

Recommendation 1. We recommended that the Deputy Administrator, Defense Nuclear Nonproliferation take appropriate action to ensure that Energy licensing officers have access to the Department of Commerce's Export Control Automated Support System (ECASS).

As discussed in the findings section of this report, we are closing this recommendation.

Recommendation 2. We recommended that the Deputy Administrator, Defense Nuclear Nonproliferation take appropriate action to ensure that Energy licensing officers are properly trained in the use of this system.

As discussed in the findings section of this report, we are closing this recommendation.

"Contractor Compliance with Deemed Export Controls," DOE/IG-0645, April 2004

Recommendation 1. We recommended that the Director, Office of Security and Safety Performance Assurance expedite issuance of a draft unclassified foreign visits and assignments Order 142.X that addresses training requirements and responsibilities for hosts of foreign nationals.

Energy management reported that Energy Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included training requirements and responsibilities for hosts of foreign nationals and agreed to close this recommendation.

Recommendation 2. We recommended that the Deputy Administrator, Defense Nuclear Nonproliferation ensure that export control guidance, including deemed export guidance, is disseminated and is being consistently implemented throughout the Energy complex.

As discussed in the findings section of this report, this recommendation will remain open.

"Inspection of the Department of Energy's Automated Export Control System," DOE/IG-0533, December 2001

Recommendation 1. We recommended that the Assistant Deputy Administrator for Arms Control and Nonproliferation coordinate with the Departments of Commerce and Treasury to ensure access by Energy to information within the Automated Export System regarding the purchase and/or shipment of commodities under an approved export license, and develop guidelines for Energy's access to the information.

Energy management reported that the National Nuclear Security Administration (NNSA) has taken actions as far as its cognizant authority allows. All remaining actions are contingent on

other Government agencies. NNSA recommended that the interagency OIG group involved with export controls make specific recommendations to individual agencies in order to effect change. While actions are not completed, NNSA can no longer report meaningful status. The Energy OIG agreed to close this recommendation.

Recommendation 2a. We recommended that the Assistant Deputy Administrator for Arms Control and Nonproliferation coordinate with State to improve communications regarding review of export license applications for munitions commodities.

Energy management reported that NNSA has taken actions as far as its cognizant authority allows. All remaining actions are contingent on other Government agencies. NNSA recommended that the interagency OIG group involved with export controls make specific recommendations to individual agencies in order to effect change. While actions are not completed, NNSA can no longer report meaningful status. The Energy OIG agreed to close this recommendation.

Recommendation 2b. We recommended that the Assistant Deputy Administrator for Arms Control and Nonproliferation coordinate with State to ensure access by Energy to information maintained by State regarding final disposition (i.e., approval/denial of license applications and the purchase and/or shipment of commodities) of export license applications and develop guidelines for Energy's access to the information.

Energy management reported that NNSA has taken actions as far as its cognizant authority allows. All remaining actions are contingent on other Government agencies. NNSA recommended that the interagency OIG group involved with export controls make specific recommendations to individual agencies in order to effect change. While actions are not completed, NNSA can no longer report meaningful status. The Energy OIG agreed to close this recommendation.

"Inspection of the Department of Energy's Export License Process for Foreign National Visits and Assignments," DOE/IG-0465, March 2000

Recommendation 1. We recommended that the Acting Deputy Administrator for Defense Nuclear Nonproliferation ensure that senior Energy officials work with senior Commerce officials to assure clear, concise, and reliable guidance is obtained in a timely manner from Commerce regarding the circumstances under which a foreign national's visit or assignment to an Energy site would require an export license.

Energy management was advised by the Commerce Assistant Secretary for Export Administration that extensive guidance regarding compliance with the deemed export rule was available on the Commerce Web site and that Commerce would continue to strengthen its outreach training programs for Energy's National Laboratories. The Energy OIG agreed to close this recommendation.

Recommendation 2. We recommended that the Director, Office of Security and Emergency Operations ensure that a proposed revision of the Energy Notice concerning unclassified foreign visits and assignments includes the principal roles and responsibilities for hosts of foreign national visitors and assignees.

Energy management reported that Energy Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included the principal roles and responsibilities for hosts of foreign national visitors and assignees and agreed to close this recommendation.

Recommendation 3. We recommended that the Director, Office of Security and Emergency Operations, include a requirement for Energy and Energy contractor officials to enter required foreign national visit and assignment information in the Foreign Access Records Management System, or a designated central database, in a complete and timely manner.

Energy management reported that a new Energy-wide information system, the Foreign Access Centralized Tracking System (FACTS), was developed and implemented. Energy management further advised that draft Order 142.X includes a requirement for Energy sites to enter required foreign national visit and assignment information into FACTS in a complete and timely manner.

Because Energy management's corrective action addressed usage of FACTS by all Energy Federal and contractor employees, the Energy OIG agreed to close this recommendation and track this issue under recommendation 8.

Recommendation 4. We recommended that the Manager of Energy's Oak Ridge Operations Office ensure that requests for foreign national visits and assignments at the Oak Ridge site are reviewed by the Y-12 National Security Program Office to assist in identifying those foreign nationals who may require an export license in conjunction with the visit or assignment.

Energy management reported that, to ensure requests for foreign national visits and assignments at the Oak Ridge National Laboratory receive appropriate export license consideration, Oak Ridge National Laboratory initiated a system of reviews. Under the system, requests are reviewed by five separate disciplines (Cyber Security, Export Control, Classification, Counterintelligence, and Security). In addition, requests associated with concerns are referred for resolution to the Non-citizen Access Review Committee. Energy management further reported that while each of the reviews can involve the National Security Program Office, the Oak Ridge National Laboratory Export Control Officer is responsible for referring requests to the National Security Program Office as necessary. The Energy OIG agreed to close this recommendation.

Recommendation 5. We recommended that the Director, Office of Security and Emergency Operations ensure that the requirements in the revised Energy Notice for unclassified foreign national visits and assignments are clearly identified and assigned to responsible officials or organizations.

Energy management reported that Energy Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included clear identification of requirements for foreign national visits and assignments, and identifies responsible officials and organizations and agreed to close this recommendation.

Recommendation 6. We recommended that the Acting Deputy Administrator for Defense Nuclear Nonproliferation ensure that guidance issued by the Office of Nuclear Transfer and Supplier Policy to advise hosts of their responsibilities regarding foreign nationals includes the appropriate level of oversight to be provided by the host during the period of the visit or assignment.

Energy management reported that DOE Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included the principal roles and responsibilities for hosts of foreign national visitors and assignees and agreed to close this recommendation.

Recommendation 7. We recommended that the Director, Office of Security and Emergency Operations revise the Energy policy regarding foreign national visits and assignments to ensure that Energy sites are maintaining consistent information about foreign nationals visiting or assigned to work at the site.

Energy management reported that DOE Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included the requirement for documentation in FACTS for all visit and assignment requests in a timely manner and agreed to close this recommendation.

Recommendation 8. We recommended that the Director, Office of Security and Emergency Operations require that all Energy sites with foreign national visitors or assignees enter information regarding the visits or assignments into Foreign Access Records Management System, or a designated central Energy database.

Energy management reported that DOE Order 142.3 was approved on June 18, 2004. The Energy OIG determined that Energy Order 142.3 included the requirement that all sites having foreign national visitors or assignees are required to enter information regarding the visits and assignments into FACTS and agreed to close this recommendation.

Department of Energy
Washington, DC 20585

May 7, 2007

MEMORANDUM FOR GREGORY H. FRIEDMAN
INSPECTOR GENERAL

FROM: GLENN S. PODONSKY
HEALTH, SAFETY AND SECURITY OFFICER
OFFICE OF HEALTH, SAFETY AND SECURITY

SUBJECT: COMMENTS FOR IG DRAFT INSPECTION REPORT: Review of Status of Prior Export Control Recommendations at the Department of Energy (SO6IS045)

The Office of Health, Safety and Security (HSS) has reviewed the subject draft inspection report provided by the Inspector General's Office on April 20, 2007, and provides the following comments.

Recommendation 2: We recommend that the Chief Health, Safety and Security Officer:

> Revise Order 142.3 to reflect the actual process for reviewing access requests for nationals of state sponsors of terrorism.

Response:

Concur. The Office of Health, Safety and Security (HSS) has begun the process of modifying the Order to reflect the current process of including only HSS, The Office of Intelligence and Counterintelligence, and a representative of the cognizant Under Secretary in the Headquarters Management Panel advisory review of access requests for nationals of state sponsors of terrorism prior to final approval determination by the cognizant Under Secretary. HSS will submit a justification for this modification, in line with the requirements of DOE Manual 251.1-1B, *Departmental Directives Program*, in May, 2007.

If you have any questions, you may contact me at (301) 903-3777 or have a member of your staff contact Jennifer Emanuelson at (202) 586-6828.

cc: Richard Speidel, NA-66

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Department of Energy
National Nuclear Security Administration
Washington, DC 20585

May 17, 2007

MEMORANDUM FOR Christopher R. Sharpley
Deputy Inspector General
for Investigations and Inspections

FROM: Michael C. Kane
Associate Administrator
for Management and Administration

SUBJECT: Comments to Review of Status of Prior Export Control Recommendations; S07IS045/2007-00568

The National Nuclear Security Administration (NNSA) appreciates the opportunity to review the Inspector General's (IG) draft report, "Review of Status of Prior Export Control Recommendations at the Department of Energy." We understand that this report came about because the National Defense Authorization Act for FY 2000 required that from 2000 through 2007, the IG was to provide a report on the export of technologies with a potential military application. During that time NNSA responded to seven reports with a corresponding 17 recommendations towards improving our export control efforts.

NNSA appreciates the work conducted by the IG. We acknowledge that the IG is closing two of the three remaining recommendations and is further recommending that we expedite actions related to the open recommendations. One of the possible solutions that we are pursuing is the modification of the Department's Acquisition Regulations. This would then require any contractor who has business with the Department to comply with Export Controls rules. We will complete the actions to ensure the most efficient and effective means to accomplish that which the IG is recommending by December 2007.

Should you have any questions related to this response, please contact Richard Speidel, Director, Policy and Internal Controls Management.

cc: Will Tobey, Deputy Administrator for Defense Nuclear Nonproliferation
David Boyd, Senior Procurement Executive
Karen Boardman, Director, Service Center

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IG Report No. INS-O-07-01

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Appendix E. Department of State Report

Important Notice

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United States Department of State and the Broadcasting Board of Governors

Office of Inspector General

Office of Audits

Compliance Follow-Up Review on Export Controls

Report Number AUD/IP–07-44, August 2007

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Summary

The Department of State Office of Inspector General (OIG) found, based on its review, that the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (PM/DDTC), had implemented 28 of the 29 recommendations contained in OIG reports on export controls issued from 2000 to 2006. OIG's recommendation from its 2006 report that PM/DDTC should establish performance measures that detail benchmarks and timeframes for reducing and eliminating the number of unfavorable post-license end-use checks remains unresolved. Nevertheless, PM/DDTC stated that over the next year it would consider whether such measures, along with time-lines and benchmarks, would be of value in its compliance and licensing functions. As a result, this recommendation will remain unresolved until PM/DDTC makes its final determination.

Background

In response to requirements of Section 1402 of the National Defense Authorization Act (NDAA) for FY 2000,[1] the Inspectors General of the Departments of Commerce, Defense, Energy, Homeland Security, and State, in consultation with the Director of Central Intelligence and the Director of the Federal Bureau of Investigation, are required to conduct an annual review through 2007 to assess the adequacy of current export controls and counterintelligence measures to prevent the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. The Offices of Inspector General of these agencies conduct both agency-specific and interagency reviews.

Sound export controls and licensing operations are essential to preventing the spread of weapons of mass destruction technologies and to provide conventional technologies only to those entities that will use them responsibly. The Department registers U.S. companies and universities and issues licenses for the export of defense articles and defense services, including sensitive technical information, on the U.S. Munitions List (USML). PM/DDTC is responsible for controlling the export and temporary import of defense articles and defense services covered by the USML. A primary responsibility is to take final action on license applications for defense trade exports and for addressing matters related to defense trade compliance, enforcement, and reporting.

The Arms Export Control Act (AECA), as amended in 1996,[2] requires the President to establish a program for end-use monitoring of defense articles and services sold or exported under the provisions of the AECA and the Foreign Assistance Act.[3] The requirement states that, to the extent practicable, end-use monitoring programs should provide reasonable assurance that recipients comply with the requirements imposed by the U.S. government on the use, transfer, and security of defense articles and services. In

[1] Public Law 106-65.
[2] 22 U.S.C. 2785.
[3] 22 U.S.C. 2151.

addition, monitoring programs, to the extent practicable, are to provide assurances that defense articles and services are used for the purposes for which they are provided.

To comply with the AECA, PM/DDTC conducts end-use monitoring of the commercial export of defense articles, services, and related technical data. End-use monitoring refers to the procedures used to verify that foreign recipients of controlled U.S. exports use such items according to U.S. terms and conditions of transfer. PM/DDTC's end-use monitoring is conducted through the "Blue Lantern" Program and entails an in-depth review either before (prelicense) or after (postlicense) the license is issued. U.S. embassy or, in some cases, PM/DDTC personnel conduct end-use checks abroad to verify the specific use and recipient of commercial defense exports and transfers controlled under the AECA.

Objective, Scope, and Methodology

To comply with the requirements of the NDAA for FY 2007, the overall objective of the Inspectors General, as defined in the Interagency Implementation Agreement, was to determine whether management had effectively addressed recommendations contained in export control reports required by the NDAA and that were issued between 1999 and 2007. The 2007 report will contain the results of reviews performed by the Inspectors General of the Departments of Commerce, Defense, Energy, Homeland Security, State, Treasury, United States Postal Service, and the Central Intelligence Agency. The Department of State's objective was to follow up on prior recommendations that remained open and determine the actions needed to implement the recommendations.

To achieve its objective, OIG reviewed the status of each recommendation contained in its export control reports issued from 2000 to 2006. (The reports and the status of each recommendation are detailed in the Results of Audit section of this report.) Additionally, OIG obtained and reviewed current PM/DDTC licensing policies and procedures, conducted interviews with appropriate staff, and reviewed applicable documentation and system checks. OIG also evaluated the Bureau Performance Plans for FYs 2006 and 2008. Finally, OIG discussed the status of each report recommendation with PM/DDTC officials.

To guide OIG's determination for the resolution of audit findings and recommendations, OIG examined guidance from the Government Accountability Office (GAO) concerning the definition of "Open Recommendation" and the standard in regard to the length of time that a recommendation should remain open. Additionally, OIG's Office of Audits (AUD) Manual, July 2006, Chapter 19, "Audit Resolution," defines AUD's policies and procedures for the resolution of audit findings and recommendations.

OIG's Office of Audits, International Programs Division, conducted this review from November 2006 through July 2007 in the Washington, DC, area. OIG performed this work in accordance with government auditing standards and included such tests and auditing procedures that were considered necessary under the circumstances.

Results of Audit

Based on its review of the audit reports it had issued from 2000 to 2006 on export controls, OIG determined that 28 of the 29 recommendations contained in six reports (one report did not have any recommendations)[4] had been implemented. The one remaining recommendation is unresolved because PM/DDTC officials stated that they would consider, over the next year, whether to implement the recommendation.

Reports With All Recommendations Closed

All of the recommendations contained in the reports below are considered closed as follows:

- "Department of State Controls Over the Transfer of Military Sensitive Technologies to Foreign Nationals From Countries and Entities of Concern" (00-CI-008), issued in March 2000, contained three recommendations relating to the transfer of military sensitive technologies to foreign nationals. OIG found that all of the recommendations had been implemented.

- "U.S. Munitions List and the Commodity Jurisdiction Process" (01-FP-M-027), issued in March 2001, contained seven recommendations relating to the USML and the commodity jurisdiction process. OIG found that all of the recommendations had been implemented.

- "Streamlined Processes and Better Automation Can Improve Munitions License Reviews" (IT-A-02-02), issued in March 2002, contained four recommendations relating to improving the munitions license reviews. OIG found that all of the recommendations had been implemented.

- "Review of End-Use Monitoring of Munitions Exports" (AUD/PR-03-31), issued in March 2003, contained nine recommendations relating to end-use monitoring of munitions exports. OIG found that all of the recommendations had been implemented.

- "Review of Export Controls for Foreign Persons Employed at Companies and Universities" (AUD/PR-04-24), issued in April 2004, contained four recommendations relating to export controls for foreigners employed at companies and universities. OIG found that all of the recommendations had been implemented.

Report With Unresolved Recommendation

OIG's report "Review of Export Controls" (AUD/IP-07-01), issued in October 2006, found that although PM/DDTC had followed its policies and procedures before

[4] "Export Licensing of Chemical and Biological Commodities" (AUD/PR-05-29), issued in April 2005.

issuing a license, there were instances in which its end-use check, conducted either before or after a license was issued, resulted in "unfavorable determinations." Unfavorable means that PM/DDTC had found derogatory, incomplete, or inaccurate information in the license application or there was a violation of export control policies and procedures. OIG discussed its report findings and proposed recommendations with PM/DDTC officials before it issued its draft report. OIG then provided a copy of the draft report to PM/DDTC officials, who reviewed the draft but did not provide comments on it. Subsequently, in an October 6, 2006, memorandum to OIG, PM/DDTC officials stated that they were "fully consider[ing]" the report's two recommendations. As a result, both recommendations were considered unresolved, which required OIG to follow up on the recommendations to determine their statuses.

Recommendation Closed

OIG recommended (Recommendation 1) that PM/DDTC reassess its licensing policies and procedures and report to OIG within 60 days of report issuance the changes it will make to reduce and eliminate unfavorable post-license end-use checks.

PM/DDTC, in a May 14, 2007, e-mail to OIG, said that it was "always willing to consider any recommendation that would improve [its] licensing and compliance functions." Its response provided a summary of "new and continuing" initiatives "to improve upon [its] work product" as follows:

- Education and Training

- PM/DDTC said that management from all of its divisions provide periodic training to incoming and current licensing staff "to help understand end-use monitoring and identify potential cases" and that in 2006 it had issued an updated Blue Lantern Guidebook.

- PM/DDTC also said that U.S. government staff and management participated in educational outreach efforts with federal law enforcement and intelligence communities that had "led to the establishment of better working relationships among staff and organizations."

- PM/DDTC said that staff from the Research and Analysis Division (RAD), the division that implements the Blue Lantern end-use program, had visited over 20 countries in Europe, Asia, Latin America, and the Middle East to educate these governments on U.S. end-use monitoring and to improve their support to U.S. embassy officials. Also, PM/DTCC staff and management participate in forums on public training and education, including the Blue Lantern Program.

- Personnel

- PM/DTCC said that each licensing division has a compliance specialist from RAD who performs compliance duties and that RAD has added another contractor to its staff.

- Information Technology (IT)

- PM/ DTCC said that its personnel and IT staff had developed and implemented new Watchlist software that results in a "more user-friendly format and a more efficient and effective search tool." It also said that it would begin to develop software that supports the Blue Lantern Program "in the winter of 2008" that will be "interoperable with existing IT products" and that it plans to implement the software before FY 2009. According to PM/DTCC, the software will improve its ability to "research and analyze Blue Lantern data to help identify trends and high-risk transactions."

- Coordination and Staff Visits

- PM/DTCC said that there would be better coordination among its three divisions and that it had made 23 compliance staff visits to U.S. defense companies in FY 2006.

OIG Analysis

OIG recognizes the significant enhancements PM/DDTC has both made and formulated to its licensing and compliance program and therefore to implement Recommendation 1. As a result, OIG considers Recommendation 1 closed.

Recommendation Unresolved

In its October 2006 report, OIG recommended (Recommendation 2) that PM/DDTC establish performance measures that detail benchmarks and timeframes for reducing and eliminating the number of unfavorable post-license end-use checks.

In its October 6, 2006, response, PM/DDTC said that it would "examine whether to incorporate the measures already used by DDTC in managing the Blue Lantern Program into the Bureau's performance metrics." It also said, in its May 14, 2007, e-mail to OIG, that it would "over the next year . . . agree to consider whether such measures, along with time-lines and benchmarks, would be of value in . . . overall compliance and licensing functions."

OIG Analysis

OIG believes that the recommendation should be implemented. Performance measures for end-use checks could demonstrate progress in reducing and eliminating unfavorable determinations. Additionally, PM/DDTC could use the measures to track performance, identify areas for improvements, and make decisions about resource

allocations. Therefore, the recommendation remains unresolved until PM/DDTC makes a final determination.

Appendix F. Department of the Treasury Report

Audit Report

OIG-07-040

EXPORT CONTROLS: CFIUS and OFAC Implemented Prior OIG Recommendations

June 12, 2007

Office of Inspector General

Department of the Treasury

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Abbreviations

CFIUS	Committee on Foreign Investments in the United States
ICE	United States Immigration and Customs Enforcement
NDAA	National Defense Authorization Act
OFAC	Office of Foreign Assets Control
OIG	Office of Inspector General
Treasury	Department of the Treasury

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June 12, 2007

Clay Lowery
Acting Under Secretary for International Affairs

Adam J. Szubin
Director, Office of Foreign Assets Control

This report presents the results of an audit we conducted to follow up on recommendations from two prior Office of Inspector General (OIG) reports on the Department of the Treasury's enforcement of controls for the export of militarily sensitive technology to countries and entities of concern. We conducted this follow-up audit under the auspices of an interagency working group of OIGs that focused on federal agencies' implementation of such controls.[1] The working group was established to help carry out certain reporting requirements of the National Defense Authorization Act (NDAA) for Fiscal Year 2000,[2] as amended by the NDAA for Fiscal Year 2001.[3]

The objective of this audit was to determine whether Treasury had effectively implemented recommendations in audit reports issued during fiscal years 2000 and 2003.[4] The fiscal year 2000 report contained one recommendation, addressed to the Chair of the Committee on Foreign Investment in the United States (CFIUS). The fiscal year 2003 report contained two recommendations,

[1] The participating agencies for the fiscal year 2007 working group consists of the OIGs of the Departments of Commerce, Defense, Energy, Homeland Security, State, Treasury, the United States Postal Service, and the Central Intelligence Agency.
[2] Pub. L. 106-65, § 1402, 113 Stat. 798 (Oct. 5, 1999).
[3] Pub. L. 106-398, § 1204, 114 Stat. 1654A-325 (Oct. 30, 2000).
[4] *Department of the Treasury Efforts to Prevent Illicit Transfers of U.S. Military Technologies*, OIG-00-072 (Mar. 23, 2000); *Export Enforcement: Numerous Factors Impaired Treasury's Ability to Effectively Enforce Export Controls*, OIG-03-069 (Mar. 25. 2003).

addressed to the Director of the Office of Foreign Assets Control (OFAC). The responding Treasury officials concurred with the recommendations and outlined actions planned in response to the recommendations.

We conducted our audit fieldwork from December 2006 through March 2007. We met with officials of the Office of Investment Security, which is part of the Office of International Affairs, and OFAC. We also reviewed relevant CFIUS and OFAC documentation. Appendix 1 contains a more detailed description of our objective, scope, and methodology.

Results in Brief

In our 2000 report, we recommended that the CFIUS Chair coordinate efforts with other committee members to identify and evaluate all sources of available data that could help identify Exon-Florio non-filers. After identifying data sources, CFIUS was to develop a methodology and establish procedures for using these data sources effectively. We found the procedure that CFIUS implemented in response to our recommendation was effective.

In our 2003 report, we recommended that the Director of OFAC coordinate with State Department officials to implement an automated process to allow both agencies to track the status of license determination referrals. We also recommended that the Director of OFAC coordinate with Customs officials to ensure that OFAC investigative referrals can be linked to Customs' cases. We found that OFAC had implemented procedures that fulfilled the intent of these two recommendations but had not formalized the procedures as written policy. We recommend OFAC develop written policy to formalize the procedures. OFAC agreed to implement the recommendations in its response to our report.

We obtained written comments to a draft of this report from the Assistant Secretary of International Affairs and the Director of OFAC. The comments are provided in appendix 2.

Background

Reporting Under NDAA

The NDAA for Fiscal Year 2000 requires the President to submit annual reports to Congress through fiscal year 2007 on transfers of militarily sensitive technology to countries and entities of concern. The reports' contents are to include audits by the Inspectors General of the Departments of Commerce, Defense, Energy, and State of policies and procedures related to the export of technologies and technical information to countries and entities of concern.[5] The reporting requirement was amended in fiscal year 2001 to require that the annual interagency report include OIG follow-up on the status or disposition of recommendations made in earlier reports.[6]

Although Treasury enforces export controls, Treasury OIG was not required to participate in the audits mandated by the 2000 and 2001 laws. Nevertheless, we chose to participate when the interagency working group addressed topics specifically relevant to the Department's enforcement efforts. The topics scheduled for review were decided by the interagency working group in 2000. For fiscal year 2007, the interagency working group decided that the report would include a review of how effectively agencies had addressed recommendations made in previously issued reports. The findings in this report represent our contribution to that effort.

Treasury OIG issued three audit reports in support of the NDAA. The reports contained a total of 16 recommendations, but only 3 remain applicable to Treasury. The other 13 recommendations were addressed to management of entities that are no longer part of Treasury – the legacy U.S. Customs Service and Bureau

[5] Pub. L. 106-65, § 1402(b)(3), 113 Stat. 798 (Oct. 5, 1999).
[6] Pub. L. 106-65, § 1402, was amended by Pub. L. 106-398, § 1204, 114 Stat. 1654A-325 (Oct. 30, 2000).

of Alcohol, Tobacco and Firearms.[7] Of the 3 remaining recommendations, 1 was directed to CFIUS and the other 2 to OFAC.

CFIUS

CFIUS was established in 1975 mainly to monitor and evaluate the effect of foreign investment in the United States. The Secretary of the Treasury was designated the Chair of CFIUS.[8] In 1988, Congress passed the Exon-Florio amendment to the Defense Production Act of 1950.[9] The amendment authorized the President or his designee to (1) receive voluntary notices from companies engaged in transactions subject to Exon-Florio; (2) to determine whether a particular acquisition has national security issues; and (3) as appropriate, to undertake investigations. The President delegated these authorities to CFIUS. Exon-Florio also gave the President authority to prohibit or suspend a transaction if necessary to protect national security, and the President retained this authority.

In our 2000 report,[10] we found that although CFIUS did deter some foreign acquisitions that may have had national security implications, it needed to do more to identify nonfilers engaged in activities subject to Exon-Florio. Our specific recommendation was as follows:

We recommend that the CFIUS Chair coordinate efforts with other Committee members to identify and evaluate all sources of available data that can assist in identifying Exon-Florio non-filers. Once data sources are identified, CFIUS needs to develop a

[7] The border security and inspection arm of the U.S. Customs Service is now part of the Bureau of Customs and Border Protection; the enforcement and investigation arms of the U.S. Customs Service and the law enforcement arm of the Immigration and Naturalization Service is now part of U.S. Immigration and Customs Enforcement (ICE). Both Customs and Border Protection and ICE are within the Department of Homeland Security. The Bureau of Alcohol, Tobacco and Firearms is now within the Department of Justice and is known as the Bureau of Alcohol, Tobacco, Firearms and Explosives.
[8] The other CFIUS member agencies are the Departments of State, Defense, Justice, Commerce, and Homeland Security; the Office of Management and Budget; the Council of Economic Advisers; the National Economic Council; the Office of the United States Trade Representative; the Office of Science and Technology Policy; and the National Security Council.
[9] 50 U.S.C. App. § 2170.
[10] OIG-00-072.

methodology and establish procedures as to how these data sources can be effectively used to meet its responsibilities.

CFIUS concurred with our recommendation.

OFAC

OFAC, located within Treasury's Office of Terrorism and Financial Intelligence, administers and enforces economic and trade sanctions against targeted foreign countries, organizations that sponsor terrorism, and international narcotics traffickers, based on U.S. foreign policy and national security goals. OFAC regulations require exporters, importers, and others under U.S. jurisdiction to obtain OFAC licenses before engaging in any type of commercial transactions with targeted countries or nationals.

During our 2003 audit,[11] we found that OFAC sent referrals to the State Department for license determinations when OFAC was unsure whether to grant licenses to exporters. The State Department, however, did not routinely process these referrals promptly, resulting in delays in OFAC license approvals. Both State Department and OFAC officials attributed the State Department's processing delays to (1) mandatory rotation cycles that required employees within the Bureau of Economic and Business Affairs, Office of Economic Sanctions Policy, to rotate every two years and (2) the State Department's lack of an automated system to track OFAC referrals.

We also found during our 2003 audit that OFAC referred approximately 30 cases to Customs each year for criminal investigation and that Customs initiated its own investigations of OFAC export violations. We determined that Customs did not always inform OFAC when Customs closed an OFAC investigative referral, decided not to take action on an OFAC referral, or initiated its own investigation of export violations. In addition, Customs and OFAC used different numbers to identify referrals; as a result, OFAC officials said they found it difficult to link their referrals to a Customs' investigative case number. The failure of Customs to notify OFAC officials about closed referrals and investigations

[11] OIG-03-069.

hampered OFAC's ability to assess civil penalties when it was determined that criminal prosecution was not warranted.

As a result of these findings, we made the following two recommendations:

1. The Director of OFAC should coordinate with State Department officials to implement an automated process to allow both agencies to track the status of license determination referrals.

2. The Director of OFAC should coordinate with Customs officials to ensure OFAC investigative referrals can be linked to Customs' cases.

OFAC concurred with these recommendations.

Findings and Recommendations

CFIUS Established and Implemented Procedures to Help Identify Nonfilers

In response to our recommendation, the CFIUS Chair established procedures for coordinating with other Committee members to identify and evaluate data sources to help identify Exon-Florio nonfilers. Specifically, CFIUS members met in May 2000 to identify available sources of data and developed a procedure for reporting non-notified transactions. The procedure requires CFIUS members to provide the Committee Chair with information on transactions they believe may be appropriate for review by the Committee under Exon-Florio. Upon receipt of the information, the Committee Chair is to add public information and develop a list of non-notified transactions. This list is then to be circulated to member agencies for review. If a CFIUS member believes that the parties in the transaction should file, CFIUS is to take appropriate action. This procedure has been used by members to identify non-notified transactions since 2000.

OFAC Has Taken Steps to Track Referrals to Other Agencies but Lacks Written Policy

We found that, in response to our recommendations, OFAC took steps to coordinate with the State Department on license referrals and with ICE on investigative referrals.

OFAC Coordination with the State Department

OFAC established regular meetings with the State Department to review license determination referrals and, since 2003, monthly meetings have been held and attended by Licensing Officers and office Directors. These meetings are used to elevate licensing policy issues between OFAC and the State Department. However, OFAC did not implement an automated process that allows both agencies to access each other's system to track the status of licensing determination referrals because it said that the cost was prohibitive. According to OFAC personnel, institution of the monthly meetings has resolved most of the timeliness issues that the recommendation was intended to address.

OFAC Coordination with ICE

OFAC has coordinated with ICE and held regular meetings to review the status of ICE-initiated investigations and OFAC referrals. During these meetings, ICE has provided its active embargo case reports to OFAC for review. These reports detail the status of both ICE-initiated investigations and OFAC referrals. To link OFAC referrals to ICE cases, OFAC assigns case names to their referrals and ICE utilizes these OFAC case names in their active embargo reports.

The steps OFAC took to coordinate with the State Department on license referrals and with ICE on investigative referrals fulfilled the intent of our recommendations. However, OFAC does not have written policy in place that formalizes these procedures. The meetings with the State Department and ICE represent an important internal control, defined in the Government Accountability Office's *Standards for Internal Control in the Federal Government* as the plans, methods, and procedures used to meet

missions, goals, and objectives. Further, internal control should be clearly documented and the documentation should be readily available for examination.[12] Without a written policy requiring continued coordination with the State Department and ICE, lapses in coordination could occur in the future.

Recommendations

To help ensure continuity of coordination between OFAC and the State Department and OFAC and ICE, we recommend the Director of OFAC do the following:

1. Ensure OFAC develops written policy to formalize the procedure of having monthly meetings with the State Department to review the status of license determination referrals.

2. Ensure OFAC develops written policy to formalize the procedure of having regular meetings with ICE to review the status of ICE-initiated investigations and OFAC referrals.

Management Response

OFAC concurred with the two recommendations. OFAC has drafted a policy memo to ensure continued implementation of their current practice of conducting monthly meetings with the Department of State to resolve issues relating to license applications submitted to OFAC that involve foreign policy issues. OFAC has also drafted a policy memo to ensure continued implementation of their current practice of coordinating with criminal law enforcement agencies, including ICE, concerning violations of OFAC regulations. OFAC was to distribute both policy memos no later than May 30, 2007.

OIG Comment

Management's planned actions are responsive to the intent of our recommendations.

[12] Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (November 1999).

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5400 or Alain Dubois, Director of Banking Audits, at (202) 927-0382. Major contributors to this report are listed in appendix 3.

Marla A. Freedman
Assistant Inspector General for Audit

Our objective was to determine whether certain prior OIG recommendations directed to the Chair of the Committee on Foreign Investments in the United States (CFIUS) and to the Director of the Office of Foreign Assets Control (OFAC) had been implemented. These recommendations are restated on pages 6 and 8.

To accomplish this objective, we performed the following activities:

- Conducted interviews with Office of Investment Security personnel
- Reviewed CFIUS guidance on non-notified transactions
- Conducted interviews with current OFAC managers and one former OFAC manager
- Reviewed and analyzed an OFAC report on all outstanding referrals to the State Department
- Reviewed OFAC documentation related to monthly meetings with the State Department
- Reviewed a U.S. Immigration and Customs Enforcement report on Active Embargo Cases

We performed our audit from December 2006 through March 2007 in accordance with generally accepted government auditing standards.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

June 4, 2007

Marla A. Freedman
Assistant Inspector General for Audit
Office of the Inspector General
Department of the Treasury
740 15th Street, N.W., Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

This to acknowledge receipt of the draft audit report you sent me on May 3: Export Controls: CFIUS and OFAC Implemented Prior OIG Recommendations. I am pleased to learn your office's view that the Committee on Foreign Investment in the United States (CFIUS) has implemented effective procedures in response to the prior audit report's recommendations, and that there are no further recommendations directed to CFIUS.

I would like to express my appreciation for the work of you and your staff on this draft report. Your efforts ensure that Treasury meets the highest levels of excellence and that Treasury, as chair of CFIUS, continues to implement this process effectively.

Sincerely,

Clay Lowery
Assistant Secretary (International Affairs)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FAC No GEN- 343251

MEMORANDUM FOR MARLA A. FREEDMAN
ASSISTANT INSPECTOR GENERAL FOR AUDIT
OFFICE OF INSPECTOR GENERAL

FROM: **ADAM J. SZUBIN** AJS 5/17/07
DIRECTOR
OFFICE OF FOREIGN ASSETS CONTROL

SUBJECT: **OFAC Comments on the OIG Draft Audit Report – OFAC Implementation of Prior OIG Recommendations.**

OFAC has received and reviewed the draft audit report "Export Controls – CFIUS and OFAC Implemented Prior OIG Recommendations," which was attached to your letter dated May 3, 2007. It concerns the implementation of prior OIG recommendations previously contained in report: "OIG-03-069, Export Enforcement – Numerous Factors Impaired Treasury's Ability to Effectively Enforce Export Controls." I am hereby submitting OFAC's response to the recommendations contained in your draft audit report. Pursuant to OFAC's review of the report and our recent discussions with you on the details of your recommendations, OFAC concurs with the recommendations as noted below:

1. "Ensure OFAC develops written policy to formalize the procedure of having monthly meetings with the State Department to review the status of license determination referrals."

OFAC has drafted a policy memo to be disseminated to OFAC's Licensing Division employees. It will ensure continued implementation of our current practice of conducting monthly meetings with the Department of State to resolve issues relating to license applications submitted to OFAC that involve foreign policy issues. Distribution of the memo will take place no later than May 30, 2007.

2. "Ensure OFAC develops written policy to formalize the procedure of having regular meetings with ICE to review the status of ICE-initiated investigations and OFAC referrals."

OFAC has drafted a policy memo to be disseminated to OFAC's Enforcement Division employees. It will ensure continued implementation of our current practice of coordinating with criminal law enforcement agencies, including ICE, concerning violations of OFAC regulations. Distribution of the memo will take place no later than May 30, 2007.

If we can be of any further assistance or if you have any questions, please contact Dale Thompson, Chief, General Investigations and Field Operations, at 622-1523.

Alain Dubois, Director, Banking Audits
Jeffrey Dye, Audit Manager
Amnoiphorn Bannavong, Program Analyst
Bobbie Gambrill, Auditor
Esther Tepper, Communications Analyst
Horace Bryan, Referencer

The Department of the Treasury

Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

Office of International Affairs

Office of International Affairs
Liaison Officer

Office of Foreign Assets Control

Office of Foreign Assets Control
Liaison Officer

Department of Defense

Department of Defense Office of Inspector General

Office of Management and Budget

OIG Budget Examiner

Appendix G. United States Postal Service Report

March 29, 2007

PAUL E. VOGEL
MANAGING DIRECTOR, GLOBAL BUSINESS AND SENIOR VICE PRESIDENT

SUBJECT: Management Advisory – Follow-up of the Postal Service's Enforcement of Export Controls (Report Number SA-MA-07-001)

This report presents the results of our follow-up review of the U.S. Postal Service's enforcement of export controls (Project Number 07YV001SA000). We conducted this review as part of an interagency group of Inspectors General[1] to determine whether each agency's management had effectively addressed recommendations in prior reports on enforcing export controls.

Background

Each year companies in the U.S. export billions of dollars worth of dual-use items[2] with both commercial and military applications. For example, dual-use items can be incorporated into golf clubs but can also help missiles evade radar detection.[3] To protect U.S. interests and limit illegal exports, Congress authorized the President to prohibit or curtail the export of any goods or technology subject to the jurisdiction of the U.S. or exported by any person of the U.S under the Export Administration Act.[4] The Secretary of Commerce exercises this authority in consultation with other departments and agencies, as the Secretary considers appropriate, and issues Export Administration Regulations (EAR)[5] to carry out this law.

The EAR requires exporters to obtain a license or determine that government authorization is not needed before exporting controlled items. In a 1999 export licensing review, the Department of Commerce Office of Inspector General (OIG) raised the concern that individuals could circumvent export control laws by sending, through

[1] The Inspectors General from the Departments of Commerce, Defense, Energy, Homeland Security, State, Treasury, the U.S. Postal Service, and the Central Intelligence Agency comprise this year's interagency review team.
[2] Dual-use items include commodities, software, and technology.
[3] U.S. Government Accountability Office, *Export Controls: Improvements to Commerce's Dual-Use System Needed to Ensure Protection of U.S. Interests in the Post-9/11 Environment*, June 2006.
[4] 50 U.S.C. App. §§ 2401 et seq. The EAA is not permanent legislation. Authority granted under the act lapsed in August 2001 but was extended under Executive Order Number 13,222 (Aug. 17, 2001) and Continuation of Emergency Regarding Export Control Regulations, 71 Fed. Reg. 44,551 (Aug. 7, 2006).
[5] 15 C.F.R. Parts 730-774.

the U.S. mail, controlled commodities to countries or entities of concern without seeking an export license.

The Department of Commerce, Bureau of Industry and Security's Office of Export Enforcement (OEE) and the Department of Homeland Security, Bureau of Customs and Border Protection (Customs) are both responsible for export enforcement activities related to dual-use items;[6] however, Customs is the primary inspector of items to be exported.

Since Customs has a major role in enforcing export controls and coordinates enforcement activities concerning outbound mail with the Postal Service, the Inspectors General for both agencies participated in a 2002 interagency review of federal export enforcement efforts government-wide. The objective of the Postal Service OIG's review was to determine the role of the Postal Service in enforcing export controls. We participated in this 2006 interagency follow-up effort to determine whether management effectively addressed recommendations made in our previous report, discussed below in the **Prior Audit Coverage** section.

The Postal Service processes international mail at five International Service Centers (ISC). The ISCs are located in New York, Miami, Chicago, Los Angeles, and San Francisco. Customs employees are co-located at each ISC and focus on inspecting inbound international mail.[7]

Objectives, Scope, and Methodology

Our objectives were to determine whether the Postal Service implemented recommendations made in the prior report and whether corrective actions are working as intended. We reviewed applicable criteria, including the Postal Service's *International Mail Manual*, *Administrative Support Manual* (ASM), and Domestic-Originating International Mail Standard Operating Procedures; the Trade Act of 2002;[8] the Export Administration Act; and EAR. We also interviewed officials from the Postal Service, Postal Inspection Service, Customs, and Department of Commerce, OEE.

We conducted this review from December 2006 through March 2007 in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Inspections.* We discussed our observations and conclusions with management officials on March 1, 2007 and included their comments where appropriate. We made no recommendations in this report and Postal Service management was not required to provide written comments.

[6] Other entities responsible for enforcement activities include the Department of Homeland Security, Immigration and Customs Enforcement Division; Department of Justice, Federal Bureau of Investigation; and the U.S. Attorney's Office.
[7] Customs personnel are also co-located at seven other postal facilities nationwide that process international mail.
[8] Pub. L. No. 107-210, § 344 (2002).

Prior Audit Coverage

The OIG report titled, *Review of the Postal Service's Enforcement of Export Controls* (Report Number AO-MA-03-001 (R), April 17, 2003), stated that the Postal Service's enforcement of export controls could be strengthened. The report recommended that the Postal Service finalize and implement an agreement allowing Customs to expand and make permanent the outbound mail inspection program; ensure that any outbound mail inspection program provides for inspection of items declared for export, according to the EAR; and establish a working group to coordinate with the Department of Commerce, OEE on export enforcement issues for mail. Postal Service management neither agreed nor disagreed with our recommendations; however, their comments were responsive and their actions taken and planned should have corrected the issues we identified.

Results

The Postal Service has taken actions to address OIG recommendations made in 2003. Specifically, the Postal Service worked with Customs to develop procedures for an outbound mail inspection program. The Postal Service also revised its policy to assist Customs in complying with its export enforcement responsibilities, and is currently working with Customs on an Outbound Mail Manifest Pilot for inspection of outbound international mail. Additionally, the Postal Inspection Service has recently reestablished contact with the Department of Commerce, OEE to exchange information on export enforcement issues.

Although the Postal Service and Customs have worked to address compliance with export regulations, a nationwide outbound mail inspection program does not exist. Because of recent terrorist acts, continuous threats, and a related focus on preventing the proliferation of weapons of mass destruction, both agencies must continue to work together to expand and implement a program to search outbound international mail and ensure compliance with the EAR.

Finalize Outbound Mail Inspection Program

The Postal Service worked with Customs to establish and finalize an outbound mail inspection program. In February 2003, Customs issued a memorandum to its field offices allowing ports to conduct searches of outbound mail shipments as part of enforcement operations. The memorandum, which was prepared in coordination with the Postal Service, provided guidance on working with Postal Service officials and examining outbound mail. It also discussed the criteria Customs should use when inspecting different types of outbound mail.

According to a Customs official, the memorandum permitted each Customs port director to establish an outbound mail inspection program based on that port's resources and

threat assessment priorities. However, because of resource constraints, no programs were implemented at that time. Customs did not attempt to establish a national program in collaboration with the Postal Service until 2006.

Revision to Postal Service Policy. The Postal Service also revised ASM 13 to allow Customs to execute its export enforcement responsibilities and implement an outbound mail inspection program. Specifically, ASM 13, Sections 274.912-913, provide guidance on Customs' authority to open and inspect outbound international mail to ensure compliance with federal laws and regulations. In accordance with the law,[9] the policy states that Customs can inspect outbound mail weighing more than 16 ounces. It also provides guidance on Customs' authority to screen international transit mail that is handled by the Postal Service and mail that is handled by airlines or other carriers without the direct intervention of the Postal Service.

Outbound Mail Manifest Pilot. The Postal Service is currently working with Customs to establish a nationwide outbound mail inspection program. In June 2006, the Postal Service and Customs implemented an Outbound Mail Manifest Pilot at the Chicago ISC to facilitate Customs inspections of outbound mail.[10] The pilot, which consists of three phases,[11] allows the Postal Service to electronically provide Customs with advance manifest information on outbound mail shipments of Air Parcel Post and Global Express Mail®[12] submitted on-line through the Postal Service's Click-N-Ship® function at the Internet site, www.usps.com. Customs uses a risk management approach to target selected shipments for further examination. This system allows Customs to perform fewer manual inspections and instead use a more selective and systematic method for screening outbound mail. However, according to a Postal Service official, mail submitted through the Internet site represents only about 5 percent of all outbound international mail, and the majority of this mail is sent through Postal Service retail windows. Postal Service and Customs officials are working together to implement a nationwide outbound mail inspection program that will comply with export laws and regulations.

Ensure Outbound Mail Inspection Program Is in Accordance with Export Administration Regulations

The Postal Service does not have the authority to execute an outbound mail inspection program in accordance with the EAR. Although the EAR grants Postal Service officials the authority to inspect items declared for export,[13] the Postal Service is prohibited by

[9] 19 U.S.C. § 1583(c).
[10] The pilot began in June 2006; however, it was suspended in September 2006 at Customs' request. The pilot entered the final phase in February 2007.
[11] Phase 1 was for data collection only and tested the flow of electronic information between the Postal Service and Customs. Phase 2 tested the physical process of holding mail items for Customs. Phase 3 will complete the process and allow the pilot operation to run full course.
[12] Effective May 6, 2007, Air Parcel Post will be Priority Mail International and Global Express Mail will be Express Mail International®.
[13] 15 C.F.R. § 758.7(a).

law from opening mail that is sealed against inspection without a warrant, unless exigent circumstances exist (for example, where the screening of the mail has disclosed the presence of materials that pose a physical threat to persons or property).[14] This statute applies to both mail delivered inside the U.S. and its territories, as well as domestic mail being exported.[15] As a result, Postal Service policy does not allow its officials to randomly open and examine the contents of mail declared for export.

Customs is the entity authorized to open and inspect outbound mail. A Customs officer may, without a search warrant, search outbound international mail that weighs more than 16 ounces and is sealed against inspection if there is reasonable cause to suspect that the mail contains items such as monetary instruments, weapons of mass destruction, narcotics, or merchandise mailed in violation of the Export Administration Act.[16] Outbound international mail that weighs less than 16 ounces and is sealed against inspection may not be searched by Customs without a search warrant.[17]

Establish Liaison with Department of Commerce

The Postal Inspection Service recently reestablished contact with the Department of Commerce, OEE in response to our 2003 recommendation. During our follow-up review, Postal Inspection Service officials informed us that the original liaison had been transferred and a new point of contact had not been established. However, in January 2007, the Inspector In Charge of Dangerous Mail Investigations and Homeland Security sent a letter to the Director, Department of Commerce, OEE to introduce himself and provide a point of contact for coordination on export enforcement issues.

Conclusion

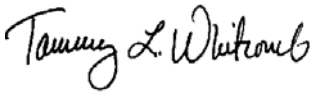
The Postal Service has a cooperative relationship with Customs and has taken appropriate actions to assist Customs with its responsibility to search outbound international mail and ensure compliance with the EAR. Although both agencies have taken measures to strengthen the enforcement of export controls concerning the mail, a national outbound mail inspection program has not been implemented. The outbound mail manifest program is currently a pilot at only one of the five ISCs. Additionally, the pilot is limited to Air Parcel Post and Global Express Mail submitted on-line through the Postal Service's Click-N-Ship function at www.usps.com, which, according to a postal official, is only 5 percent of all outbound international mail.

We strongly encourage the Postal Service to continue to work with Customs to expand the pilot program nationwide and include other classes of mail as well as mail that is presented at retail windows. Not examining more outbound mail on a national or

[14] 39 U.S.C. § 3623(d).
[15] 39 U.S.C. § 3623(d) authorizes the Postal Service to open mail without a search warrant for the sole purpose of determining an address at which the letter can be delivered, or pursuant to the authorization of the addressee. However, this authority does not extend to conducting random searches of domestic mail that will be exported.
[16] 19 U.S.C. §1583(c)(1).
[17] Id. § 1583(d).

systematic basis, could allow illegally exported items to be shipped using the Postal Service. Such items could jeopardize security in the U.S. and abroad.

We appreciate the cooperation and courtesies provided by your staff during the review. If you have any questions or need additional information, please contact Andrea Deadwyler, Director, Inspection Service and Facilities, or me at (703) 248-2100.



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