

GAO

Report to the Chairman, Subcommittee  
on Federal Services, Post Office and  
Civil Service, Committee on  
Governmental Affairs, U.S. Senate

June 1994

# EXPORT CONTROLS

## License Screening and Compliance Procedures Need Strengthening



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National Security and  
International Affairs Division

B-254478

June 14, 1994

The Honorable David H. Pryor  
Chairman, Subcommittee on Federal Services,  
Post Office and Civil Service  
Committee on Governmental Affairs  
United States Senate

Dear Mr. Chairman:

In response to your request, we reviewed export control activities at the Departments of State and Commerce. Specifically, we examined (1) whether these agencies effectively use automated systems to screen license applications, (2) how well these agencies cooperate with each other and the U.S. Customs Service, (3) whether State is monitoring reexports and technology transfers by collecting and reviewing annual sales reports submitted by companies involved in munitions manufacturing or distribution agreements, and (4) how State ensures that munitions licenses are issued only to U.S. persons or foreign governments as required by law.

## Background

The U.S. export control system is, in essence, administered by two agencies. Commerce, through its Bureau of Export Administration, licenses sensitive dual-use items (items with both civil and military uses) under the Export Administration Act (EAA); State, through its Office of Defense Trade Controls, licenses munitions items under the Arms Export Control Act (AECA).<sup>1</sup> In addition to export licenses, State's approval is required before a U.S. company is allowed to enter into an agreement with a foreign party involving the manufacture or distribution of munitions items.

Under AECA, all munitions manufacturers or exporters are required to register with State. AECA also requires that licenses not be issued to foreign persons (other than a foreign government). Customs serves as State's enforcement arm for AECA. In contrast, EAA has no registration or U.S. person requirements. Also, EAA specifies how enforcement authority is to be shared between Commerce and Customs, and Commerce, unlike State, has its own enforcement staff.

<sup>1</sup>In addition, the Nuclear Regulatory Commission licenses exports of nuclear reactors. Dual-use nuclear exports are licensed by Commerce in consultation with a number of other agencies.

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After a 1987 hearing<sup>2</sup> and our subsequent report,<sup>3</sup> State established an automated license application screening system at the Office of Defense Trade Controls, and Congress amended AECA to authorize State to deny licenses to persons who have been convicted of violating specific statutes enumerated in the AECA. Since 1991, State has maintained an automated watchlist of suspicious organizations and individuals to use when processing export license applications. Commerce has been using an automated watchlist since 1984 to screen its applications.

Watchlist names serve to prompt closer agency review of export license applications. The contents of the watchlists are different, and one of the reasons is that the agencies have different legal requirements for denying export applications. Under AECA, State is required to identify and may deny export licenses to (1) persons who have been indicted or convicted of export violations, foreign corrupt practices, internal security violations, and espionage, and (2) persons who are ineligible to contract with or receive import or export licenses from any U.S. agencies. Under EAA, Commerce may deny export licenses to persons convicted of export violations for up to 10 years from the date of conviction. Both State and Commerce also place on their watchlists parties under U.S. economic sanctions identified by the Treasury Department, parties identified by intelligence sources as suspected or known diverters or proliferators, and those identified from negative pre-licensing or post-shipment checks.

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## Results in Brief

Both State and Commerce use automated computer systems to screen export applications for ineligible or questionable parties, but they did not include on their watchlists many pertinent individuals and companies. The missing names included those on a Department of Justice list of parties convicted of or listed as fugitives for export violations, parties on whom pre-licensing checks have revealed derogatory information, and parties identified by intelligence reports as known or suspected diverters or proliferators. Consequently, State and Commerce issued licenses to some of these parties without considering the available derogatory information against those parties. Had the information been considered, the licensing decisions may or may not have been different. Additionally, because of procedural and system design deficiencies, the two agencies' screening systems did not identify all the licenses involving watchlist parties.

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<sup>2</sup>Senate Governmental Affairs Committee hearing on February 20, 1987, on federal licensing problems for arms exports.

<sup>3</sup>Arms Exports: Licensing Reviews for Exporting Military Items Can Be Improved (GAO/NSIAD-87-211, Sept. 9, 1987).

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Furthermore, Commerce has not made the most effective use of intelligence information in its licensing decisions.

While State and Commerce exchange some information regarding export policies and questionable license applications via interagency coordinating committees, cooperation between State and Commerce in the sharing of their watchlists has been limited. The agencies do not routinely share the names on their respective watchlists despite the potential benefits and the agencies' similar export control missions. Consequently, each agency issued licenses to parties that are on the other agency's list without the benefit of the information. While cooperation between State and Customs has been excellent, cooperation between Commerce and Customs has been poor.

State is not monitoring manufacturing and distribution agreements by routinely collecting or reviewing annual sales reports that are required as part of these agreements. State attributed this lack of monitoring to limited staff resources. In addition, State's agreements files are in disarray; many of the files are missing copies of the completed, signed agreements. Without the signed agreements or the annual sales reports, State cannot check for indications of unauthorized sales or transfers.

To fulfill the statutory requirement that no munitions license be issued to a foreign person, State relies strictly on the applicant's certification that the person signing the application is a U.S. person. State does not require documentary evidence and performs only limited telephonic spot checks of the certifications. Additionally, State approved some licenses even though the applications did not have the required certifications.

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## Weaknesses in License Screening System and Procedures

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### Agencies' Watchlists Are Not Complete and Current

State and Commerce did not place on their watchlists many parties that, according to their own procedures, should have been included. This failure to capture all of the available derogatory information on suspicious

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parties is due to inadequate procedures used to maintain the watchlist databases.

We obtained documents from law enforcement, intelligence, and other agencies used by State and Commerce to update their watchlists and checked to see if the names had in fact been entered onto the agencies' watchlists. We checked 2,126 names that should have been included on the State watchlist and 708 names that should have been included on the Commerce watchlist. Each agency failed to include about 27 percent of the names on their watchlists. More details on the results of this analysis are shown in appendix I.

State and Commerce have inadequate procedures to add names to their watchlists and ensure that data is complete and current. At the time of our review, State did not have formalized procedures for ensuring all pertinent names were entered on the watchlist, including those derived from intelligence information. State also had not designated personnel responsible for entering names from various source documents on a continuing basis. As a result, responsibility for adding and reviewing names was not well-defined and was diffused among the staff. One State official attributed the inadequate procedures to a lack of staff resources. He told us that much of the data entry was done by part-time personnel who also have other administrative duties and that State's watchlist was built with a "catch as catch can" approach. In fact, State requested but did not receive dedicated data entry personnel in its financial plans for fiscal years 1993 and 1994. However, State informed us that, as a result of our review, it has assigned to a specific compliance division employee the responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals. We did not verify or evaluate the effectiveness of this action.

Commerce also does not have formalized procedures for controlling what information should be entered on its watchlist and by whom. Information can be added to the watchlist by staff from the Office of Enforcement Support or by Office of Export Enforcement headquarters personnel and agents in the field. However, while many people in Commerce can add names to the list, no one is directly responsible for ensuring that relevant information is in fact entered. For example, no one is responsible for obtaining and reviewing information from State's Blue Lantern inspection program.<sup>4</sup> Responsibility for entering names from the Department of Justice's periodic report of significant export control violation cases was

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<sup>4</sup>Blue Lantern is the program name for State's pre-licensing or post-shipment checks.

only recently assigned. While Commerce staff routinely review intelligence reports distributed to its Office of Intelligence Liaison, these reviews are not documented, and there is no written guidance on what information and names should be pulled from these reports for inclusion on Commerce's watchlist.

Because State and Commerce did not capture all the relevant names on their watchlists, they issued many licenses to parties without considering derogatory information regarding them. Had the information been available, these licenses may or may not have been approved.

Our search of State's and Commerce's licensing databases covering the period fiscal year 1990 to August 1993 showed that the agencies had issued 224 licenses to 15 parties whose names should have been but were not on the agencies' watchlists. Of the 224 licenses, Commerce issued 4 licenses to 2 parties while State issued 220 licenses to 13 parties. For example:

- A State Blue Lantern inspection revealed in January 1992 that an Israeli company was selling F-16 parts without U.S. authorization, but the name of this company was never placed on State's watchlist. In May 1993, State issued a license for exports involving this company.
- A company in Indonesia was listed in a December 1991 Commerce document as a subject of an unfavorable pre-licensing or post-shipment check. State used this document as one of the sources for its watchlist. However, State did not put this company on its watchlist until November 1992, 11 months after the information first became available. In the meantime, State issued a license in September 1992 for exports involving this company without knowledge of the unfavorable information regarding the company.

Appendix II contains more details on the 224 cases.

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### Agencies' Screening Systems Do Not Always Capture Applications With Watchlist Names

Between fiscal year 1990 and August 1993, Commerce and State approved 847 licenses involving parties who were on their watchlists without first considering derogatory information contained in their own watchlists (see app. III). Had the information been considered, the licensing decisions may or may not have been different.

Commerce uses a sophisticated computer name-matching program to assign identification numbers to all exporters and consignees in its database. The identification numbers of those exporters and consignees

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that are on Commerce's watchlist are flagged by the computer. When a license application is processed, the computer systematically compares the identification numbers on the application to the identification numbers of the parties on its watchlist. When a match is made the system automatically sends the application to the enforcement staff for review.<sup>5</sup> Also, the name is flagged on the licensing officer's computer screen to prevent the license from being issued until the flag has been removed by the enforcement staff.

Commerce, however, has not ensured that each party is given only one identification number and has in some cases assigned multiple identification numbers to the same party. Some of these identification numbers have watchlist flags on them, while others do not. Consequently, license applications involving parties on the watchlist may not always be caught because the parties may be assigned identification numbers that do not carry watchlist flags. Commerce noted in its comments that, in the fall of 1992, it had initiated an effort to eliminate multiple identification numbers. However, our analysis of the Commerce data shows this effort has not solved the problem.

State's system for identifying watchlist parties on license applications uses a limited computer name-matching program that has difficulty finding matches when there is slight variation on how names are entered into the system or when there is a minor data entry error. Further, unlike Commerce, State has a largely manual screening system. When a name on a license application matches a watchlist party, unless it is the name of the applicant, State's computer system does not automatically flag the application for the licensing officer or send the case to the Compliance Division. For example, if the application is to export to a questionable end user, the case would not automatically be flagged. Instead, Compliance Division personnel must manually review a computer matching report to identify matches and refer the cases to compliance specialists for further investigation. Moreover, unlike Commerce's system, State's system does not prevent a license from being issued until compliance staff have completed their review. State's system also does not automatically track whether a compliance officer examined the case, length of the review, or what actions resulted from the review. Consequently, there is no documentation to determine which cases were caught by the screening system or processed without review by compliance staff.

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<sup>5</sup>Enforcement staff are responsible for reviewing the applications and considering the information included on the screened party and then making appropriate recommendations to the licensing officer.



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Between fiscal year 1990 and August 1993, Commerce processed 851 license applications involving 179 different parties on its watchlist without sending these applications to its enforcement staff for review. While 75 of these applications were eventually denied or returned without action through the licensing review process, 776 were approved. Commerce had placed these parties on its watchlist based on nuclear weapons proliferation concerns, missile technology control concerns, unfavorable pre-license checks, or derogatory enforcement intelligence information. For example, the following licenses were not caught by Commerce's screening system and not reviewed by enforcement staff:

- Commerce issued two licenses involving a company placed on its watchlist in 1986 for nuclear proliferation reasons.
- Commerce issued 15 licenses involving a company placed on its watchlist in 1991 for past export control sanctions.

In a sample of 86 State licenses,<sup>6</sup> State processed 83 license applications involving 28 companies on its watchlist without these applications being reviewed by compliance staff.<sup>7</sup> Officials at State said that their compliance specialists reviewed 3 of the 86 licenses. They also stated that they might have reviewed some of the remaining 83 licenses, but there was no record, computerized or manual, to support this statement, and they acknowledged it was unlikely because these licenses were approved in 2 days or less. While 12 of these licenses were eventually denied or returned without action through the licensing review process, 71 were approved. These parties were placed on State's watchlist for missile technology control concerns, chemical and biological weapon concerns, and compliance concerns. For example, State issued 3 licenses involving a company placed on its watchlist in 1991 for missile technology control concerns.

During the course of our work, we also found that in 1992 State issued four licenses involving a company recently convicted of illegally selling aircraft parts to Iran even though in 1991 State had debarred the company from future export licenses and had included the company on its watchlist.

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<sup>6</sup>Due to limitations in State's computer system, we examined only a judgmental sample of State licenses. Specifically, we examined applications involving watchlist parties that were processed in 2 days or less between fiscal year 1990 and August 1993.

<sup>7</sup>State compliance staff, like Commerce enforcement staff, are responsible for reviewing derogatory watchlist information and making recommendations to licensing officers.

## Commerce Has Not Made the Most Effective Use of Intelligence Information to Screen Licenses

Unlike State, Commerce does not deny an export application solely on the basis of derogatory intelligence information in its watchlist. Commerce approved 49 licenses after its pre-license checks failed to corroborate the negative intelligence information involving the parties on the applications. Commerce officials said they cannot deny a license based on intelligence information unless it is corroborated by a negative pre-license check or other information. However, recent GAO and Inspector General reports have noted limitations and recommended improvements in Commerce's pre-licensing check program.<sup>8</sup>

Under AECA, State has broad authority to deny an application on national security or foreign policy grounds without having to provide a detailed explanation. Commerce, however, is required under EAA to provide the applicant a more detailed explanation, consistent with national security and foreign policy, as to why an application is denied. Because of this requirement, the intelligence agencies do not want Commerce to deny licenses solely on the basis of intelligence information for fear that such denials may compromise their sources or collection methodologies.

Under the current procedure, Commerce enforcement agents use intelligence information as a lead to develop collateral information that can be used to deny a license. When the name of a party on a license application is identified through the screening process as a potential diverter or proliferator based on information from intelligence sources, Commerce may request a pre-licensing check on the party. If the check produces derogatory information, Commerce can use that as the basis for denying the license. Otherwise, the intelligence information alone does not get used to deny the license. Commerce does not routinely refer such cases to the intelligence sources to (1) assess the merits of the intelligence information and (2) determine whether the information could be sanitized to permit its use in denying a license application. Commerce and intelligence officials estimated that over the last 5 years, Commerce had consulted with intelligence sources on only about three such cases.

For fiscal years 1990 to 1993, we found 49 licenses that had names on the Commerce watchlist based on intelligence information and that Commerce approved after a pre-license check failed to corroborate the negative information in the intelligence report. While Commerce's current procedure is designed to accommodate the concerns of the intelligence

<sup>8</sup>Nuclear Non-Proliferation: Export Licensing Procedures for Dual-Use Items Need to Be Strengthened (GAO/NSIAD-94-119, Apr. 26, 1994) and The Federal Government's Export Licensing Processes for Munitions and Dual-Use Commodities (Joint State/Commerce/DOD/Energy Inspector General Report, Sept. 1993).

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agencies, it also limits the effective use of available intelligence information for licensing purposes. For example, during the same period, we found only two applications involving parties flagged based on intelligence information that Commerce denied or returned because a pre-license check produced unfavorable results.

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## Cooperation Among Commerce, Customs, and State

### State and Commerce Do Not Share Their Watchlists

While State and Commerce exchange some information regarding export policies and questionable license applications via interagency coordinating committees, they do not routinely share information from their watchlists with each other. Some entries on each agency's watchlist are of unique interest only to that agency. However, thousands of names on the watchlists are of interest to both Commerce and State but, because the watchlists are not shared, are not being used to screen export applications. In fact, each agency has processed licenses involving relevant parties on the watchlist of the other agency.

Each agency's watchlist includes many entries dealing with compliance problems, intelligence reports, reports provided by the Justice Department and Customs agents, pre-license or post-shipment checks, and other issues directly relevant to the missions of both agencies. Commerce's watchlist has about 33,000 entries while State's watchlist has about 30,000 entries. Many of the entries on both lists are duplicates of the same name (for example, Commerce may list a name separately for each different company address). While both agencies are generally concerned or interested in many of the same types of parties (that is, front companies, suspected diverters, and parties indicted or convicted of export violations), some watchlist entries are of interest only to one agency.<sup>9</sup> (See app. IV for the composition of each agency's watchlist and information of interest to the other agency.)

We compared State's and Commerce's watchlists to determine how many entries of interest to both agencies are not being used by both agencies to

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<sup>9</sup>For example, names listed on State's watchlist because they are on General Services Administration's (GSA) list of parties excluded from federal contracts (over 60 percent of State's watchlist) would not be relevant to Commerce's licensing decisions.

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screen applications. About 5,000 entries on the State watchlist of interest to Commerce were not on Commerce's watchlist. Similarly, about 32,000 entries on the Commerce list of interest to State were not on State's watchlist. These entries represent derogatory information that State and Commerce are not using in their licensing reviews. The actual numbers of unique names of interest to each agency, however, are smaller than our estimates due to duplicate entries and other limitations cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite in this area.

State officials noted that they recognize the utility of sharing each other's watchlist with Commerce, and the agencies have held discussions to this end. Commerce officials stated that the two agencies discussed sharing information 3 years ago, but nothing came of these discussions.

Each agency has processed licenses involving parties on the watchlist of the other agency. We estimate State processed about 6,700 licenses involving about 300 relevant parties on Commerce's watchlist that were not on State's watchlist. State approved about 6,100 of these licenses.<sup>10</sup> Similarly, Commerce processed 17 licenses involving 3 parties on State's watchlist that were not on Commerce's watchlist and approved 9 of these licenses.<sup>11</sup>

These State and Commerce licensing decisions were made without considering the derogatory information in the other agency's possession because the agencies do not routinely share their watchlists.<sup>12</sup> The derogatory information not used in these licensing decisions included parties listed for enforcement intelligence, unfavorable post-shipment checks, and nuclear proliferation and missile technology concerns. Had the derogatory information been considered, the agencies might have requested pre-licensing checks, denied the licenses, or approved them with conditions.

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<sup>10</sup>These estimates are subject to limitations cited in app. V.

<sup>11</sup>We verified the names of the 3 parties and the disposition of the 17 Commerce licenses.

<sup>12</sup>Commerce does provide State a copy of its Economic Defense List. However, this list includes only some of the entries from Commerce's watchlist and is published just once a year.

## Cooperation Between State and Customs Contrasts Sharply With That Between Commerce and Customs

On the basis of interviews with State and Customs officials and our observations, cooperation between the two agencies is excellent. Customs screens State's registration applications for law enforcement concerns, and State uses the results for input into its watchlist. Customs has also given State access to its enforcement database. State, in return, has given Customs access to its licensing database for use by Customs officers at the ports throughout the United States. In addition, Customs has liaison personnel on detail at State to facilitate and coordinate case investigations and other Customs enforcement actions.

In contrast, cooperation between Commerce and Customs has been poor. As we recently reported,<sup>13</sup> over the past several years, the agencies have engaged in ongoing disputes over their overlapping jurisdiction in enforcing dual-use export controls. They have significantly disagreed in, among other things, the area of sharing of licensing data. From the early 1980s, Customs had attempted to gain full access to Commerce licensing data to aid its inspections and investigations. Commerce, however, was reluctant to extend full access to Customs because of cost, time, and security concerns. Despite 1985 legislation that mandates the sharing of information and subsequent negotiations between the agencies in January 1992, Commerce did not agree until September 1993 to give Customs licensing data. However, Commerce noted in its comments that the poor cooperation ended with the September 1993 memorandum of understanding and agreements between Commerce and Customs. While this represents a significant step towards a cooperative relationship, we have not verified that real progress has been achieved.

## State Is Not Routinely Collecting or Reviewing Annual Sales Reports

State requires the U.S. company or its licensee to submit annual sales reports when entering into a manufacturing or distribution agreement involving defense articles.<sup>14</sup> The reports are to include information on sales or other transfers of the licensed articles, by quantity, type, dollar value, and purchaser or recipient. However, State officials noted that due to limited staff, they have not routinely collected or reviewed these reports.

We selected a sample of 18 approved agreements to see whether the annual sales reports had been submitted, as required, and whether State

<sup>13</sup>Export Controls: Actions Needed to Improve Enforcement (GAO/NSIAD-94-28, Dec. 30, 1993).

<sup>14</sup>Unlike routine export licenses, distribution and manufacturing agreements cover the export of large volumes of defense articles for distribution from a foreign country or the manufacture of defense articles in a foreign country.

had reviewed them. In 6 of the 18 cases, State did not have copies of the final agreements or documentation indicating that the agreements were ever concluded. Companies are required to inform State within 60 days if a decision is made not to conclude an agreement. In 14 of the 18 cases where we determined that annual reports should have been filed, annual reports were not on file in 13 cases. State subsequently received annual reports for six of the cases by contacting the companies at our request.

Additionally, State officials acknowledged that the agreement files were in such disarray that they could not distinguish between those companies that failed to submit the reports and those that did submit the reports but whose reports may have been misplaced. They attributed the poor management of the files to a lack of staff and a move of their document storage facility a few years ago. We noted that, notwithstanding limited resources, State had not assigned oversight responsibility for the agreements among the staff. State is now attempting to bring the files up-to-date by contacting companies to determine what records are missing from the files. Without the signed agreements or the annual sales reports, State cannot check for indications of unauthorized sales or transfers.<sup>15</sup>

State informed us that, in an effort to achieve the same compliance goals with fewer resources, it is considering a system whereby companies would certify that they were maintaining these records and would be subject to sanctions if they fail to do so. We believe this would further reduce State's ability to effectively monitor the arrangements.

## State Does Not Require Documentary Evidence to Prove U.S. Person Status

State officials told us that they do not require any documentary evidence of U.S. person status to be submitted with export license applications for munitions items. Instead, they rely on the applicants' certifications that the persons signing the applications are U.S. persons. Moreover, State told us it performs verification only when staff notice unfamiliar signatures on the applications, and then verification is usually done by telephone. Under these procedures, State does not have reasonable assurances that the persons signing applications are U.S. persons.

Under AECA, a license to export a munitions item may not be issued to a foreign person (other than a foreign government). State's implementing regulation requires that an official empowered by the applicant certify that

<sup>15</sup>In December 1993, State reported that, despite major improvements in its management of defense trade, material weaknesses still exist in overseas posts' implementation of the process used for end-use checks used to verify compliance with AECA. State acknowledged that as a result it did not have reasonable assurances that defense exports were not being diverted to unauthorized uses.

the person signing the application (1) is a citizen or national of the United States; (2) has been lawfully admitted to the United States for permanent residence under the Immigration and Nationality Act, as amended; or (3) is an official of a foreign government entity in the United States. State officials explained that the significance of this requirement is that if an export violation associated with the license is detected, the government could more easily prosecute a U.S. person than a foreign person.

Seven of 40 approved cases we sampled did not contain the proper certification. In six of the seven cases, a company official signing the transmittal letter certified that he/she was a U.S. person, but there was no certification that the person (a different official) signing the application was a U.S. person. In the remaining case, there was no certification of any kind. In another approved case, which was not part of our sample, the person signing the application was, according to his registration with State, a non-U.S. citizen, and there was no other evidence that he was a U.S. person. State informed us that recently introduced application forms should correct the improper certification problem. Nevertheless, the new forms do not address the need for documented verifications.

## Recommendations

We recommend that the Secretary of State direct the Office of Defense Trade Controls to take the following actions:

- Formally assign watchlist data-entry responsibilities among staff and establish procedures and guidance to ensure data entries are complete and up-to-date.
- Share the relevant portion of State's watchlist with Commerce on a regular basis and incorporate the relevant portion of Commerce's watchlist into State's watchlist.
- Redesign State's screening system to (1) create an automated license tracking system that will document compliance division review for licenses involving watchlist parties, (2) automatically inform the licensing division if any party on a license is on the watchlist, and (3) prevent a license from being issued until compliance staff have completed their review.
- Assign oversight and monitoring responsibilities for the manufacturing and distribution agreements among the staff and ensure that the files on these agreements are updated.
- Either require documentary proof instead of a certification of U.S. person status the first time an applicant applies for a license, or randomly verify with documentation the applicants' certifications of U.S. person status.

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We recommend that the Secretary of Commerce direct the Bureau of Export Administration to take the following actions:

- Formally assign watchlist data-entry responsibilities among the staff and establish procedures and guidance to ensure data entries are complete and up-to-date.
- Share the relevant portion of Commerce's watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into Commerce's watchlist.
- Establish and implement adequate procedures to ensure that multiple identification numbers are not assigned to the same party and eliminate existing multiple identification numbers from the system.
- When pre-licensing checks are conducted because of information from intelligence sources but result in no derogatory information, routinely consult with the intelligence sources to (1) assess the merits of the intelligence information and (2) determine whether the information could be sanitized to permit its use in denying a license application.

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## Agency Comments and Our Evaluation

We obtained written comments from the Departments of Commerce and State and the U.S. Customs Service on a draft of this report (see app. VI, VII, and VIII). Commerce indicated that our recommendations merit serious consideration but indicated that the intelligence community should not make final licensing decisions. We clarified the recommendation to better reflect the desired actions.

State generally agreed with the analyses and recommendations in the report. State expressed concern, however, that the draft report gave the impression that, when licenses were issued to parties on another agency's watchlist or to parties missing from a watchlist, those licenses should not have been issued. We revised the report where appropriate to further emphasize that decisions on those licenses may or may not have been different if the watchlist information had been available.

Customs commented that the sharing of watchlists between State and Commerce should enhance export enforcement.

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Our work was performed from October 1992 to June 1994 in accordance with generally accepted government auditing standards. The scope and methodology for our review is discussed in appendix V.

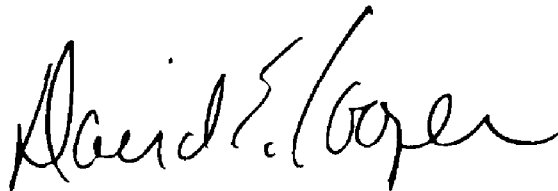


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Unless you publicly disclose the contents of this report earlier, we plan no further distribution of this report until 5 days from its issue date. At that time we will send copies of this report to other congressional committees, the Secretaries of State and Commerce, and the Commissioner of Customs. We will also make copies available to other interested parties upon request.

Please contact me at 202-512-4587 if you or your staff should have any questions concerning this report. Major contributors to this report are James F. Wiggins, Davi M. D'Agostino, John P. Ting, David C. Trimble, and Jai Eun Lee.

Sincerely yours,

A handwritten signature in cursive script that reads "David E. Cooper". The signature is written in black ink and is positioned above the typed name and title.

David E. Cooper  
Director, Acquisition Policy, Technology,  
and Competitiveness Issues

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**Abbreviations**

AECA	Arms Export Control Act
EAA	Export Administration Act
GSA	General Services Administration

# GAO-Identified Missing Names From State and Commerce Watchlists

Source of derogatory information	Names checked against State watchlist (dated 4/20/93)	Number and percentage of names not found on State watchlist	Names checked against Commerce watchlist dated 1/27/93	Number and percentage of names not found on Commerce watchlist
Department of Justice <sup>a</sup>	92	47 51%	92	69 75%
Treasury's list of designated nationals <sup>b</sup>	184	3 2%	184	33 18%
Intelligence information <sup>c</sup>	45	26 58%	45	26 58%
Department of Commerce <sup>d</sup>	1,120	404 36%	e	e
Commerce "negative" pre-license checks <sup>f</sup>	39	36 92%	39	11 28%
State "negative" Blue Lantern checks <sup>g</sup>	57	29 51%	57	41 72%
GSA list of excluded parties <sup>h</sup>	298	19 6%	e	e
Denial orders <sup>i</sup>	291	2 1%	291	17 6%
Total	2,126	566 27%	708	197 28%

<sup>a</sup>Names taken from the Department of Justice's list of significant export control cases for fiscal years 1990, 1991, and 1992 through August 1992. The names include only those parties convicted of violations or listed as fugitives.

<sup>b</sup>Names were based on a GAO judgmental sample from the March 1992 Treasury report on specially designated nationals.

<sup>c</sup>Names of known or suspected diverters or proliferators were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to the Office of Defense Trade Controls between January and March 1993. Names were checked against a later edition of Commerce's watchlist dated November 1993.

<sup>d</sup>Names are from Commerce's December 1991 Economic Defense List, which includes parties known or suspected of involvement in prohibited activity such as terrorism.

<sup>e</sup>Not applicable. Names from the Economic Defense List were not checked because this list is taken from Commerce's watchlist. Names from GSA's list of excluded parties were not checked because this information is not relevant to Commerce's licensing decisions.

<sup>f</sup>Names were developed by GAO based on a file review of fiscal year 1992 Commerce pre-license checks identified by Commerce as providing derogatory information.

<sup>g</sup>Names were developed by GAO based on a file review of fiscal year 1991 and 1992 State Blue Lantern checks that State identified as producing derogatory information.

<sup>h</sup>Names based on a GAO judgmental sample taken from the September 1992 edition of GSA's Lists of Parties Excluded from Federal Procurement or Nonprocurement Programs.

<sup>i</sup>Names taken from the October 1992 edition of Commerce's report entitled Denial Orders Currently Affecting Export Privileges.

# Licenses Issued Involving Parties Whose Names Should Have Been but Were Not on Watchlists (Fiscal Year 1990 - August 1993)

Company	Country	Source of derogatory information	Information first available	Number of licenses issued	Date
<b>Commerce licenses</b>					
A	Singapore	Intelligence	3/93	3	4/93 to 6/93
B	Hong Kong	Intelligence	1/93	1	2/93
<b>Subtotal</b>				<b>4</b>	
<b>State licenses</b>					
C	Pakistan	Intelligence	3/93	1	7/93
D	U.K.	EDL	1/92	1	7/92
E	Trinidad	EDL	1/92	1	8/93
F	Hong Kong	Blue Lantern	10/92	6	10/92 to 4/93
G	India	PLC	5/92	2	4/93 7/93
H	India	PLC	11/92	1	4/93
I	Israel	Intelligence	3/93	7	4/93 to 7/93
J	Israel	Intelligence	3/93	137	4/93 to 8/93
K	Israel	Blue Lantern	2/92	1	5/93
L	Israel	Blue Lantern Intelligence	9/92 3/93	20	10/92 to 7/93
M	Singapore	Intelligence	3/93	39	4/93 to 8/93
N	Denmark	Intelligence	3/93	3	5/93 to 7/93
O	Indonesia	EDL	1/92	1	9/92
<b>Subtotal</b>				<b>220</b>	
<b>Total</b>				<b>224</b>	

#### Legend

Intelligence — Names were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to the Office of Defense Trade Controls between January and March 1993.

EDL — Commerce Department's Economic Defense List issued on 12/31/91.

Blue Lantern — State Department's program name for pre-licensing or post-shipment checks.

PLC — Commerce Department pre-licensing checks.

Note: Due to the proprietary nature of information, company names are not disclosed.

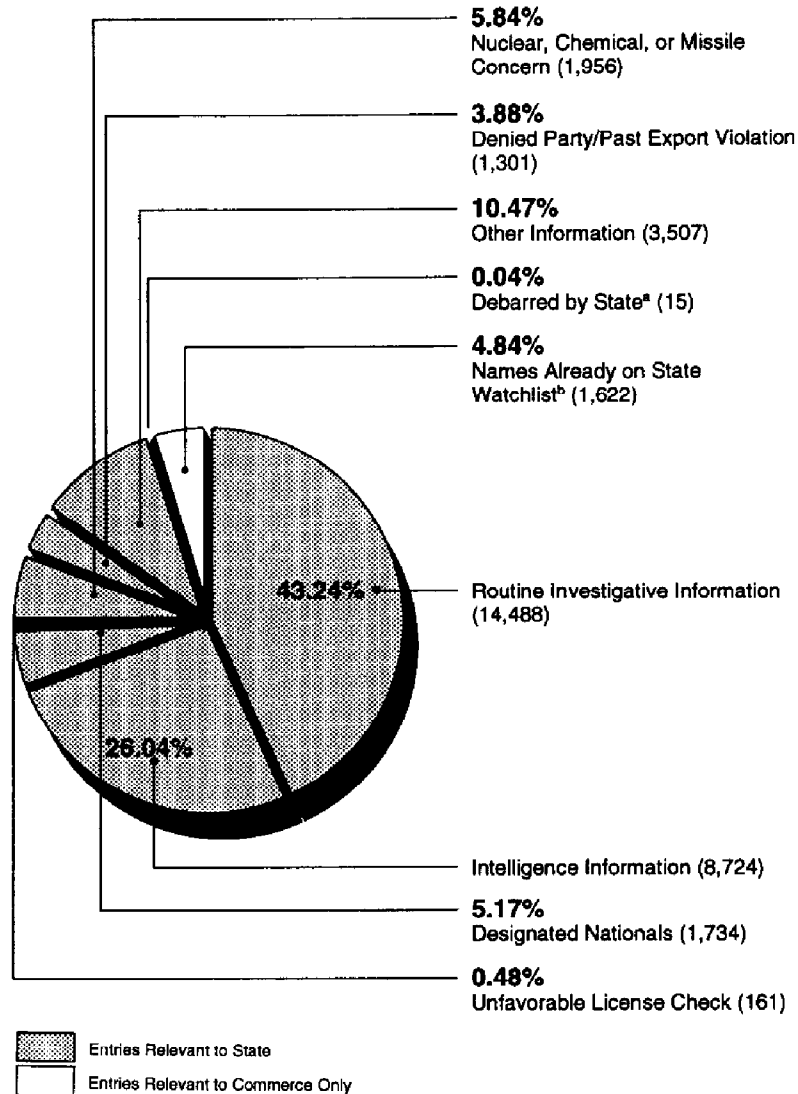
# Licenses Involving Watchlist Parties Approved Without Being Screened by Compliance and Enforcement Personnel (Fiscal Year 1990 - August 1993)

Agency	Derogatory watchlist information	Licenses processed	Licenses approved
Commerce	Routine investigative observation	666	622
	Enforcement intelligence	59	47
	Pre-license check performed	56	48
	Nuclear proliferation concern	24	18
	Commerce Economic Defense List	17	16
	Past export control sanction	16	15
	Apartheid supporting party	7	6
	Missile technology control concern	3	2
	East-West equity firm	1	1
	U.S. Customs information	1	1
	Unfavorable pre-license check	1	0
	<b>Subtotal</b>		<b>851</b>
State <sup>a</sup>	Missile technology control concern	59	50
	State compliance information	18	16
	Office of the Courts	4	4
	Unfavorable Blue Lantern check	1	1
	Chemical/biological weapon concern	1	0
<b>Subtotal</b>		<b>83</b>	<b>71</b>
<b>Total</b>		<b>934</b>	<b>847</b>

<sup>a</sup>Due to limitations in State's computer system, we examined only a judgmental sample of State licenses. Specifically, we examined licenses involving watchlist parties that were processed in 2 days or less between fiscal year 1990 and August 1993.

# State and Commerce Watchlist Entries of Mutual Interest (as of Aug. 1993)

**Figure IV.1: Commerce Watchlist Entries of Interest to State by Source of Information**



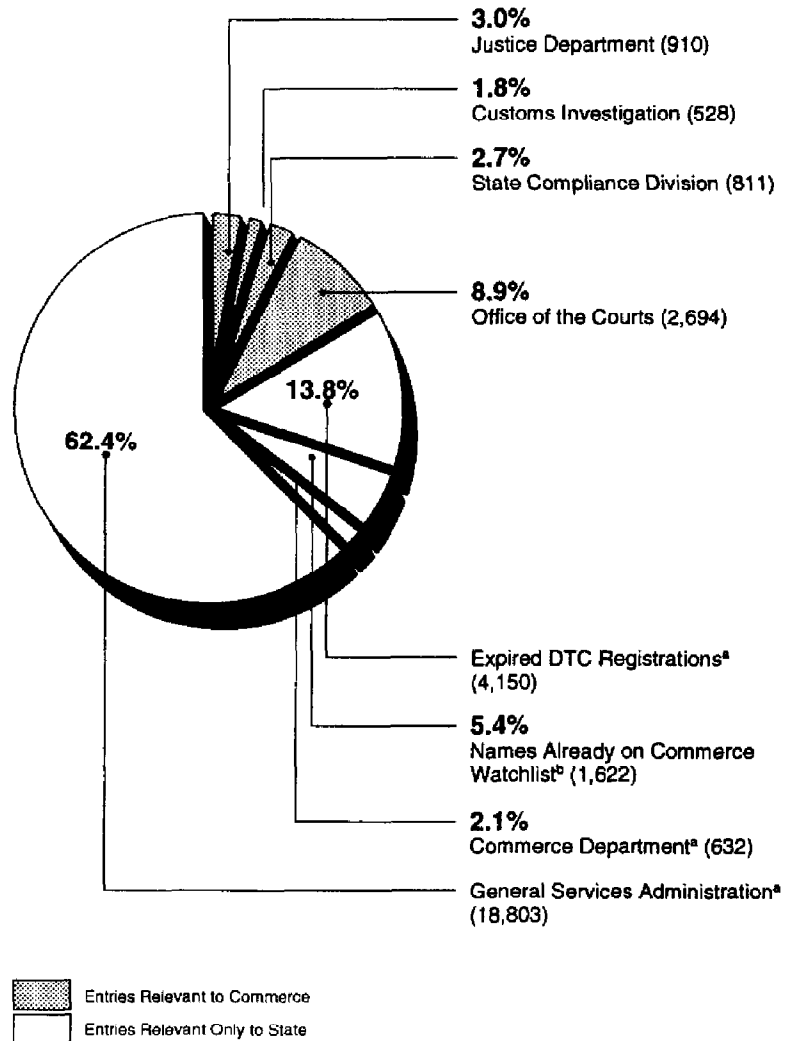
Note: These estimates are subject to limitations cited in appendix V.

<sup>a</sup>Parties listed as debarred by State are not relevant to State. Since State is the source of this information, State would not benefit from receiving these watchlist entries from Commerce.

<sup>b</sup>The number of entries also on the State watchlist is larger due to the same names being entered multiple times.

**Appendix IV  
State and Commerce Watchlist Entries of  
Mutual Interest (as of Aug. 1993)**

**Figure IV.2: State Watchlist Entries of  
Interest to Commerce by Source of  
Information**



Note: These estimates are subject to limitations cited in appendix V.

<sup>a</sup>Watchlist entries based on Commerce information are not relevant to Commerce since they provided the information. Expired Registration and General Services Administration Information is not relevant to Commerce's mission.

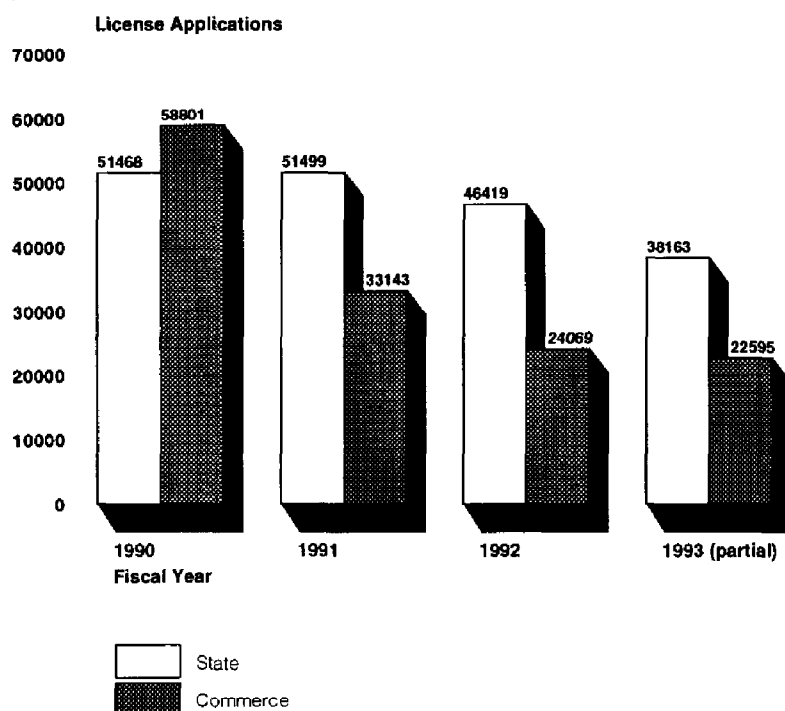
<sup>b</sup>The number of entries also on the Commerce watchlist is actually larger due to the same names being entered multiple times.



# Scope and Methodology

To perform the name matching and license searches of State and Commerce watchlist and license files, we obtained these records on computer tapes from State and Commerce. The licensing records covered the period from fiscal year 1990 through August 1993.

**Figure V.1: State and Commerce Licenses by Year**



We chose to work with the most recent four fiscal years because (1) this period provided a sufficiently large volume of licenses for analysis, (2) this period was the most relevant to current operations at State and Commerce, and (3) State did not have an automated watchlist screening system prior to 1991.

To determine the reliability of the data, we assessed the relevant and general application controls for Commerce and State's systems and found them to be generally adequate. We also conducted sufficient tests of the data. Commerce reported that since fiscal year 1988, data entry reliability has approached 100 percent with the addition of electronic license

application filing and optical character reader technology. We did not systematically sample licensing records to test data accuracy but did verify specific cases throughout the course of our review. We concluded on the basis of these tests and assessments that the data was sufficiently reliable to be used in meeting the assignment's objectives.

To determine whether the agencies effectively use automated systems to screen license applications, we interviewed State and Commerce officials to obtain an understanding of how their automated watchlists are compiled and used. We then obtained some of the documents used by State and Commerce to compile their watchlists and conducted checks to see if the names from those sources had in fact been entered onto the watchlists. For those names that the agencies failed to capture on their watchlists, we checked the agencies' licensing records to see if any licenses had been issued involving such parties after they had been listed in the source documents. To see how well the agencies' screening processes work, we searched each agency's licensing records for parties listed on the watchlist to see if any licenses were issued without being caught by the screening procedures and reviewed by compliance or enforcement personnel. We also discussed with State, Commerce, and intelligence officials whether and how intelligence information is used to screen license applications.

To ascertain how well State and Commerce cooperate with each other and with the U.S. Customs Service, we examined how well the agencies share enforcement information with one another and held discussions with State, Commerce, and Customs officials to see what type of information they were or were not sharing.

To assess the extent of information not shared between State and Commerce, we compared the State and Commerce watchlists to identify names unique to each agency's watchlist but of interest to the other agency. To assess the benefits of increased information sharing, we searched the agencies' licensing records to see if licenses were issued by one agency when the other agency possessed derogatory information about a party to the license. Specifically, we identified entries of interest (e.g., nuclear proliferation controls) to the other agency using the reason codes describing why the entries were placed on the watchlist. Because the Commerce and State watchlists include over 60,000 entries, many of which are duplicate entries or repeat a name with a slightly different spelling, we used a 10-character name-matching program to determine the number of entries unique and common to both watchlists. We manually

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reviewed all the potential matches identified through this program to remove any non-matches.

This approach has inherent limitations. First, Commerce and State watchlists have multiple entries for the same party which makes estimating the true number of unique and common entries difficult. Second, the use of a 10-character computer matching program is affected by variations and errors in how names are entered in the agencies' watchlists. These limitations are likely to result in estimates which overstate (1) the number of entries on one agency's watchlist which are of interest to the other; (2) the number of entries on one list but missing from the other; and (3) the number of licenses issued by State to parties on Commerce's watchlist which were missing from State's list. The limitations are further likely to result in an understated estimate of the common names on the two agencies' watchlists. Nevertheless, our methodology provides a valid indication of the problems we cite in the report. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists.

We visited Customs headquarters to see how Customs screens registrations for State. We also visited a Customs field office to corroborate that State is giving Customs officials at the ports access to its licensing data. We interviewed Customs, State, and Commerce officials concerning relations among the agencies. However, we relied primarily on our December 1993 report to document Customs' difficulties in gaining access to Commerce's licensing data.<sup>1</sup>

To determine whether State was collecting and reviewing annual sales reports required of the manufacturing or distribution agreements, we interviewed State officials to gain an understanding of reporting requirements and filing and review procedures. We selected a sample of 18 approved agreement cases to see if the reports were being submitted as required and what reviews State had made of them. Because many of the files we selected were missing documents, State officials contacted the companies to try to obtain the missing documents, but their effort was only partially successful.

To determine how State ensures that munitions licenses are issued only to U.S. persons, we met with State officials to gain an understanding of the purpose of the requirement and how State ensures the requirement is satisfied by the applicants. We then selected a sample of 40 approved

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<sup>1</sup>Export Controls: Actions Needed to Improve Enforcement (GAO/NSIAD-94-28, Dec. 30, 1993).

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licenses to see if the applicants had made the certifications required by State.

The samples of agreement files we selected for review and the sample of approved licenses we selected for determining whether they were issued to U.S. persons were not statistical samples and are therefore not projectable.

# Comments From the Department of Commerce

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



**THE SECRETARY OF COMMERCE**  
Washington, D.C. 20230

JUN - 2 1994

Mr. David E. Cooper  
Director, Acquisition Policy,  
Technology & Competitiveness Issues  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Cooper:

I am pleased to enclose our comments on your draft report, "Export Controls: Licensing Screening and Compliance Procedures Need Strengthening" (GAO/NSIAD-94-178).

Sincerely,

A handwritten signature in dark ink, appearing to read "Ronald H. Brown".

Ronald H. Brown

Enclosure

**ENCLOSURE**

**U.S. DEPARTMENT OF COMMERCE  
COMMENTS ON GAO DRAFT REPORT ENTITLED  
"EXPORT CONTROLS: License Screening and  
Compliance Procedures Need Strengthening"  
GAO/NSIAD 94-178**

Appendix VI  
Comments From the Department of  
Commerce

SUMMARY

Notwithstanding our concerns about a number of points in the draft study, which are detailed below, we believe that its recommendations merit serious consideration.

COMMENTS ON DRAFT STUDY:

Now on p. 2.

On page 3, under Results in Brief, there are several items mistakenly attributed to Commerce. In the second sentence, the words "...indicted or..." should be replaced with "listed as fugitives" to make this information consistent with footnote A of Appendix I. Also, in this same sentence the words "...-or post-..." should also be deleted as footnote F of Appendix I indicates no post-shipment checks were included. Finally, in this same sentence, the phrase "...and parties identified by intelligence reports as known or suspected weapons proliferators" should also be deleted as BXA is not privy to these reports.

See comment 1.

Now on pp. 3 and 8.

On page 4 and also top of page 12, the report states that Commerce cannot deny an export application solely on the basis of derogatory intelligence information. This was told to GAO during discussions with Office of Enforcement Support (OES) personnel. Based on OES's access to original source intelligence through its Memorandum of Understanding with several different agencies, it cannot use this original intelligence information as the basis for denial of an export license application. In cases where derogatory information is based on such intelligence, OES attempts to corroborate it and develop an unclassified information source through other available means, such as completing a pre-license check (PLC) or researching other open sources of information. However, in certain circumstances, the Office of Export Licensing (OEL) may use sanitized versions of intelligence information as the basis for denial. In all cases where intelligence information is used as the basis to deny an export license application, Commerce thoroughly coordinates with the originator of the information in order to preclude the compromise of sensitive intelligence sources and methods.

See p. 8.

See comment 2.

Now on p. 3.

In the first paragraph at the top of page 4, the following sentence should be deleted or revised. "Furthermore, Commerce issued licenses even when parties of concern identified by intelligence sources were flagged by its screening system." This sentence is misleading because it implies all applications involving screened parties should be denied. The screen includes information from a variety of sources, and this information varies in its specificity and detail. There is not a direct causal relationship between screened parties and license

See comment 3.

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rejections. In all cases when there is a screen match pertaining to intelligence information, this information is considered against other facts included on the export application and the current licensing policies in place for the involved commodities and country destination. After BXA considers all information surrounding that particular export transaction (intelligence information, pre-license or post-shipment check information, investigative information, other background information, interagency comments, licensing policy issues, etc.), then the appropriate licensing decision is made.

See p. 11.

In the last sentence of the second paragraph of page four, the report states that "...cooperation between Commerce and Customs has been poor." We believe that the Memorandum of Understanding and Agreement signed in September, 1993 provides the basis for effective cooperation and sharing of information between the two agencies, and, in fact, has achieved that result.

Now on p. 4.

The first sentence of the last paragraph on page six states that Commerce does not have formalized procedures for controlling what information should be entered on its watchlist and by whom. In fact, we do have formalized procedures for all of the items on this list including the Department of Justice (DOJ) list. This DOJ list was formally assigned in October, 1993. In addition, we wrote to Justice on October 25, 1993 and stressed the importance of receiving continual updates to this list and immediate notification of any convictions as they occur. Justice replied on November 2, 1993, and agreed to the procedures set forth in our letter regarding notifications. It is also important to note that there are formal procedures that have existed since the beginning of Commerce's automated screening system that include standards for screening parties. These procedures can be found today in Section 12 of the Special Agent's Manual, dated October 3, 1989. Also, BXA's Office of Information Resource Management (OIRM) produced and distributed specific guidance for all Export Enforcement personnel regarding how to add, delete, or change an entry on the automated screen in Section 7 of its March, 1992, publication, Using the ENFORCE System.

See p. 5.

See comment 4.

In the second sentence of the last paragraph of page six, the report inaccurately states who may update BXA's watchlist. It should read that staff from the Office of Enforcement Support, and Office of Export Enforcement field agents and headquarters personnel may update BXA's watchlist.

Now on p. 4.  
See comment 1.

In several places in the report, there are references to licenses issued to parties that should have been on the watchlist or names of parties missing from our watchlist. GAO specifically refused to supply us with the entire list of 197 parties allegedly missing from our watchlist and agreed to supply us only with a sample of 10 instead. We hereby formally request all of this

See comment 5.



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data so that we might review it in detail and provide additional information regarding our actions in these cases. The specific references in the report are:

o The last sentence of the third paragraph on page seven states that Commerce issued four licenses to parties who should have been on its watchlist.

o At the first inset point made at the bottom of page 10, the report states that Commerce issued two licenses involving a party on its watchlist in 1986 for nuclear proliferation reasons.

o At the top of page 11, the report states that Commerce issued 15 licenses involving a company on its watchlist in 1991.

o At the top of page 16, there is a statement regarding Commerce approving nine licenses involving three parties on State's watchlist.

o Finally, we would like to request that GAO provide us with the complete listing of all 197 names allegedly missing from Commerce's watchlist. We appreciate GAO providing us with a sampling of ten of these names and would like to pass along our analysis of these. Of the ten names provided, seven of these parties are currently screened on our watchlist. Only one of these seven parties was added to our watchlist based on GAO's input to Commerce provided during this study. Of the three parties that were not on our watchlist, one has been added. We would like to discuss the details of the other two parties with GAO to enable us to complete the screening actions necessary. As our findings indicate that at least 6 of the entries in the sample of 10 were actually properly screened on our watchlist, we would appreciate the opportunity to discuss our findings with GAO in more detail to determine the actual number of entries that might be missing from our watchlist.

On page eight, in the first sentence under the section "Agencies' Screening Systems Do Not Always Capture Applications With Watchlist Names," this sentence should be reworded as it is misleading. If the parties were on Commerce's watchlist as stated, then all information was considered before making any final licensing action.

In the first sentence of the first full paragraph of page nine, the report states that "Commerce has not ensured that each party is given only one identification number and has in some cases assigned multiple identification numbers to the same party." As the report notes, "BXA has a sophisticated computer name-matching program to assign identification numbers to all parties in its database." The report does not address the entire process and the specific attempts made by BXA to limit multiple

See comment 5.

See comment 6.

Now on p. 5.

See comment 7.

Now on p. 6.

See pp. 6 and 14.

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identification (ID) numbers. At the beginning of BXA's automated screening system in the mid-1980's, parties were added if there were any small differences in the name or address. It was believed at this time that this method would ensure no screened names would slip through the application review process.

During the fall of 1992 discussions began between the Director of OIRM and the Director of the Office of Enforcement Support (OES) involving eliminating duplicate companies in BXA's database. Many steps were taken to meet this goal. First, OES took over the coding function from OIRM in December, 1992. This coding function involves reviewing the company matches assigned by the computer system to ensure accuracy, and reviewing and adding companies to those fewer entries the computer did not match. OES took over this function because transaction parties are predominately used by Export Enforcement personnel and thus OES is in a better position to make decisions on matches or additions of companies. Guidance was developed for those individuals in OES that handle this function and specific instructions were included pertaining to limiting the creation of multiple companies in the system.

See pp. 6 and 14.

Next, OIRM proposed completing a massive archiving effort of ID numbers to retire the older and larger number of duplicate or multiple ID numbers that were created during the mid-1980s. This archiving effort was completed by OIRM around Feb. 5, 1993. It eliminated duplications and redundancies, which enabled us to reduce the list by over 50%. After this archiving effort was complete, OES initiated a review of companies in two U.S. states and two foreign countries to determine the percentage of duplicates remaining in the system. This review was completed by OES on March 29, 1993. The total number of entries reviewed was 7,799. The number of multiple entries of three or more ID numbers was 167, or 2% of the total. The number of multiple entries of only two ID numbers was 536, or about 7%.

See pp. 6 and 14.

In addition to this reduction in the numbers of multiple entries, further reductions are already in the pipeline. We have drastically reduced the number of duplicates being added on incoming applications since December, 1992. However, this marked change is reflected only gradually because the screening system holds 5 years of data in its active database. Still, by continuing our yearly archiving process we will eliminate the vast bulk of duplicates that remain in the system during the next few years. Finally, we remain vigilant on our current reviews of new applications and company assignments.

See pp. 6 and 14.

Now on p. 6.

On footnote number 5 on the bottom of page 9, this sentence is inaccurate and misleading and should be re-written as follows. "Enforcement staff are responsible for reviewing applications and considering the information included on the screened party and

See comment 1.

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then making appropriate recommendations to the licensing officer."

Now on p. 8.

In the second sentence of the second paragraph of page 12, the report states that Commerce must provide an applicant with a detailed explanation as to why an application is denied. This is inaccurate as well. Commerce notifies an applicant of its intent to deny an application first and then ultimately of the final denial decision itself. Under Section 10 (f) of the Export Administration Act (EAA), Commerce must provide specific details only to the extent consistent with U.S. national security and foreign policy.

See comment 8.

Now on p. 8.

At the end of the first paragraph on page 13, the report includes a statement that Commerce essentially ignores intelligence information if no derogatory information is uncovered during a pre-license check (PLC) request. This is not an accurate assessment of Commerce's consideration of intelligence information. It is true that we will often request a PLC on transactions where intelligence information is present to establish a collateral source of information. However, even if we cannot corroborate this information in a PLC request, there are other sources available to EXA to tap into to support an unfavorable action on the application. Further, even if these sources do not uncover collateral information, OEL is notified of the original intelligence information. At this point, all pertinent information surrounding the export license application, including the technical level of the commodities, the proposed end-use and end-user, the destination country, the risk of diversion, the current licensing policies in place, and the details and source of the intelligence information are considered before a final licensing decision is made.

See comment 1.

See comment 9.

The intelligence community plays exactly the role it should in these matters. That is, it supplies the raw intelligence information to the licensing agencies and allows the technical experts within these agencies to evaluate this information against all other factors involved in the license review process.

See p. 14.

Now on p. 9.

In the first paragraph at the top of page 14, the report states that thousands of watchlist names are of interest to both Commerce and State and that these names are not shared. We agree that additional periodic meetings to discuss this specific area would be beneficial to both agencies and we commit to initiating these efforts. However, based on our experience with State's watchlist, we have doubts that the number of parties that are applicable to Commerce's watchlist is in the thousands. Commerce routinely coordinates with State on matters of mutual interest involving license screening and reviews. Both agencies are very familiar with the general composition of the other's watchlist, and information is shared between the two agencies regarding parties of potential interest for each other's watchlist. For

See comment 10.

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See comment 10.

example, BXA forwards copies of its Economic Defense List (EDL) to State yearly for its use and information. The EDL is a subset of Commerce's screen that, among other entries, includes parties that have been involved in unfavorable PLCs or PSVs, parties that have been denied export privileges or parties that have had past violations of the Export Administration Regulations. We are currently working on providing this information in an automated medium to assist State in its use of this data.

Now on p. 10.

In the second full paragraph of page 15, the report includes a statement that "...Commerce is very reluctant to share information ...". We believe this statement is inaccurate as we have voluntarily provided State with Commerce watchlist information since the early 1980s. Based on the positive relationship that Commerce and State have maintained over the last several years, we believe that this statement should be explained further or deleted from the report.

See comment 11.

Now on p. 11.

Again, at the top of page 17, there is a statement regarding the "poor" cooperation between Commerce and Customs. As stated previously, we believe that the Commerce-Customs problems are behind us because of the September, 1993 Memorandum of Understanding (MOU) and the new spirit of cooperation between the two agencies. For the most part, this report concerns a time period prior to the MOU.

See p. 11.

We appreciate GAO sharing the names of the 179 parties they believe had additional ID numbers that were not properly included on Commerce's watchlist. After analysis of the 179 names, we believe that 129 of these names (72.5%) may no longer require Export Enforcement review, and can be removed from Commerce's watchlist without compromising enforcement concerns. A more detailed review and analysis of these 129 names is currently underway. Our review also indicated that 20 of these parties (11%) are, in fact, properly on the watchlist. Finally, 5 of these parties (3%) are no longer being monitored by EE personnel and have been removed from the watchlist.

See comment 12.

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RESPONSES TO RECOMMENDATIONS

RECOMMENDATION: Formally assign watchlist data-entry responsibilities among the staff and establish procedures to ensure data entries are complete and up to date.

RESPONSE: We fully assigned all watchlist data-entry responsibilities within the Office of Enforcement Support in October, 1993. In response to this report, we have begun to develop programs that will facilitate periodic reviews of all parties entered on Commerce's watchlist to ensure entries are complete and up to date. These reviews will begin by July 1, 1994.

See comment 4.

RECOMMENDATION: Share the relevant portion of Commerce's watchlist with State on a regular basis and incorporate the relevant portion of State's watchlist into Commerce's watchlist.

RESPONSE: We currently share relevant portions of Commerce's watchlist with State by forwarding annually BXA's Economic Defense List. Moreover, we are prepared to make available all portions of our watchlist that State deems relevant to its needs. Additionally, we are prepared to review State's watchlist in further detail to determine what portions may be relevant for BXA.

See comment 10.

RECOMMENDATION: Review Commerce's identification number assigning procedures to ensure that multiple numbers are not assigned to the same party.

RESPONSE: From October to December, 1992, we completed a major purging of multiple entries and reduced the number of these entries by over 50%. Since December, 1992, we have operated a system that has largely arrested the problem of adding multiple entries. Its two-step procedure combines computer automation and human quality control review. Each day, BXA's computer system automatically assigns approximately 75% of the ID numbers to parties involved in export license applications on the basis of both name and address-matching criteria. Individuals within OES then review all matches made by the computer to ensure they were done appropriately, and manually assign ID numbers to the remaining 25% of the parties who cannot be matched automatically.

See pp. 6 and 14.

RECOMMENDATION: When pre-licensing checks are conducted because of information from intelligence sources but they result in no

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derogatory information, notify the intelligence sources that the information was not corroborated and discuss whether the application should be approved.

RESPONSE: As discussed earlier, we believe that the intelligence community's role in this process is to provide the raw intelligence information and that the licensing agencies should evaluate this information in light of all other information known and then make the final decision. Whenever a pre-license check contradicts intelligence information, Commerce will provide its results to the original source agency.

See p. 4.

See comments 4, 8, and 9.

The following are GAO's comments on the Department of Commerce's letter dated June 2, 1994.

## GAO Comments

1. We modified the report as appropriate according to Commerce's suggestions.
2. Commerce and intelligence agency officials told us that Commerce has taken the extra step to consult with the intelligence agencies only about three times in the past 5 years. Further, when asked, Commerce officials could not provide any examples where they denied a license based on intelligence information from its watchlist.
3. We revised this section to more clearly emphasize our point that Commerce is not most effectively using available intelligence information in its licensing decisions.
4. Although Commerce stated that it has had formalized procedures since 1989 for controlling what information should be entered on its watchlist and by whom, it acknowledged that its procedure for entering the Department of Justice list was established only in October 1993, after we brought it to Commerce's attention. We further note that the Office of Enforcement Support did not have formalized procedures or written guidance to ensure that all pertinent information was entered into the watchlist. Commerce did not address in its comments why it had not established procedures for entering information from State's Blue Lantern inspection program or why it lacks documentation and guidance on the use of intelligence reports for its watchlist. Moreover, Commerce did not explain why so many names were missing from its watchlist.
5. We are providing the entire list of the missing parties to Commerce as originally agreed.
6. We note these ten names were not found on Commerce's watchlist when we checked, but were likely added to the list after our check. Our point that Commerce's watchlist was not complete and current at the time of our check remains valid.
7. Our analysis showed that Commerce processed over 800 licenses involving parties on its watchlist without considering the derogatory information. None of these licenses were flagged by Commerce's screening system or sent to the enforcement staff for review.

8. When the details for denying license applications are based on or involve intelligence information, it is reasonable to expect Commerce to go back to the intelligence source to assess the merits of the intelligence information and determine whether the information can be sanitized to permit its use for a denial if warranted.

9. Our recommendation seeks to ensure the enforcement staff routinely coordinate with the intelligence community when a pre-licensing check, which has limitations, does not corroborate the intelligence data. Merely passing the original intelligence to the licensing officer will not be helpful because, under the agreements with the intelligence community, the licensing officer cannot use it to deny a license unless the intelligence community is first consulted.

10. Commerce's Economic Defense List is published only once a year. Further, coordination is now done on a limited case-by-case basis; we believe the agencies' compliance and enforcement functions would greatly benefit from a routine sharing of the watchlist information. State's response to our draft report acknowledged the utility of greater sharing of watchlist information.

Our draft report noted that not all of the watchlist entries would be relevant to both agencies. Our estimates of the number of entries relevant to each agency were made on the basis of a review of the categories of names on each list and each agency's enforcement interests. Limitations on our estimates are cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists.

11. The statement has been deleted.

12. Whether or not the 179 parties should remain on Commerce's watchlist is Commerce's decision, but the removal of those parties from the list does not invalidate our analysis that they were not screened when they were on the watchlist and of enforcement concern.



# Comments From the Department of State

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



United States Department of State

Washington, D.C. 20520

JUN 6 1994

Dear Mr. Conahan:

We are pleased, on behalf of the Chief Financial Officer, to provide the Department of State comments on your draft report, "EXPORT CONTROLS: License Screening and Compliance Procedures Need Strengthening," GAO/NSIAD-94-178, GAO Job Code 463833.

If you have any questions concerning this response, please call Mr. Phillip Kosnett, State - PM/DTC, at 875-5664.

Sincerely,

Carolyn S. Lowengart  
Director  
Management Policy

Enclosure:  
As stated.

cc:  
GAO - Mr. Ting  
State - Mr. Kosnett

Mr. Frank C. Conahan,  
Assistant Comptroller General,  
National Security and International Affairs,  
U.S. General Accounting Office.

GAO DRAFT REPORT -

"EXPORT CONTROLS: License Screening and Compliance Procedures Need Strengthening," GAO/NSIAD-94-178, GAO Job Code 463833

Overview

State's Office of Defense Trade Controls (DTC) is responsible for regulating and facilitating responsible defense trade consistent with U.S. foreign policy and national security goals.

We agree with much of the draft's analysis; we are already implementing most of the draft's recommendations. Yet there are several areas of interpretation and methodology which we believe require reassessment on the part of GAO:

Interagency Cooperation

We agree that State and Commerce could do more to exchange watchlist information, and we are working to do so. Yet we are also unclear on the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to State were not on State's watchlist. We believe there is already greater overlap than the draft report states; GSA's list of firms barred from USG contracts comprises about 19,000 of the entries on both lists. Many of the entries on Commerce's database are for companies with no interests or activities related to defense trade. We request clarification of these figures.

Moreover, State and Commerce do exchange information to identify and prevent questionable exports by means other than database

See comment 1.

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sharing, and we believe the report could be improved by an explanation of this. The implication (for example, on Page 15, Para 3) of refusal to share information gives an incomplete picture of interagency cooperation on export license compliance.

Watchlist Procedures

We agree that DTC's watchlist needs to be expanded and procedures modified to ensure that full advantage is taken of this resource and accurate records are kept. We have already taken steps in that direction. That said, we believe the draft is based on a fundamental misunderstanding (e.g., Page 7, Para 3; Page 11, Para 2) that any time State issued a license to a company which was on a watchlist, State erred. This misunderstanding of DTC's compliance function needs to be corrected.

The purpose of placing firms or individuals on the watchlist is not to ensure denial, but to ensure appropriate review. Entries are made in the watchlists for varying purposes, reflecting information of varying reliability and problems of varying severity (ranging from ineligibility for U.S. Government contracts to potentially politically sensitive end users).

Some companies are placed on the watchlist to ensure monitoring of specific types of exports (e.g., those regulated by the Missile Technology Control Regime), without a presumption that the firms would be denied the opportunity to engage in unrelated transactions. For example, in one case cited by the draft (Page 11, para 2), State issued licenses to a company which had been debarred. In this case, the debarment was intentionally structured to allow for exceptional exports to the company seen as in the interest of the USG, and the licenses were issued in keeping with that policy.

In other cases, State will issue a license after a review of derogatory information (obtained via the watchlist or other sources, such as interagency committee consultations) and a determination that the information provided insufficient grounds for denial. For example, the draft cites an Indonesian company (page 8, para 1) as an example of a firm which slipped through the cracks. In fact, Commerce informed State that the company was not a violator.

Our intent is not to quibble over GAO's examples. GAO's criticism that DTC has not computerized record-keeping of compliance review and thus does not always know or cannot demonstrate what compliance actions it has taken is a valid one. Yet we strongly believe the draft needs to be modified to explain to the reader the purpose of the watchlist.

Now on p. 9.  
See comment 2.

See p. 14.  
See comment 2.

Now on p. 7.

See comment 3.

Now on p. 5.

See comment 4.

See comment 5.

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Documentary Proof of U.S. Person Status

We believe there is some confusion in the draft report between the term of art "U.S. person," as defined at Section 120.15 of the International Traffic in Arms Regulations (ITAR), and the specific term "U.S. citizen." The recently revised ITAR definitions of "U.S. person" and "foreign person" have reinstated DTC's practice of including "lawful permanent residents" as "U.S. persons." U.S. citizenship is not a requirement for AECA/ITAR purposes so long as an applicant meets the definition of "U.S. person." It is our understanding that the "U.S. person" requirement exists to facilitate United States jurisdiction over any violator. We have generally required that applicants certify their U.S. person status as a less burdensome alternative to providing documentary proof.

See comment 6.

We agree that we generally receive no documentary proof that an applicant is a U.S. person. However, we receive assurances through applicants' certifications and conduct spot verifications of that information. Misrepresenting U.S. person status can subject a person to a fine of up to \$1,000,000 or imprisonment up to ten years, or both.

Without knowing specific details about the case described, we are unable to respond on point. Still, given the above circumstances, it is possible that no violation occurred at all.

Specific suggestions for modifications to the text follow.

Legal Questions

See comment 2.

Page 1, Para 1: The draft states that munitions licenses are to be "issued only to U.S. persons as required by law." Section 38(g)(5) of the Arms Export Control Act specifies that "A license to export an item on the United States Munitions List may not be issued to a foreign person (other than a foreign government)." We recommend the draft be modified to read "issued only to U.S. persons or foreign governments as required by law." The same change is necessary in Page 2, Para 2.

See comment 2.

Page 2, Para 3: The draft's statement that "Congress amended AECA to authorize State to deny licenses to persons with criminal records" would benefit from clarification. Section 36(g)(3)(4) of the AECA grants this authority to State only in regard to certain circumstances and crimes. Violations of statutes other than those enumerated in the AECA, even for serious crimes, are not grounds for denial of a license. We recommend the draft be modified to read "Congress amended AECA to authorize State to deny licenses to

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persons who have been convicted of violating specific statutes enumerated in the AECA."

See p. 3.  
See comment 6.

Page 5, Para 1, Line 5: State does conduct limited spot verifications; we recommend replacing "no" with "limited."

Now on p. 8.  
See comment 2.

Page 12, Para 2: We suggest clarifying the language regarding State's denial authority by changing the first sentence to read: "Under AECA, State has broad authority to deny an application on national security or foreign policy grounds without having to provide a detailed explanation."

Now on p. 12.  
See comment 2.

Page 19, Page heading: Replace "CITIZENSHIP" with "U.S. PERSON STATUS." (Applicants are not required to prove citizenship.)

Now on p. 13.  
See comment 2.

Page 19, Para 1-3: New application forms introduced in 1993 integrate the "U.S. person" certification (formerly a separate letter) into the form, eliminating the problem of missing certifications. DTC does, in fact, conduct spot verifications of certifications. We suggest the following changes to the language:

See comment 2.

Para 1, Line 2: Change "citizenship" to "U.S. person status."

Para 1, Line 5: Change sentence beginning "Moreover, they do not conduct..." to "State officials say that they conduct limited spot verifications of the certifications."

Para 1, Line 7: Insert "absolute" before "assurance." (The certification does provide assurance.)

See comment 2.

Para 2, Line 4: Change "is a citizen..." to "either is a citizen or national..." (Section 126.13 of the ITAR provides that a natural person may belong to certain specified categories.)

Para 3, Line 3: Change "U.S. citizen" to "U.S. person."

Now on p. 13.  
See comment 2.

Page 20, Para 1, Line 4: If GAO's point is that the person signing was a non-U.S. citizen, change "person" to citizen. ("Foreign person" is a term of art in the ITAR. The ITAR term "U.S. person" may include non-U.S. citizens who are lawful permanent residents and thus "U.S. persons" for ITAR purposes.)

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**Interagency Cooperation**

Now on p. 9.

Page 4, Para 2: In line with the comments made in the Overview, we recommend changing the paragraph to begin:

See comment 2.

"State and Commerce exchange some information regarding export policies, departmental sanctions, and questionable license applications via interagency coordinating committees, such as the Technology Transfer Working Group and the Missile Technology Export Control Committee. Cooperation between State and Commerce on database integration has been limited. The agencies..."

Now on p. 10.  
See comment 7.

Page 15, Para 3: We believe a more accurate picture of the State/Commerce effort to improve information sharing would be:

"State officials stated that they recognize the utility of greater database integration with Commerce, and the agencies have had discussions to this end. Implementation has been hampered by technical difficulties (e.g., computer hardware and database format incompatibility) but both agencies wish to pursue the effort. Commerce officials noted..."

**Watchlist Procedures**

Now on p. 4.

Page 6, Para 2: We recommend adding a sentence at the end of the paragraph:

See comment 2.

"State officials say that, since the time of the GAO review, State has assigned to a specific compliance division employee responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals."

Page 9, Para 3/Page 10, Para 1: State has placed a high priority on upgrading DTC's computer system. Many recent innovations (e.g., electronic license submission, electronic intra-agency staffing) have focused on the licensing side, in a successful effort to meet U.S. industry's needs for efficient processing. A number of small modifications (e.g., creation of an end-use check database) support compliance directly. We are now turning to address some of the issues noted in the GAO draft. In addition, the procedural guidelines provided to all compliance division personnel contains a section explaining the use of the watchlist.

We recommend adding a paragraph on Page 11 before the current Para 2:

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individuals on the watchlist is not to ensure automatic denial, but to ensure thorough review. Issuance of a license to a firm identified on the watchlist should not be taken as prima facie evidence of error. Some companies are placed on the watchlist to ensure control of specific types of export, without a presumption that the firms should be denied the opportunity to engage in unrelated transactions. In other cases, State will issue a license after reviewing derogatory information and determining that the information provides insufficient grounds for denial."

See p.14.  
See comment 2.

Page 15, Para 2: Again, we are unclear on the methodology GAO used to conclude that about 30,000 of the 33,000 entries on the Commerce list relevant to State were not on State's watchlist. We request that this paragraph be deleted or rewritten to make the case more explicitly.

Now on p. 10.  
See comment 1.

**Agreement Procedures**

Page 17, Para 2: We acknowledge that, in light of resource constraints at DTC, collecting, filing, and monitoring of agreements and sales reports have not been top priorities. In an effort to achieve the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining these records and would be subject to spot audits and to sanctions if they fail to do so." We suggest adding a sentence at the end of Page 18, Para 2 that:

Now on p. 12.  
See p. 12.

"State officials note that in an effort to achieve the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining these records and would be subject to spot audits and to sanctions if they fail to do so."

**Blue Lantern**

Page 16, footnote: The reference to Blue Lantern is not an accurate paraphrasing of the 1993 Federal Managers' Financial Integrity Act (FMFIA) report and raises issues which cannot accurately be addressed in a footnoted or parenthetical aside. We recommend dropping the footnote or, if GAO believes the reference is warranted, replacing it with the following accurate text from the FMFIA report:

Now on p. 12.  
See comment 2.

"In December 1993, State reported that 'Despite major improvements in the Department's management of defense trade, reported under the material weakness for munitions control, weaknesses still exist in overseas post implementation of the process used for end-use checks used to verify compliance with the

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Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR). As a result, the Department does not have reasonable assurance that defense exports are not diverted to unauthorized use."

**Recommendations**

We acknowledge the usefulness of these recommendations, and have already taken steps commensurate with them:

See p. 4.

-- Formally assign watchlist responsibilities: Since the time of the GAO review, State has assigned to a specific compliance division employee responsibility for monitoring the watchlist and ensuring receipt of other agencies' information that is produced at regular intervals.

See comments 2 and 7.

-- Share with Commerce: We have reinvigorated efforts to overcome technical obstacles to improving the exchange of watchlist information with Commerce. We continue to exchange other forms of information relating to export concerns via interagency coordinating groups like the Technology Transfer Working Group and the Missile Technology Export Control Committee.

See pp. 6 and 13.

See comment 8.

-- Redesign State's screening system: DTC's in-house systems staff is currently reprogramming the Office of Defense Trade Controls' dedicated computer system to flag applications when any party is on the watchlist, and to prevent a flagged license from being logged out for issuance until compliance staff have completed their review. This is technically straightforward, but may have implications for licensing efficiency (because more licenses will be delayed in processing while the compliance division reviews the increased number of flagged applications). We view this as an experiment, to determine what benefits to compliance accrue and what costs in licensing efficiency must be paid.

See comment 9.

The system already has the capability to permit record-keeping on compliance actions, and the compliance division has implemented procedures to ensure that compliance staff use the computer in documenting their actions.

State is examining other systems improvements in support of compliance as part of an ongoing enhancement of the Office of Defense Trade Controls computer system (including migration to open systems ADP).

See p. 12.

-- Update agreement files: In an effort to obtain the same compliance goals with fewer resources, State is considering a system whereby companies would certify that they were maintaining these records and would be subject to spot audits and to sanctions if they fail to do so.



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-- Document or audit U.S. person status information:  
Applicants are already subject to spot verifications of  
the "U.S. person" certification.

See comment 6.

The following are GAO's comments on the Department of State's letter dated June 6, 1994.

## GAO Comments

1. Our draft report acknowledged that not all of the watchlist entries would be relevant to both agencies. Our estimates of the number of entries relevant to each agency were made on the basis of a review of the categories of names on each list and each agency's enforcement interests. Limitations on our estimates are cited in app. V. Nevertheless, our approach provides a valid indication of the problems we cite. The precise number of entries that are relevant to each agency cannot be determined until the agencies actually share their watchlists. We note that Commerce's list of about 33,000 entries does not include GSA's list of about 19,000 entries.
2. We modified the pertinent section of our report as appropriate based on State's comments.
3. State's compliance officials told us that when a company is debarred by State, it can be issued a license only if an exemption is granted by State and that the exemption is granted only on a case-by-case basis. This particular company was issued 4 licenses without receiving any exemptions from State.
4. In this particular case, the Indonesian company was listed by Commerce as a subject of unfavorable pre- or post-license check. Had that information been considered, the decision may or may not have been different.
5. We stated clearly on page 2 of our draft report that the purpose of the watchlist is to prompt closer agency review of license applications.
6. Our review did not reveal random or spot verifications were routinely done by State; rather, we were told that when State officials see an unfamiliar signature on an application, they may call the company to query whether the person is a U.S. person. State does not document its queries and, in any case, does not require documentary evidence to corroborate or verify the certifications.
7. At no time during our review did either State or Commerce inform us of their attempt to integrate their watchlists or the technical difficulties involved.

8. Licensing efficiency is not more important than a thorough review of applications involving parties on the watchlist. While licensing efficiency is desirable, the AECA requires State to screen all applications for questionable parties.

9. The compliance staff's use of the computer to document their actions would make an incremental improvement over the current system. However, we continue to believe that State should redesign its system to permit automatic flagging of licenses with any watchlist names and to ensure these licenses are not issued until compliance staff have completed their reviews. Fully implementing this recommendation would result in a major improvement in State's compliance and enforcement functions that could also enhance licensing efficiency.

# Comments From the U.S. Customs Service



**THE COMMISSIONER OF CUSTOMS**

WASHINGTON, D.C.

June 6, 1994

Frank G. Conahan  
Assistant Comptroller General  
National Security and International  
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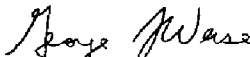
Dear Mr. Conahan:

In response to your request to the Secretary of the Treasury dated May 23, 1994, for comments on the General Accounting Office (GAO) draft report entitled, Export Controls: License Screening and Compliance Procedures Need Strengthening, the U.S. Customs Service has reviewed the draft report.

The report recommends in part, that State and Commerce share their respective watchlists with each other on a regular basis. The recommendation should enhance enforcement of the Export Administration Act (EAA) and the Arms Export Control Act (AECA).

We appreciate the opportunity to review the draft report.

Sincerely,

  
George J. Weise  
Commissioner

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