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EXPORT CONTROLS

License Screening and
Compliance Procedures
Need Strengthening

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Mr. Chairman and Members of the Committee:

It is a pleasure to be here today to discuss the results of our review of the automated export license screening and compliance procedures at the Departments of State and Commerce.¹

In a 1987 report on licensing activities at the Department of State's Office of Munitions Control, now known as the Office of Defense Trade Controls (DTC), we reported that DTC was not routinely using readily available information to screen license applications to help identify those potentially needing closer scrutiny.² In 1991, DTC established automated license application screening procedures to identify ineligible and undesirable parties. Commerce has had automated license screening procedures since 1984. We believe that effective license screening is essential in the licensing process because it provides the first line of defense against issuing licenses to parties seeking to misuse or divert sensitive U.S. items and technology.

Our most recent work in the export licensing area focused on the effectiveness of the license screening procedures at both the Departments of State and Commerce and some compliance issues that are applicable only to State. We covered both agencies because, as you know, State licenses munitions exports and Commerce licenses exports of sensitive dual-use items. Our review uncovered several weaknesses in the screening procedures at both agencies, and in the compliance area.

I would like to focus on six key questions addressed in our review.

- Are Commerce and State maintaining complete and current watchlists to screen export applications?
- Do the screening systems used by State and Commerce identify all applications involving watchlist parties?
- Do Commerce and State effectively share the information on their watchlists?
- Is Commerce making the most effective use of intelligence information to screen export applications?
- Is State monitoring agreements involving the manufacture and distribution of defense articles outside the United States?
- Does State verify that only U.S. persons are granted munitions export licenses?

¹Export Controls: License Screening and Compliance Procedures Need Strengthening (GAO/NSIAD-94-178, June 14, 1994).

²Arms Exports: Licensing Reviews for Exporting Military Items Can Be Improved (GAO/NSIAD-87-211, Sept. 9, 1987).

AGENCIES' WATCHLISTS ARE NOT COMPLETE AND CURRENT

Commerce and State compile separate watchlists to use for screening license applications. Watchlist names serve to prompt closer review of export license applications. The watchlists include, for example, individuals and companies that (1) have been convicted of export violations, (2) are subjects of unfavorable pre-license or post-shipment checks, (3) are under economic sanctions imposed by Treasury, (4) have been identified as known or suspected diverters or proliferators by intelligence reports, or (5) have been debarred by Commerce or State from export activities.

We obtained documents and information State and Commerce told us they use to update their watchlists and checked to see if the names had in fact been entered onto the agencies' watchlists. We checked over 2,100 names that should have been included on the State watchlist and over 700 names that should have been included on Commerce's watchlist. Of the names we checked, we found that each agency had failed to include about 27 percent of the names on their watchlists.³ For example, we examined 92 names listed by the Department of Justice as fugitives indicted for or convicted of significant export control violations. At the time we checked, Commerce had not placed 69 of these names on its list, and State had not placed 47 of these names on its watchlist.

We believe the reason so many names are missing from the agencies' watchlists is that the agencies have not clearly assigned data entry responsibilities and do not have adequate procedures to ensure names are entered systematically and in a timely manner. As a result, names from the documents are haphazardly entered and updated.

We searched State's and Commerce's licensing databases to see if any licenses had been issued to the parties whose names should have been but were not on the watchlists. We found a total of 224 such licenses issued to 15 parties between fiscal year 1990 and August 1993.⁴ For example, in January 1992 a State Blue Lantern inspection revealed that a 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 approved an export license involving this company.

At this point, I want to emphasize that we are not saying these licenses should not have been issued. What we are saying is that these licenses were issued without considering the negative or derogatory information regarding these parties. Had the

³Details of this analysis are in attachment I.

⁴Details about the 224 cases are in attachment II.

information been considered, the licensing decisions may or may not have been different.

Our report recommends that State and Commerce formally assign watchlist data-entry responsibilities among staff and establish adequate procedures and guidance to ensure data entries are complete and up-to-date. In a response to our draft report, Commerce stated that it has had formalized procedures since 1989 for controlling what information should be entered on its watchlist and by whom, but acknowledged that, until October 1993, it did not have procedures for entering Department of Justice names. Commerce also did not address the lack of procedures and guidance for gathering information from State's Blue Lantern program (a pre- and post-license check program) and from intelligence reports. State commented that, since our review, it has assigned responsibility to a specific employee for monitoring its watchlist and for ensuring the list is updated at regular intervals. We believe State is taking the proper action, but we will have to follow up on and verify the effectiveness of that action.

AGENCIES' SCREENING SYSTEMS DO NOT ALWAYS CAPTURE APPLICATIONS WITH WATCHLIST NAMES

State's and Commerce's screening systems are designed to identify, or flag, applications that have watchlist names on them so that they can be scrutinized by enforcement staff. However, we found that their systems do not always do that. At Commerce, we identified 851 license applications with watchlist names that slipped through Commerce's watchlist screening system without being reviewed by its enforcement staff. While 75 of these applications were eventually denied or returned without action, 776 were approved. For example, Commerce approved two licenses involving a company placed on its watchlist for nuclear proliferation reasons. The screening system had not flagged the applications, and they were not sent to enforcement staff for review.

Similarly, at State, based on a sample of 86 license applications,⁵ we found 83 license applications involving 28 companies slipped through State's screening system without being reviewed by its compliance staff. Seventy-one of these licenses were approved. In a case outside our sample, a company convicted of illegally selling aircraft parts to Iran had been debarred by State from future export licenses and placed on State's watchlist. Nonetheless, in 1992 State issued four licenses involving this company without the applications being flagged by its screening system. Further details on the watchlist parties that slipped through the screening systems at State and Commerce are in attachment III.

⁵We selected for our sample only licenses processed within 2 days that involved State watchlist parties.

Again, we are not saying those licenses should not have been granted. What we are saying is that they were granted without considering the negative or derogatory information regarding the watchlist parties.

We believe that weak internal controls are causing Commerce and State to miss applications involving watchlist parties. For example, Commerce assigns identification numbers to all exporters and consignees in its database to automatically flag watchlist parties on license applications. However, in many cases Commerce has assigned multiple identification numbers to the same party, not all of which have watchlist flags. As a result, license applications involving parties on the watchlist may not always be caught by the screening system.

There are several possible explanations as to why licenses slipped through State's screening system. State's system is less automated than Commerce's and largely relies on staff to manually review a computer report to find the name matches between applications and its watchlist. Also, unless the matched watchlist party is the applicant, the system does not automatically flag the application or send the case to the Compliance Division for review. Moreover, unlike Commerce's system, State's system does not track the review made by compliance staff, nor does it prevent a license from being issued until after compliance staff have completed their review. As a result, a case could slip through because the staff did not manually spot the match or because the compliance specialist did not complete a review of the case. There are additional technical limitations in State's matching program that could also cause a case to slip through. Because State's process is not well documented, it was difficult for us to determine exactly why 83 of the 86 cases we examined slipped through.

Our report recommends that State and Commerce review and make the necessary changes to their systems' design and screening procedures to ensure that applications with watchlist names will be caught by their systems. In its response, Commerce said that it has been attempting to eliminate multiple identification numbers since the fall of 1992, but our analysis of the Commerce data shows this effort has not solved the problem. State agreed to consider redesigning its system but is concerned that a new system might reduce its licensing efficiency. We believe that a thorough review of applications involving parties on the watchlist is more important than issuing licenses quickly. Moreover, a redesigned system may actually improve State's licensing efficiency.

AGENCIES DO NOT SHARE THEIR WATCHLISTS

State and Commerce do not routinely share information from their watchlists with each other.⁶ While some entries on each agency's watchlist are of unique interest to only that agency, thousands of names are of common interest to both Commerce and State and, because they are not shared, are not being used to screen export applications for questionable parties.

We compared State's and Commerce's watchlists to determine how many entries of interest to both agencies are not being used to screen applications. About 5,000 entries on the State watchlist relevant to Commerce were not on Commerce's watchlist. Similarly, about 32,000 entries on the Commerce list relevant to State were not on State's watchlist.⁷ These entries represent negative or derogatory information on companies and individuals that State and Commerce are not using in their licensing reviews.

Each agency has processed licenses involving parties on the watchlist of the other agency. 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. 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.

Because of multiple entries in the agencies' watchlists and our computer name-matching approach, our estimates likely overstate the number of entries on one watchlist of interest to the other and the numbers of licenses issued involving these parties.⁸ Nevertheless, our methodology provides a valid indication of the potential problems created by the agencies' failure to share their watchlists. For example, in June 1991, Commerce placed a company name on its watchlist because of an unfavorable post-shipment check. State did not have this name on its watchlist and approved three licenses involving this company.

Our report recommends that State and Commerce share the relevant portions of their watchlists with one another on a regular basis.

⁶Commerce does provide State a copy of The Economic Defense List. This report is published only once a year, however, and contains only a partial listing of names from Commerce's watchlist.

⁷Details of these analyses are in attachment IV.

⁸These limitations are discussed in more detail in appendix V of our report.

COMMERCE HAS NOT MADE THE MOST EFFECTIVE USE
OF INTELLIGENCE INFORMATION
TO SCREEN APPLICATIONS

Commerce officials told us that they do not deny a license based on intelligence information in its watchlist 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-license check program.⁹

Because Commerce must provide detailed explanations to exporters who are denied licenses, the intelligence agencies do not want Commerce to deny licenses solely on the basis of intelligence information without first consulting them. Consequently, under current procedures, Commerce enforcement agents essentially use intelligence information as a lead to develop collateral information that can be used to deny a license. For example, when the application screening process identifies a party as a potential diverter or proliferator based on intelligence information, Commerce may request a pre-license check on the party. If the check produces negative or derogatory information, Commerce can use that as the basis for denying the license. When the checks do not produce negative results, however, 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. From fiscal year 1990 to August 1993, we found 49 licenses that had names on the Commerce watchlist based on intelligence information and that Commerce approved after pre-license checks failed to corroborate the negative information in the intelligence reports.

In our report, we recommend that Commerce routinely refer to intelligence sources those cases for which pre-license checks have not corroborated the derogatory intelligence information. In consultation with the intelligence sources, such cases should be reviewed to (1) assess the merits of the intelligence information, and (2) determine whether the intelligence information could be sanitized to permit its use in denying a license application. Although Commerce implied in its response to our draft report that it routinely consults with the intelligence sources regarding those types of cases, both Commerce and intelligence officials told us that it has taken this extra step to consult with the intelligence source only about three times in the past 5 years.

⁹Nuclear 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).

STATE HAS NOT MONITORED MANUFACTURING
AND DISTRIBUTION AGREEMENTS EFFECTIVELY

State requires the U.S. company or its licensee to submit annual sales reports when entering into an agreement to manufacture or distribute defense articles outside the United States. 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 told us that, due to limited staff, they have not routinely collected or reviewed these reports. We noted that, notwithstanding limited resources, State had not assigned oversight responsibility for the agreements among its staff.

State officials also acknowledged that the agreement files were in such disarray that they could not distinguish between those companies that had failed to submit the reports and those that had submitted reports that may have been misplaced. Some files were even missing copies of the final agreements. State officials attributed the poor management of the files to a lack of staff and a move of their document storage facility a few years ago. 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.

Our report recommends that State assign oversight and monitoring responsibilities for the manufacturing and distribution agreements among its staff and ensure that the files on these agreements are updated. State responded that it is now 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 manufacturing and distribution agreements.

STATE REQUIRES NO DOCUMENTARY
EVIDENCE TO PROVE U.S. PERSON STATUS

Under the Arms Export Control Act, a license to export a munitions item may not be issued to a foreign person (other than a foreign government). 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 person signing the application is either a U.S. citizen, a permanent resident, or an official of a foreign government entity in the United States. Moreover, State performs spot verifications only when staff notice an unfamiliar signature and these verifications are conducted by telephone. Under these procedures, State does not have reasonable assurance that the persons signing applications are U.S. persons.

We reviewed a sample of 40 approved licenses to see if the applications had been properly certified as required. Seven of the 40 cases did not have the proper certifications for the person signing the application. 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.

Our report recommends that State either require documentary proof of U.S. person status in lieu of certification the first time an applicant applies for a license, or conduct random verifications of the U.S. person certifications. State responded that recently introduced application forms should correct the problem of improper certifications. Nevertheless, the new forms do not address the need for documented verifications.

Mr. Chairman, that concludes my statement. I will be pleased to answer any questions that you or other committee members may have.

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 ^a	92	47 51%	92	69 75%
Treasury's list of designated nationals ^b	184	3 2%	184	33 18%
Intelligence information ^c	45	26 58%	45	26 58%
Department of Commerce ^d	1,120	404 36%	^e	^e
Commerce "negative" pre-license checks ^f	39	36 92%	39	11 28%
State "negative" Blue Lantern checks ^g	57	29 51%	57	41 72%
GSA list of excluded parties ^h	298	19 6%	^e	^e
Denial orders ⁱ	291	2 1%	291	17 6%
Total	2,126	566 27%	708	197 28%

^aNames 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.

^bNames were based on a GAO judgmental sample from the March 1992 Treasury report on specially designated nationals.

^cNames 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.

^dNames are from Commerce's December 1991 Economic Defense List, which includes parties known or suspected of involvement in prohibited activity such as terrorism.

^eNot 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.

^fNames were developed by GAO based on a file review of fiscal year 1992 Commerce pre-license checks identified by Commerce as providing derogatory information.

^gNames 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.

^hNames 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.

ⁱNames 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
Commerce licenses					
A	Singapore	Intelligence	3/93	3	4/93 to 6/93
B	Hong Kong	Intelligence	1/93	1	2/93
Subtotal				4	
State licenses					
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
Subtotal				220	
Total				224	

Legend

Intelligence -- Names were provided to GAO by State's Office of Intelligence and Research based on its review of intelligence reports given to DTC 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.

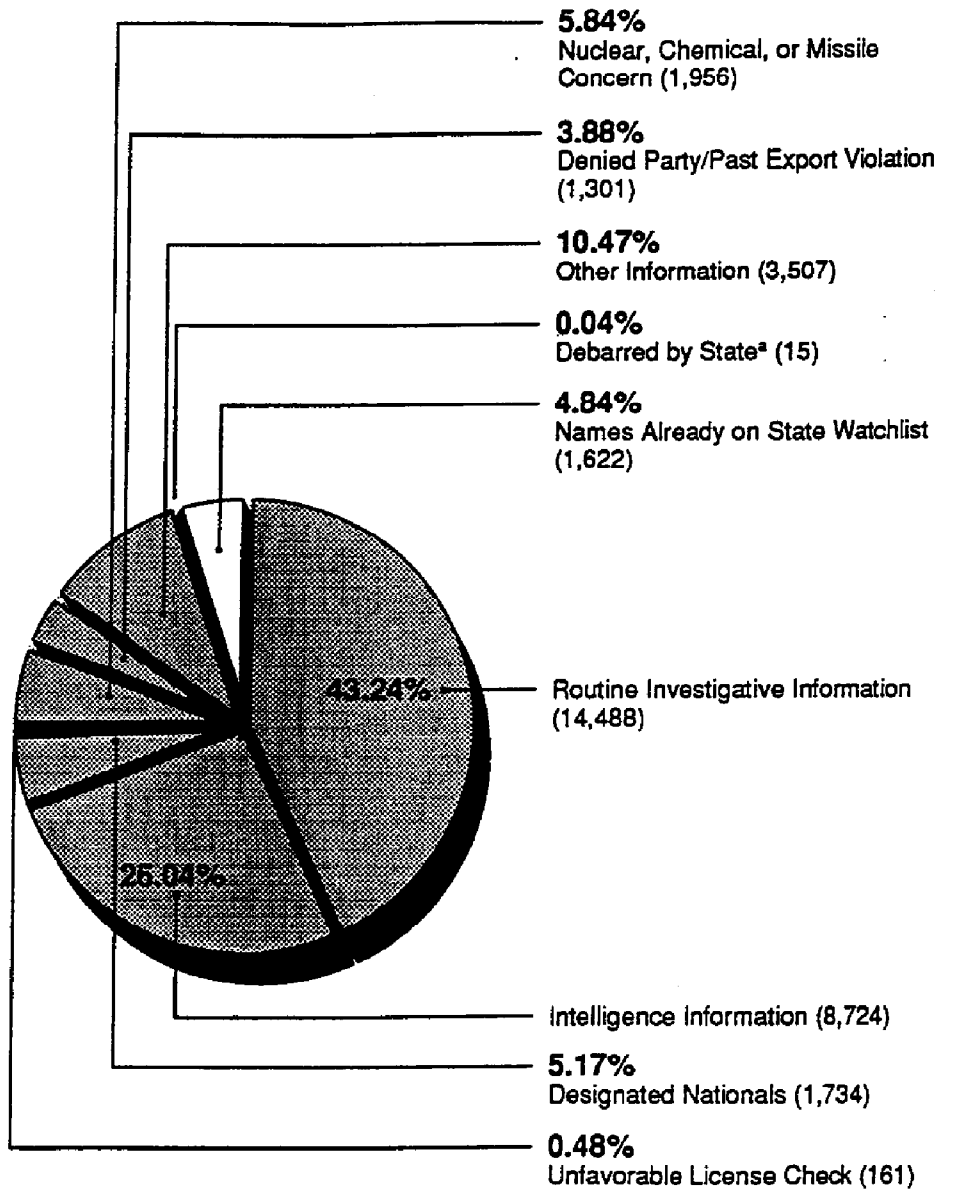
Note: Due to the proprietary nature of information, company names are not disclosed.



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
	Subtotal	851	776
State ^a	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
	Subtotal	83	71
	Totals	934	847

^aDue 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.

Figure IV.1: Commerce Watchlist Entries of Interest to State by Source of Information (as of Aug. 1993)

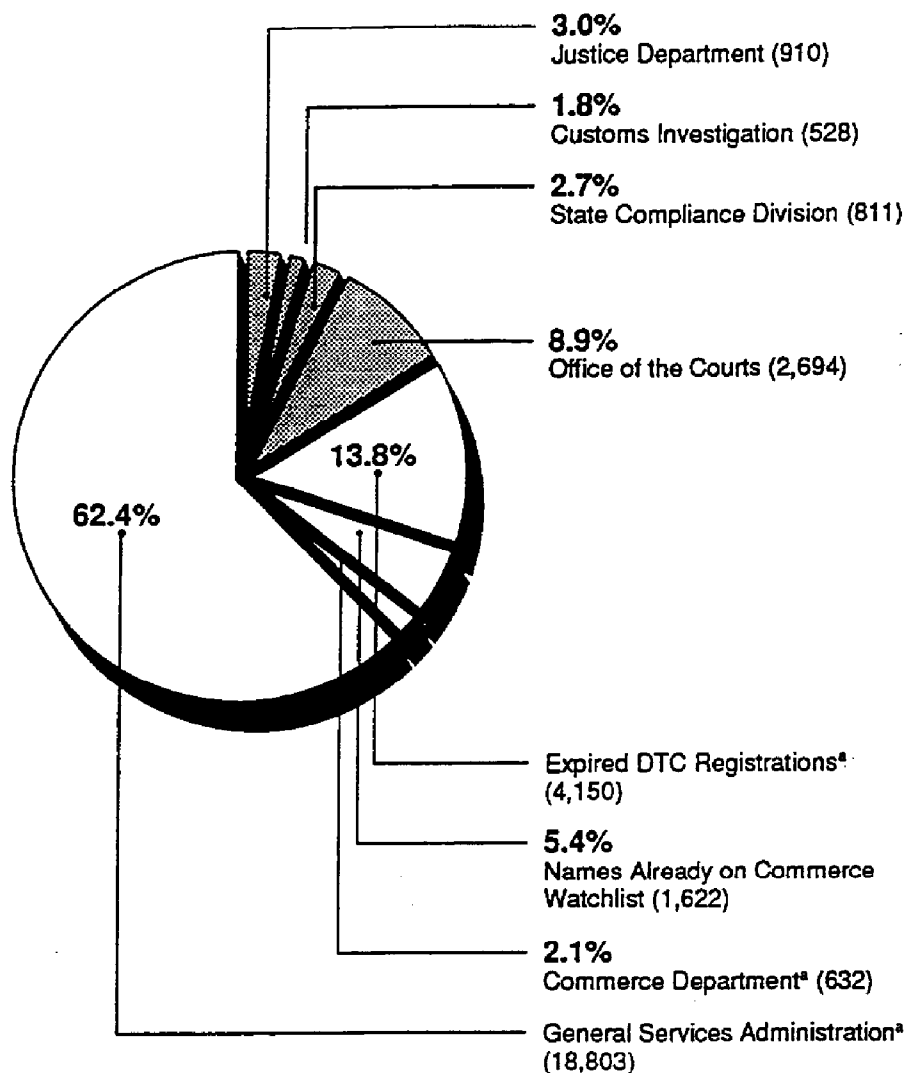




 Entries relevant to State
 Entries relevant to Commerce only

Note: These estimates are subject to the limitations cited in appendix V of our report.

*Since State is the source of this information, State would not benefit from receiving these watchlist entries from Commerce.

Figure IV.2: State Watchlist Entries of Interest to Commerce By Source of Information (as of Aug. 1993)

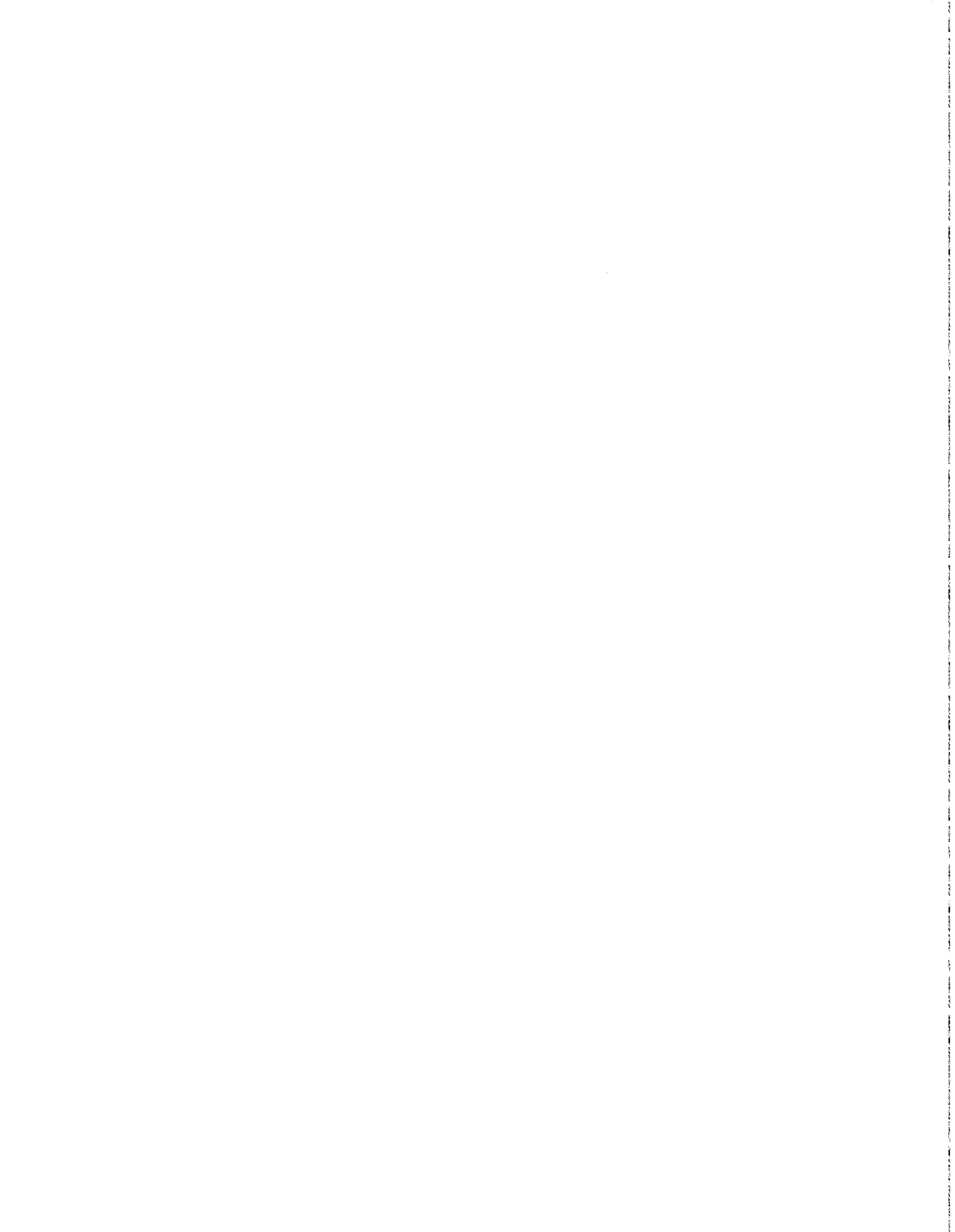


 Entries relevant to Commerce
 Entries relevant to State only

Note: These estimates are subject to the limitations cited in appendix V of our report.

*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.

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