

GAO

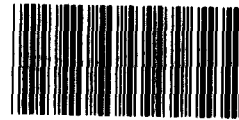
Testimony

For Release
on Delivery
Expected at
10:00 a.m.
Friday
Sept. 11, 1987

The Office of Munitions Control
Can Strengthen Its License
Review Process

Statement of
Joan M. McCabe, Associate Director
National Security and International
Affairs Division

Before the
Committee on Governmental Affairs
United States Senate



133887

039927

Mr. Chairman, Members of the Subcommittee:

I am pleased to be here to discuss our report on the State Department's Office of Munitions Control (OMC) and its arms export licensing activities.¹ Our examination focused on OMC's license application review process and exporters' compliance with certain administrative and reporting requirements.

Our review disclosed a number of areas where OMC can improve its license application reviews to help ensure that proposed exports are legitimate transactions and conform with U.S. foreign policy and national interests. Although OMC processed most license applications in less than a month, we found that

- OMC did not routinely check export license application data and information and rarely requested U.S. embassies' assistance in verifying the bona fides of the purchaser or other foreign parties to the sale.

- OMC's facilities and automation capabilities are not sufficient to provide much assistance to licensing officers during their reviews,

- OMC does not have adequate systems and procedures to ensure that exporters comply with administrative requirements, and

¹Arms Exports: Licensing Reviews for Exporting Military Items Can Be Improved (Sept. 9, 1987, GAO/NSIAD-87-211).

-- OMC understates the values on authorized arms exports and exports actually made in its reports.

OMC officials stated that an increased work load and static resources have restricted their application review efforts, including their ability to ensure compliance with all administrative requirements. OMC's volume of munitions cases (license applications and other requested approvals) has increased from about 26,000 in 1977 to over 49,000 in 1986 and is expected to exceed 52,000 in fiscal year 1987. Over the same period, OMC's staff has remained at around 30 persons with 10 staff members authorized to review licenses. OMC has prepared a plan to increase staffing levels and improve its automated systems, but important features of the plan are likely to be curtailed due to budget limitations.

BACKGROUND

The United States transfers military items and services overseas in two major ways: (1) U.S. government sales and grants under the Foreign Military Sales Program and the Military Assistance Program, respectively, and (2) commercial arms sales by individuals and business entities. For commercial arms sales, the exporter must have a U.S. government export license approved by OMC. OMC issues export licenses for items which are inherently military in nature, ranging from spare parts to major weapon systems such as fighter aircraft.²

²The Department of Commerce, on the other hand, licenses "dual-use" items, which have both military and civilian commercial applications.

In order to apply for licenses to export defense articles controlled by OMC, the person or company must register with OMC. OMC's registration list includes manufacturers and freight forwarders as well as foreign governments. This list has increased nearly 40 percent in recent years from about 2,500 active registrants in 1984 to over 3,500 in 1987.

Once registered, an exporter may apply to OMC for an export license. When OMC receives a license application, it is recorded and assigned to one of five licensing officers. These officers are usually responsible for one or more categories of the Munitions Control List. The licensing officer examines each license application to determine if applicable legal, policy, security, regulatory, and procedural requirements have been satisfied. OMC's licensing officers have been provided with a number of regulatory, policy, and administrative guidelines to assist them in performing their duties. In general, they examine licenses to see whether the application involves items not licensed before or not previously licensed to a particular country or region, whether it is politically sensitive, or whether it involves sensitive technology.

In fiscal year 1986, OMC reported issuing licenses authorizing commercial exports valued at \$14.9 billion (compared to \$8.0 billion in U.S. government foreign military sales and grant assistance). Actual exports made under these licenses, which remain valid for 2 years, are considerably less than authorized. For example, in fiscal year 1984, OMC authorized \$12.7 billion in

exports; according to OMC records, \$3.8 billion was actually exported.

MOST LICENSE APPLICATIONS ARE
ACTED ON IN 30 DAYS

According to OMC, it acted on over 49,000 applications in fiscal year 1986. Of these, OMC approved 90 percent (43,987), denied 2 percent (850) and returned 8 percent without action (4,181). A sample of license applications we examined showed similar results. Typically, license applications were denied because of concerns over the sensitivity of the technology and/or the destination country.

OMC officials told us that licensing officers can make decisions on most license applications quickly based on similar applications previously approved (precedents) and the licensing officer's familiarity with the parties and commodities involved. A recent OMC planning document stated that "[about] 80 percent of license applications can be acted on without review by other offices; most export authorizations are approved or denied by OMC within hours of receipt and returned to applicants within 2 weeks." We found that OMC processed (from receipt to final action) over three-fourths of the license applications it received in less than a month. Our random sample of 1,333 fiscal year 1986 applications showed that about 54 percent of these export license applications and other requests for OMC reviews were processed within 7 calendar days, about 71 percent within 14 days, and about 80 percent in 30 days. Less than 1 percent of the cases required more than 100 days.

As might be expected, the license applications that took the longest to review had been referred to other offices within the State Department or to other agencies for their recommendations on whether the license should be approved. This is an area OMC cannot totally control because it has to rely on other agencies to react. However, several industry representatives and DOD officials said that a number of license applications should not have been referred to DOD because the items involved had been previously approved for export or involved old technology.

The export license applications most likely to be sent out for recommendations involved either manufacturing licenses and technical assistance agreements, technical data, or selected hardware items involving sensitive technology. Factors affecting decisions to request recommendations included the lack of relevant precedents; questions about the proposed use, the contractors or intermediaries involved, or the destination country; or the licensing officer's lack of familiarity with the export item. New licensing officers are more likely to refer applications than experienced ones. OMC officials stressed that the ultimate decision over what cases are reviewed outside OMC rests with its licensing officers.

In our sample of fourth quarter fiscal year 1986 applications, 22 percent were sent to other agencies, most often to DOD and the services. Based on our sample, when OMC processed cases without asking for outside recommendations, 80 percent were completed within 7 calendar days. When recommendations were sought, 61

percent took over 30 days. For cases referred outside of OMC, we examined the processing time between key points in the review process. We found the following:

- The time from receipt of cases in OMC to referral to other organizations ranged from 0 (same day) to 17 days. Eighty-six percent were referred within 9 days or less.
- The time from referral to receipt of the last response ranged from 5 to 130 days. In 50 percent of the cases, the recommendations were received within 35 days or less.
- The time from receipt of the last referral to final action in OMC ranged from 0 to 69 days. Final action on about 47 percent was completed within 8 days.

DOD's Defense Technology Security Administration (DTSA)--which formulates DOD's position on munitions exports--is working on an export application screening system which could be useful to OMC in identifying cases needing technical review. The system is also designed to screen application information against a series of reference data bases, including intelligence data pertaining to applicants and other parties to the license. The objective of the automated system is to (1) reduce the amount of routine work performed by DTSA staff, (2) reduce case processing time, and (3) improve the quality of case analysis by making pertinent data more accessible. DTSA officials indicated a willingness to share this system.

OMC's productivity plan focuses
on timeliness

OMC's productivity plan for fiscal years 1987 to 1990--prepared in conjunction with State's participation in the Office of Management and Budget (OMB) management improvement initiatives--emphasizes the "important relationship between growing workload, static resources, and declining timeliness." OMC's plan calls for 15 additional full-time staff, temporary assignment of 2 military officers to OMC to help identify applications needing technical review, and improvements in the computer systems to speed up information retrieval. Most computer equipment (but not software) called for in the plan has been acquired, although three staff positions that were to be added in fiscal year 1988 were deleted from the State Department's request during OMB's review. The Executive Director of State's Bureau of Politico-Military Affairs told us that assignment of the military personnel was also unlikely.

LITTLE SCREENING OF REGISTRANTS AND
LICENSE APPLICATIONS

OMC reviews registration forms only to be sure that all appropriate blocks are filled in. It does not verify the accuracy of information provided by registrants or use the information in licensing reviews other than to ensure that an applicant is registered.

Also, OMC does not systematically check parties to license applications (i.e., applicants, freight forwarders, and consignees) against lists of questionable exporters, exporters convicted of past export violations, or those denied export privileges by the

Department of Commerce. We found that OMC approved over 325 export licenses valued at about \$15 million during fiscal year 1986 for a company denied export privileges by the Department of Commerce during the period. The company was denied export privileges for violation of the Export Administration Act.

Other agencies involved in munitions exports maintain information on export violators that could be used to identify license applications needing closer scrutiny in the review process. For example, Customs, which has primary munitions enforcement responsibility, keeps a listing of exporters convicted of violating export laws and regulations. The Chief of Customs' Strategic Investigations Division told us that this information could help OMC screen its registration list. However, he said that OMC had never asked Customs to screen the list, and his office had not done so because of its own resource limitations.

The Department of Commerce also maintains information from various sources regarding thousands of individuals and firms for which it has some enforcement concern. In a 1987 study, a Commerce Department official found that Commerce had negative information on approximately 26 percent of a random sample of OMC registrations. This official also found negative information on 27 percent of foreign consignees in a random sample of OMC licenses. The study did not categorize the negative information by degree of seriousness, such as separating known export violators from the subjects of less serious concerns. Thus, while this study was not sufficient to show that OMC should not have approved licenses, it

points out that screening applicants and other parties to license applications can help identify those applications potentially needing closer scrutiny.

OMC does not routinely use these lists nor has it developed one of its own. OMC officials said they have not formally developed lists of questionable firms and individuals out of concern that such lists would be subject to public disclosure under the Freedom of Information Act or disclosure to affected individuals under the Privacy Act. In the past, Commerce's General Counsel has ruled that such information is exempt from disclosure. As noted by Commerce, both acts cited by OMC provide that information may be exempted from disclosure for classification and law enforcement reasons.

Few checks to confirm end use

One way to verify application information is to ask the U.S. embassy in the destination country to check on the foreign parties to the application and try to determine whether the transaction appears legitimate. Of the approximately 49,000 license applications OMC received in fiscal year 1986, OMC officials estimated that they requested around 50 confirmation or end-use checks of application data by U.S. embassy staffs at the export destination point. OMC does not keep centralized files on those checks, and no checks were indicated in license files for the cases we sampled. Both the chief and deputy chief of OMC's Licensing Division expressed concern during our review about the limited number of end-use checks being made, yet we found no written

guidance which licensing officers would use to determine if an end-use check was warranted. According to OMC officials, resource limitations and the inability to identify questionable licenses quickly have limited the number of end-use checks requested of the embassies.

OMC authority to impose penalties

The State Department has authority to revoke licensing privileges, deny license requests based on prior export violations, and impose civil penalties. It has used this authority four times since 1976, the last time in November 1983. Of the four instances, one resulted in a debarment (60 days); the other three resulted in fines of \$7,000, \$10,000, and \$120,000. Two of the exporters were penalized because items exported were diverted to a proscribed country. Information on the other two exporters was not readily available.

INSUFFICIENT FACILITIES AND CAPABILITIES TO STORE AND RETRIEVE DATA

OMC's capabilities for retrieving historical data that could be used in licensing reviews are limited. According to OMC and other State Department officials, OMC's facilities for data storage and its automated data processing capabilities are both insufficient to meet its needs.

Due in part to limited filing space and personnel resources, OMC's hard copy files contain little of the supporting data that is submitted with license applications. OMC sends case files to storage after a couple of years to accommodate newer files. In

1986, OMC obtained microfilm equipment to record and store data, but OMC had not started using it by the time we completed our fieldwork. OMC's automated data processing system contains only limited information, which is insufficient to be useful in analyzing precedents or to do other analyses of applications. Although the system contains case tracking information going back 6 to 7 years, it does not contain detailed information that could facilitate subsequent licensing decisions--such as commodity descriptions, foreign users or consignees, comments from other agencies, or provisos from earlier similar cases. Thus, licensing officers have to rely on hard copy files, which may not be readily available after a few years, and on their individual experience and knowledge.

OMC officials told us that limited automated data retrieval capabilities also result in the staff conducting time-consuming manual searches of OMC's records to support Customs' enforcement activities. For example, the staff manually searched OMC files back to 1981 to identify 300 cases relevant to one investigation. Further, the system does not contain specific item descriptions, foreign parties to the license application, and other details that could be used to identify possible criminal actions.

In our sample of the fourth quarter fiscal year 1986 applications, we identified precedents referenced on license applications and determined their availability within OMC. About half our sample cases cited one or more prior licenses as precedents. However, about 40 percent of them were no longer retained in OMC's active

files. Additionally, the precedent cases we found were not completely documented.

OMC has attempted to compensate for its lack of complete precedent data by asking applicants for it. In a newsletter dated September 1986, OMC alerted applicants that it would continue to retire records to make room for current cases and requested that they attach copies of precedent licenses and supporting documentation to new applications.

Long-term assessment is needed

The equipment improvements cited in OMC's productivity plan included upgrading OMC's computer system at a cost of \$56,000, enhancing software design at a cost of \$20,000, acquiring a microfilming system at a cost of \$23,000, acquiring 14 new computer terminals at a cost of \$93,000, and acquiring 5 printers at an unspecified cost. The computer and microfilming systems were purchased with fiscal year 1986 funds as were 5 of the 14 terminals. Funding for the software improvements is included in the fiscal year 1988 budget, but an OMC official said that he is hopeful they will be able to obtain funds from State Department's fiscal year 1987 supplemental appropriations. As of late August, this had not happened.

OMC's productivity plan provides an approach to meeting some immediate operational needs but is not based on a long-term needs assessment. In a memorandum dated August 14, 1985, State's Systems Design and Programming Division emphasized the need for long-range

automated data processing planning by OMC. The memorandum recommended that OMC not purchase a new computer until a thorough examination of its long-term requirements had been incorporated into an action plan--including budget scheduling and project phasing. The recommended plan would also include a requirements study and a feasibility and hardware analysis to form the basis for satisfying OMC's long-term needs.

OMC has not undertaken the recommended study nor has it enhanced its computer capabilities to address needs identified in the memorandum. OMC officials and licensing officers cited ways that increased automation could support both licensing and compliance activities. However, due to funding limitations, OMC does not plan to acquire additional software to broaden the system's functional capabilities until 1988. Even with the planned software improvements, the system will remain an automated filing system with little capability for automating the license review process.

COMPLIANCE WITH ADMINISTRATIVE REQUIREMENTS

OMC does not have adequate systems and procedures to ensure compliance with some regulatory requirements, including application documentation, reporting requirements, and return of licenses. OMC officials told us that they do not have sufficient resources to ensure that the requirements are met or to review required documentation and reports even when they are received. For example:

- Most export license applications valued at or over \$250,000 are supposed to have a letter stating whether political contributions and agents' fees were paid in connection with the sale. Our sample cases showed that for approved licenses for which such reports were required, 43 percent did not contain the required statement, nor were the license approvals conditioned on its receipt, which would have indicated an attempt to obtain information not submitted with the application.
- OMC requires that licenses be returned after their use or on expiration. However, OMC does not know whether or not they have been returned. According to the Chief of OMC's Records and Reports Branch, many licenses are not returned to OMC in a timely manner--some are returned years after they should have been. He estimated that a quarter (tens of thousands annually) are not returned. We randomly selected 51 temporary export licenses for detailed examination and found that of those which were both approved and expired after 2 years, 67 percent were not in OMC's files indicating either they had not been returned or, if returned, were not properly filed. Either way, these expired licenses were not accounted for.

In addition, for manufacturing license agreement approvals, OMC requires annual reports of sales, including values and to whom sales were made. OMC's Deputy Director told us that they do not have sufficient staff to identify cases for which reports are required or to review the reports they receive.

OMC REPORTS UNDERSTATE THE VALUES
AUTHORIZED AND ACTUAL EXPORTS

OMC reports on the value of exports authorized and actual exports differ markedly. The following table shows the differences between export data provided by OMC for fiscal years 1983 through 1986. We found that while numerous factors affect the accuracy of the figures, both are understated.

Table: OMC Reported Values of
Authorized and Actual Exports

<u>Category</u>	<u>Fiscal years</u>			
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
	- - - -(dollars in billions)- - - -			
Authorized exports	\$8.7	\$12.7	\$9.9	\$14.9
Actual exports	\$4.0	\$ 3.8	\$2.3	\$ 2.0
Difference (authorized minus actual)	\$4.7	\$ 8.9	\$7.6	\$12.9

The value of approved export
licenses is understated

The value of OMC licenses authorizing commercial exports of defense articles and services is reported quarterly to the Congress. For fiscal year 1986, the reported value of such articles and services totaled \$14.9 billion, which represents permanent exports of defense articles and related technology.

Not included in the reports are values associated with OMC cases for approval of various technical assistance agreements and manufacturing licenses authorizing foreign production. These cases may not cite specific dollar values, but when values are cited, they are not recorded in OMC's data base or reported to the Congress. Values cited for some agreement cases we examined ranged from minimal or none up to several millions of dollars.

OMC reports also do not include such values as those associated with repair services or replacement items that may be authorized for export by temporary import licenses which may have been used to return items to the United states for repair.

The value of actual exports is understated

OMC provides data on actual export values to the Defense Security Assistance Agency (DSAA), which includes the information in its annual reports on foreign military sales. A DSAA official has expressed concern that OMC's data is not verified, current, or compatible with other data in the report. Based on our assessment of the data, we agree.

Actual exports can lag behind approvals by as much as 2 years, since licenses are valid for that period of time, but other factors serve to make the actual export data incomplete. They center around Custom's processing of munitions export licenses and related documents, including Shipper's Export Declarations (SEDs). Customs sends OMC data on actual exports through SEDs indicating individual shipments against licenses and ultimately sends OMC expired licenses. However, SEDs may be incomplete and inaccurate and are not always returned to OMC.

Shipment values for a given year are subject to change as OMC updates its records with SEDs or returned licenses. However, OMC does not usually update prior years' values in its end-of-year reports to DSAA. OMC updated prior years' export values only at

the end of fiscal year 1985 when it updated export values for fiscal years 1983 and 1984. In doing so, the value of exports for fiscal year 1984 increased from \$1.6 billion to \$3.8 billion, and the value of exports for fiscal year 1983 increased from \$2.4 billion to \$4.0 billion. OMC cited limited computer resources as a reason for not updating prior years' export values for fiscal year 1986.

CONCLUSIONS

We recognize that budget limitations have imposed constraints on OMC. As its work load has increased, OMC appears to have placed greater emphasis on timeliness and less on detailed review of license applications. The near doubling of license applications in the last decade, combined with little growth in OMC resources, has meant that OMC has less time to review individual applications and ensure exporters' compliance with administrative and reporting requirements.

Even within tight constraints, OMC can improve its licensing operations. In order to focus its available resources, OMC could make better use of available information from other federal agencies to identify license applications needing closer scrutiny. Also, U.S. embassies could be tasked more frequently to provide checks on application information. These steps should not require any appreciable increase in resources, yet would provide greater assurance that license application data is accurate and the proposed sale is legitimate.

In the long term, much of OMC's license application review process can be automated. Detailed information on prior export licenses should be readily available to the licensing officers during their reviews. This information should include the types and amounts of munitions involved, the various parties to the transaction, and whether administrative requirements have been met, such as whether required reports were filed or an expired license has been returned. Information should also identify exporters and others who have previously violated export laws and regulations, who are currently under investigation, or who have been barred from making exports.

This concludes my prepared remarks. I will be happy to respond to any questions you may have.