Interagency Review of U.S. Export Controls for China

VOLUME I

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Prepared by the
Offices of Inspector General
of the
Department of Commerce
Department of Defense
Department of Energy
Department of Homeland Security
Department of State
Central Intelligence Agency

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PREFACE

We are providing this interagency report for your information and use. This review was conducted as a cooperative effort by the Offices of Inspector General in the Departments of Commerce, Defense, Energy, Homeland Security, State, and the Central Intelligence Agency.

Public Law 106-65, "National Defense Authorization Act for FY 2000," section 1402 requires that the Offices of Inspector General (OIGs) prepare an annual report for Congress through 2007 on the transfer of militarily sensitive technology to countries and entities of concern. The Act further requires that the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Directors of Central Intelligence and the Federal Bureau of Investigation,[1] conduct an annual review of the adequacy of export control policies and procedures in the U.S. Government.

An amendment to the National Defense Authorization Act for FY 2001 requires the Inspectors General to report on the status of recommendations made in prior annual reports. This year[2] the OIGs conducted an interagency review of U.S. export controls for the People's Republic of China.

This report discusses issues that affect more than one agency and includes separate appendixes containing the agency-specific reports. The report is in three volumes:

- Volume I contains the interagency findings and reports from the Departments of Commerce, Defense, Energy, and State OIGs.

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

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

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

This interagency report is required by Congress and will support Congress and the Administration in shaping the future of Federal export licensing policies and procedures related to the license process for exports destined for the People's Republic of China.

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

[2] This year's interagency report fulfills our annual statutory requirement for 2006.

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Report No. D-2007-050 **January 31, 2007**

Interagency Review of U.S. Export Controls for China

Executive Summary

Background

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

Of the 15,018 dual-use export license applications received by the Department of Commerce's Bureau of Industry and Security in FY 2004, 1,728 were for exports to China and 200 were for exports to Hong Kong. The State Department's Directorate of Defense Trade Controls received 73 munitions license applications for exports to China in FY 2004 and 85 license applications for exports to Hong Kong.

Objective

To satisfy the National Defense Authorization Act reporting requirement for this year,[4] the Inspectors General from the Departments of Commerce, Defense, Energy, Homeland Security, State, and the Central Intelligence Agency agreed to conduct a review of U.S. export controls for China. Our overall objective was to assess the effectiveness of the U.S. Government's export control policies and practices with respect to preventing the transfer of sensitive U.S. technologies and technical information to China.

Review Results

The interagency review identified areas needing improvement to promote a more effective system of controls over exports to China. Specifically, the Offices of Inspector General (OIGs) at Commerce, Defense, Energy, Homeland Security, State, and the Central Intelligence Agency reported the following results.

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

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

[3] Export Administration Act of 1979, as amended, sec. 3; 50 U.S.C. app. Sec. 2402(2). Although the act last expired on August 21, 2001, the President extended existing export regulations under Executive Order 13222, dated August 17, 2001, invoking emergency authority under the International Emergency Economic Powers Act.

[4] This year's interagency report fulfills our annual statutory requirement for 2006.

The Commerce OIG determined that the coordination between the various Federal export licensing agencies was adequate during the dispute resolution process for dual-use export license applications involving China. However, the Commerce OIG highlighted several concerns related to U.S.-China export control activities, including:

- export control regulations and policies related to China should be strengthened,
- Bureau of Industry and Security end-use check[5] programs in China and Hong Kong need to be improved, and
- Bureau of Industry and Security efforts to ensure compliance with license conditions could be enhanced.

In addition, the Commerce OIG reported that Commerce's National Institute of Standards and Technology and the National Oceanic and Atmospheric Administration both actively exchange scientific information and expertise under the 1979 U.S.-China Science and Technology agreement. The Commerce OIG found that these agencies appeared to be complying with or are in the process of complying with export control regulations during the exchange of information related to the agreement.

The Defense OIG found that its Department needed to document its analyses on export applications, insert documents into its automated system to support its analyses, and elevate decisions to the extent possible to produce a decision that supports national security. Within the Department of Homeland Security, the OIG determined that the relationship between export-related arrests and the export screening process was limited and did not allow a conclusion to be drawn on the effectiveness of Customs and Border Protection's screening process.

The State Department OIG found licensing policies and procedures on the commercial export of defense items were ineffective in some cases as shown by the results of the Department's own end-use monitoring program. At the Department of Energy, the OIG determined personnel were appropriately participating in the export license review process to control the export of critical technologies to China.

The CIA OIG reported that its agency provided the Department of Commerce generally timely reviews of dual-use commodity export license applications involving Chinese end users or intermediaries. However, the CIA was unable to fully meet Department of State requirements. CIA intelligence support to the Department of State is the subject of a recommendation in this year's CIA export controls audit report.

Followup on Previous Interagency Reviews

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

Recommendations and Management Comments

There are no interagency recommendations in this year's report; therefore, management comments are not required. The participating OIGs made recommendations specific to

[5] End-use checks help verify the legitimacy of dual-use export transactions.

their own agencies. Recommendations, management comments, and OIG responses are included in the separate reports that each office issued. They may be found in Appendix B (Commerce), Appendix C (Defense), Appendix D (Energy), Appendix E (State), and Appendix F (Homeland Security). Appendixes B, C, D, and E, are in Volume I and Appendix F is in Volume II. The recommendations on previous interagency reviews are in Volume II; and Appendixes H, I, and J contain the classified results of work completed by the Central Intelligence Agency and the Department of Commerce in Volume III.

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[1] FOUO – For Official Use Only

[2] NOFORN – No Foreign National

Introduction

Public Law 106-65, "National Defense Authorization Act for FY 2000," section 1402 requires that the Offices of Inspector General (OIG) provide an annual report to Congress through 2007 on the transfer of militarily sensitive technology to countries and entities of concern. The Act further requires that the Inspectors General of the Departments of Commerce, Defense, Energy, and State, in consultation with the Directors of Central Intelligence and the Federal Bureau of Investigation, conduct an annual review of the adequacy of export control policies and procedures in the U.S. Government.

To comply with the first-year requirement of the Act, the OIGs conducted agency-specific and interagency reviews of compliance with license requirements for releasing export-controlled technology to foreign nationals in the United States. Also, the OIGs reviewed Government actions to protect against the illicit transfer of U.S. technology through select intelligence, counterintelligence, foreign investment reporting, and enforcement activities.

Two interagency reports were issued to fulfill the first-year requirement of the Act: Report No. D-2000-109, "Interagency Review of the Export Licensing Process for Foreign National Visitors," issued on March 24, 2000, and Report No. 00-OIR-05, "(U) Measures to Protect Against the Illicit Transfer of Sensitive Technology," issued on March 27, 2000.

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

To meet the third-year requirement of the Act, the OIGs conducted an interagency review of the Federal automation programs that support the export licensing and enforcement process. That interagency report, D-2002-074, "Interagency Review of Federal Automated Export Licensing Systems," was issued in March 2002.

To meet the fourth-year requirement of the Act, the OIGs conducted an interagency review of U.S. Government actions to enforce export controls and prevent or detect the illegal transfer of militarily sensitive technology to countries and entities of concern. That interagency report, Report No. D-2003-069, "Interagency Review of Federal Export Enforcement Efforts," was issued in April 2003.

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

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

That interagency report, Report No. D-2004-062, "Interagency Review of Foreign National Access to Export-Controlled Technology in the United States," was issued in April 2004.

To meet the sixth-year requirement of the Act, the OIGs conducted an interagency review to assess whether the current export licensing process could help deter the proliferation of chemical and biological commodities. An interagency report, Report No. D-2005-043, "Interagency Review of the Export Licensing Process for Chemical and Biological Commodities," was issued on June 10, 2005.

This year[1] the OIGs conducted an interagency review of U.S. controls over exports to China.

Background

The United States controls the export of commodities and technologies for national security, foreign policy, antiterrorism, and nonproliferation reasons, under the authority of several laws. The primary legislative authority for controlling the export of goods and technologies with both commercial and military applications is the Export Administration Act of 1979.[2] The export of Defense munitions is controlled under authority of the Arms Export Control Act of 1976.

China's Military Modernization Strategy and Acquisition of Foreign Technologies. The Chinese government has made public statements and DoD issued a 2005 study demonstrating that China seeks to modernize its military through an aggressive program of domestic industrial reform and acquisition of key weapons and technologies from foreign sources.[3]

Specifically, China's so-called "grand strategy" includes three main modernization and technology acquisition components: (1) "selective

Technologies Sought by China

- Information Technology
- Microelectronics
- Nanotechnology
- Space Systems
- Innovative Materials
- Propulsion Systems
- Missile Systems
- Computer-aided Manufacturing and Design

Source: U.S. Department of Defense

[1] This year's interagency report fulfills our annual statutory requirement for 2006.

[2] Export Administration Act of 1979, as amended, sec. 3; 50 U.S.C. app. Sec. 2402(2). Although the act last expired on August 21, 2001, the President extended existing export regulations under Executive Order 13222, dated August 17, 2001, invoking emergency authority under the International Emergency Economic Powers Act.

[3] U.S. Department of Defense, Office of the Secretary, "The Military Power of the People's Republic of China," Washington, DC: U.S. Department of Defense, 2005; Keith Crane, Roger Cliff, Evan Medeiros, James Mulvenon, and William Overholt, "Modernizing China's Military: Opportunities and Constraints," MG-260. Santa Monica, CA: RAND Corporation, 2005.

modernization" of its existing strengths in electronics, missile-related technologies, and precision-strike weapons; (2) "civil-military integration" aimed at reforming China's defense industries; and (3) acquisition of advanced foreign technologies that can be used to enhance China's military capabilities.

To achieve its military modernization plan, the Chinese government employed its "Three-Ways Policy," which includes: (1) technology acquisition from foreign sources, (2) joint development with foreign entities, and (3) domestic research and development. As indicated in the Chinese government's outline for the "Tenth Five-Year Plan for National Economic and Social Development (2001-2005)," China continues to seek a number of high technologies (see box on page 2).

U.S. Export Controls for China. The U.S. Government's continuing concerns over China's human rights violations and the threat of proliferation of weapons of mass destruction support continuing economic sanctions towards China, even as U.S.-China economic relations continue to deepen. The Tiananmen Square sanctions are one of the prime sources of U.S. export controls toward China.[4] These sanctions were established following the Chinese government's response to the demonstrations at Tiananmen Square in 1989. The Tiananmen sanctions most pertinent sections include: (1) the prohibition of U.S. arms exports to China, (2) restrictions on certain dual-use exports, and (3) U.S. export and licensing restrictions on Chinese entities engaged in proliferation of missiles and/or weapons of mass destruction.

U.S. Export Control Policies and Practices for Hong Kong. China and the United Kingdom agreed to the terms of Hong Kong's transfer from the United Kingdom back to China in a 1984 Joint Declaration. The declaration calls for Hong Kong to be a Special Administrative Region of China that "will enjoy a high degree of autonomy" except for defense and foreign affairs. Hong Kong is to remain a separate territory and retain its status as a free port for 50 years.

The United States-Hong Kong Policy Act of 1992 states that the U.S. Government will continue to treat Hong Kong as a separate territory with respect to economic and trade matters. Also, the Act stated that the U.S. Government will support Hong Kong's continued access to sensitive technologies if those technologies are protected. Therefore, the U.S. export control policy for Hong Kong is less restrictive than the policy for China. The U.S. Government applies different licensing policies and standards to Hong Kong than it does to China, reportedly because of Hong Kong's ability to maintain an effective export control system and the U.S. concerns over China's proliferation and military activities.

Thus, Hong Kong receives preferential licensing treatment. For example, exporters do not need to submit license applications to obtain U.S. Government approval for exports to Hong Kong for many dual-use items, such as certain types of ball bearings and optical sensors. However, those items require a license for export to China. Further, the United States generally approves export applications even when an export license to Hong Kong is required.

[4] Section 902 of the Foreign Relations Authorization Act, FYs 1990 and 1991 (P.L. 101-246; 22 U.S.C. 2151 note).

China Dual-Use Export License Application Trends. From FYs 2001 through 2005, applications for dual-use export licenses to China increased from 1,313 to 1,722, an increase of 31.2 percent. During FY 2005, 1,058 of the 1,722 applications (61.4 percent) were approved, 26 (2.5 percent) were denied, and 332 (19.3 percent) were returned to the exporter without action.

Applications for Exporting Munitions to China. The State Department's Directorate of Defense Trade Controls received 73 license applications for exports to the People's Republic of China in FY 2004 and 85 license applications for exports to Hong Kong. The State Department approved 10 and denied 63 of the 73 applications for the People's Republic of China. Hong Kong received licenses for 46 of the 85 applications.

Responsibilities of Federal Departments for Processing Export License Applications

Commerce. The Department of Commerce's Bureau of Industry and Security (BIS) administers the Export Administration Regulations by developing export control policies, issuing export licenses, and enforcing the laws and regulations for dual-use exports. After BIS conducts its initial review, the license application is referred to the Defense, Energy, and State departments, unless those agencies have delegated their decision-making authority to the Department of Commerce. If the application involves an item controlled for reasons relating to the protection of encryption technologies, Commerce also refers it to the Justice Department. In addition, as of November 2003, BIS requires its licensing officers to forward all China export license applications to the Central Intelligence Agency's Center for Weapons Intelligence, Nonproliferation, and Arms Control (WINPAC) for an end-user review.

Central Intelligence Agency. The CIA provides intelligence support to the Department of Commerce on dual-use license applications and to the Department of State on munitions license applications. CIA analysts review comprehensive intelligence records to provide information to these agencies that will assist them with making decisions to approve or deny licenses.

During FY 2004, the Department of Commerce's BIS submitted license applications to WINPAC, some of which were for exports to China. In addition to providing intelligence support to BIS, WINPAC analysts and experts are also actively involved in export licensing advisory and oversight groups.

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

control policies and procedures that are necessary to protect U.S. national security interests.

Energy. The Energy Department's Office of International Regimes and Agreements reviews license applications and recommends approval, approval with conditions, or denial of licenses. Energy reviews licenses involving nuclear, chemical, biological, and missile dual-use and munitions commodities or technology referred to it by the Commerce and State departments.

State. Under the Arms Export Control Act, the State Department's Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (PM/DDTC) administers the International Traffic in Arms Regulations (ITAR). The Bureau of Political-Military Affairs administers the ITAR by:

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

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

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

Objective

Our overall objective was to assess the effectiveness of the U.S. Government's export control policies and practices with respect to preventing the transfer of sensitive U.S. technologies and technical information to China.

Effectiveness of Controls Over Exports to China

The interagency review identified agency-specific areas needing improvement to promote a more effective system of controls over exports to China. However, this

year's interagency report contains no findings or recommendations. Therefore, management comments are not required.

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

Appendix A. Scope and Methodology

Interagency Scope

The interagency review assessed the effectiveness of the U.S. Government's export control policies and practices for preventing the unauthorized transfer of sensitive U.S. technologies and technical information to China. Specifically, we examined whether current licensing and enforcement practices and procedures were consistent with relevant laws and regulations, as well as established national security and foreign policy objectives.

In addition, we assessed the effectiveness of coordination among the various Federal agencies during the dispute resolution process for export license applications involving China. The participating review teams were from the Departments of Commerce, Defense, Energy, State, Homeland Security, and the Central Intelligence Agency.

Interagency Methodology

To coordinate the review issues related to the export licensing process for exports to China and determine the work to be performed by each OIG team, the six OIGs participated in an interagency working group and held monthly meetings while conducting agency-specific reviews.

Interagency working group members also attended meetings sponsored by the Department of Commerce's Operating Committee and its Advisory Committee on Export Policy. In addition, interagency working group members attended an Air Force-sponsored briefing on its multi-agency China program.

This report summarizes the work completed by the six interagency working group members. The four unclassified OIG reports are contained in Volume I, a For Official Use Only report is in Volume II, and a SECRET//NOFORN report and appendixes from the Central Intelligence Agency OIG and the Commerce OIG reports, respectively, are in Volume III. The interagency review was performed between May 2005 and October 2006.

Appendix B. Department of Commerce Report

U.S. DEPARTMENT OF COMMERCE
Office of Inspector General

BUREAU OF INDUSTRY AND SECURITY

U.S. Dual-Use Export Controls for China Need to Be Strengthened

Final Report No. IPE-17500/March 2006

PUBLIC RELEASE

Office of Inspections and Program Evaluations

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

March 30, 2006

MEMORANDUM FOR: David H. McCormick
Under Secretary for Industry and Security

FROM: Johnnie E. Frazier

SUBJECT: Final Report: *U.S. Dual-Use Export Controls for China Need to be Strengthened* (IPE-17500)

As a follow-up to our March 9, 2006, draft report, attached is our final report on dual-use export controls for China, the seventh report required by the National Defense Authorization Act for Fiscal Year 2000, as amended. As you know, the act mandates that we issue a report to the Congress on the policies and procedures of the U.S. government with respect to the export of technologies and technical information to countries and entities of concern by March 30 of each year through 2007. This year's report focuses on U.S. export controls for the People's Republic of China (China).

While our review found that coordination between the various federal export licensing agencies was adequate during the dispute resolution process for export license applications involving China, we identified a number of areas of concern related to U.S.-China export control activities. We offer a number of specific recommendations on page 42 that we believe will help strengthen these activities, if implemented. This report contains two classified appendices that have been provided under separate cover. Appendix C discusses end-use checks in China and is classified CONFIDENTIAL. Appendix D is classified SECRET/NOFORN and highlights concerns with the sharing and utilization of intelligence information within BIS' Export Enforcement.

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

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

Attachment

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**Appendices C and D are available separately from the Office of Inspector General*

EXECUTIVE SUMMARY

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

The United States controls the export of sensitive goods and technologies for national security, foreign policy, and nonproliferation reasons under the authority of several different laws. The primary legislative authority is the Export Administration Act of 1979.[1] Under the Act, the Commerce Department's Bureau of Industry and Security (BIS) administers the Export Administration Regulations (EAR) by developing export control policies, issuing export licenses, and enforcing the laws and regulations for dual-use exports.

Serious concerns exist over the People's Republic of China's (China's) weapons of mass destruction proliferation record, the adequacy of its export control policies, and its efforts to obtain sensitive technologies to advance its military capabilities. A critical question is the U.S. government's capacity to implement effective controls over U.S. exports to China. In addition, while current U.S. policy[2] supports the Hong Kong Special Administrative Region's (Hong Kong) high degree of autonomy established under the Joint Declaration signed by the United Kingdom and China in 1984 and the Basic Law promulgated by China in 1990, the U.S. government has been tasked with monitoring Hong Kong's ability to maintain an effective and transparent export control regime.

Between FYs 2001 and 2005, the number of China export license applications received by BIS increased approximately 31 percent. Of the 17,129 total export license applications received by BIS in FY 2005, 1,772 (approximately 10 percent) were for exports to China. Some U.S. high technology industries cite export controls as significant barriers to (1) reducing the $193.9 billion U.S. trade deficit with China in FY 2005 and (2) increasing legitimate U.S. exports to China, which totaled $38.9 billion. That same fiscal year, the value of approved exports to China requiring export licenses totaled $2.4 billion (approximately 6.2 percent of total U.S. exports to China), while the value of denied export licenses equaled $12.5 million (less than 1 percent). The value of applications returned without action totaled $587.4 million.[3]

To satisfy the FY 2006 NDAA reporting requirement, the Inspectors General from the Departments of Commerce, Defense, Energy, Homeland Security, and State, and the Central

[1] Although the act last expired on August 21, 2001, the President extended existing export regulations under Executive Order 13222, dated August 17, 2001, invoking emergency authority under the International Emergency Economic Powers Act.
[2] The United States-Hong Kong Policy Act of 1992, as amended, establishes the authority of the U.S. government to treat Hong Kong as a non-sovereign entity distinct from China for the purposes of U.S. domestic law based on the principles of the 1984 Sino-British Joint Declaration.
[3] It should also be noted that the existence of U.S. export control regulations towards China might have a discouraging effect on potential U.S. exports to China that may lead U.S. companies to not apply for export licenses.

Intelligence Agency agreed to conduct a review of U.S. export controls for China.[4] Within Commerce, we sought to evaluate (1) the consistency of BIS' export control policies, practices, and procedures regarding China with relevant laws and regulations; (2) the effectiveness of coordination among federal agencies during the dispute resolution process for export license applications involving China; (3) the potential for diversion of sensitive commodities from Hong Kong to China; (4) the effectiveness of BIS' end-use check program in China and Hong Kong; and (5) what activities Commerce bureaus are engaged in pursuant to the 1979 U.S. and China Science and Technology Agreement and, to the extent practicable, whether they are adhering to export control regulations.[5]

While our review found that the coordination between the various federal export licensing agencies was adequate during the dispute resolution process for export license applications involving China, we identified a number of areas of concern related to U.S.-China export control activities. Our specific observations are as follows:

Export Control Regulations and Policies Related to China Should Be Strengthened. There is no regulatory basis to deny an export license application solely on the basis of military end use if the item is not controlled for "national security" reasons. As a result, military end users in China may be receiving sensitive U.S. commodities that can be used in the development of conventional weapons. During the course of our review, we identified two China export license applications that the U.S. government was unable to deny despite significant concerns over the risk of diversion to unauthorized end users or end uses.

In addition, we found that BIS' public statements about its export control policy for China are inconsistent with the EAR. Specifically, while the EAR states, "[i]tems may be approved even though they may contribute to Chinese military development or the end-user or end-use is military," BIS officials have repeatedly stated that BIS does not approve export licenses to military end users in China. This inconsistency results in a lack of transparency to exporters and may cause difficulties in implementation and application of export controls within the interagency export licensing community (see page 17).

BIS' End-Use Check Programs in China and Hong Kong Need to Be Improved. End-use checks, an important part of the license review and enforcement process, verify the legitimacy of dual-use export transactions controlled by BIS. A pre-license check (PLC) is used to validate information on export license applications by determining if an overseas person or firm is a suitable party to a transaction involving controlled U.S.-origin goods or technical data. Post shipment verifications (PSVs) strengthen assurances that exporters, shippers, consignees, and

[4] Although not mandated by the NDAA for FY 2000, the Department of Homeland Security Office of Inspector General participated in this year's review.

[5] The NDAA for FY 2003 [Public Law 106-398, Section 1207(d)(2)(F)] requires the Commerce Office of Inspector General to assess the extent to which programs and activities conducted under the *Agreement Between the Government of the United States of America and the Government of the People's Republic of China on Cooperation in Science and Technology*, signed in Washington, DC on January 31, 1979, as amended and extended (hereafter referred to as the S&T Agreement) are carried out in compliance with export control laws and regulations, especially those governing deemed exports. The term "deemed export" derives from Section 734.2(b)(2)(ii) of the EAR, which states "any release of technology or source code subject to the EAR to a foreign national… is deemed to be an export to the home country or countries of the foreign national."

end users comply with the terms of export licenses, by determining whether goods exported from the U.S. were actually received by the party named on the license and are being used in accordance with the license provisions. BIS Export Control Officers (ECOs) conduct end-use checks in China and Hong Kong.

While the reluctance of the Chinese government to allow requested end-use checks has often precluded the U. S. government from performing many checks, agreement to the *End Use Visit Understanding* (EUVU) by both countries in April 2004 afforded BIS the ability to conduct end-use checks on a wider spectrum of licensed goods and technologies in China. Nonetheless, the Chinese government has periodically slowed end-use visit cooperation since agreement to the EUVU. In addition, a number of the terms for conducting end-use checks outlined in the agreement are somewhat restrictive. Furthermore, we found that neither PLCs nor PSVs were being performed within prescribed time limits. We present our specific concerns on this issue in a classified appendix to this report (see Appendix C, classified CONFIDENTIAL).

Based on our review of BIS' Hong Kong end-use check program, we determined that BIS is not aggressively enough monitoring potential diversions of export-controlled items from Hong Kong to China. Specifically, BIS' policy at the time of our review sought to have at least two PSVs a week once the ECO arrived at post in March 2004. However, there were only 68 end-use checks (including 50 PLCs and 18 PSVs) conducted in FY 2005. We learned that BIS recently decreased the number of end-use checks required in Hong Kong from a minimum of 104 to 50 in FY 2006. Given the relative ease of conducting end-use checks in Hong Kong compared to China (due the size of the territory and the lack of host government restrictions on conducting such checks), it seems reasonable that more end-use checks can be done.

In addition, BIS was not adequately targeting PSVs for shipments that can be exported to Hong Kong without a license but would require a license to China. Specifically, BIS initiated seven PSVs involving such transactions. However, four shipments were covered by a license exception and were eligible for re-export from Hong Kong to China without a license. As a result, these particular PSVs were an inefficient use of ECO resources. We identified two main reasons for the poor targeting of "no license required" shipments to Hong Kong, including (1) inadequate upfront research by the Office of Enforcement Analysis (OEA) and (2) inadequate intelligence sharing between the Office of Export Enforcement and OEA.

Finally, we noted that BIS does not have a formal staffing plan in place to help ensure continuity in its assignments of ECOs in Hong Kong and China. Specifically, there is currently no pool of talent within BIS (e.g., a law enforcement agent with Mandarin Chinese language skills) from which to draw replacement ECOs. Moreover, the ECO in Hong Kong is scheduled to depart post in May 2006 (after recently extending his assignment) and the term of the current ECO in China expires in December 2006. BIS recently informed us that it has selected a candidate for the Hong Kong position, but he is not expected to arrive at post until July 2006 since he will have to obtain basic law enforcement training (see page 23).

BIS' Efforts to Ensure Compliance with License Conditions Could Be Enhanced. The ability to place conditions on a license is an important part of the license resolution process, as well as an additional mechanism to monitor certain shipments. Of the 55 standard license

conditions, six require the licensee to submit export documentation to BIS regarding the shipment of a controlled commodity. A seventh condition, referred to as "Write Your Own" (WYO), allows licensing officers to formulate unique requirements, which may also include reporting requirements. Export Administration is responsible for monitoring five of these conditions (including the WYO condition), and Export Enforcement the remaining two.

While BIS has a process to track whether or not exporters actually submit documentation pursuant to six of the seven license reporting conditions[6] provided the licenses are properly marked, it does not require licensing officers to actually review the documentation. As a result, we identified 11 China cases that required exporters to submit technical documentation pursuant to conditions uniquely formulated by the interagency licensing agencies that did not receive a technical review. Without a substantive, technical review of the documentation, BIS cannot determine whether the exporter (and/or end user) is complying with the intent of the license conditions.

In addition, we identified five China licenses that required a PSV but were not properly marked by the licensing officer with "Condition 14."[7] Instead the text of the PSV condition was recorded in the WYO condition despite a countersigning process meant to ensure that licenses applications are processed appropriately, including making sure that license conditions are accurately reflected on the license applications. As such, these licenses were not entered into Export Enforcement's tracking system, which is monitored by OEA. While the exporters submitted the required shipping documentation to BIS for three of the five licenses,[8] this information was not forwarded to OEA. Because of the time that elapsed between the date of shipment and OEA's actual receipt of the shipping documents after our inquiry, OEA was not able to initiate the PSV request per the terms of the April 2004 *End Use Visit Understanding*. As a result, BIS cannot determine whether the goods involved in these cases were diverted to unauthorized end users or end uses (see page 32).

NIST and NOAA Conduct Various Activities Pursuant to the 1979 Agreement with China on Science and Technology. In 1979, the governments of the United States and China entered into an agreement to promote cooperation in the field of science and technology. Under this agreement, individual U.S. government agencies may engage their Chinese counterparts in activities to promote the exchange of information and expertise in specific areas of science and technology. The Commerce Department's National Institute of Standards and Technology (NIST) and the National Oceanic and Atmospheric Administration (NOAA) both maintain active protocols under the agreement.[9]

[6] Licenses requiring exporters to submit post shipment reports on high-performance computer exports to certain countries are monitored separately from Export Enforcement's Conditions Follow-up Subsystem.
[7] When a licensing officer marks "Condition 14" on a license application, the license is automatically entered into Export Enforcement's Conditions Followup Subsystem and targeted for subsequent monitoring. Exporters are required to submit copies of Shipper's Export Declarations to OEA following the initial shipment, which then initiates a PSV.
[8] According to BIS, shipments had not yet been made against the remaining two licenses as of January 17, 2006.
[9] According to the Department of State, a total of six Cabinet-level Departments and four independent federal agencies maintained active protocols under this agreement as of April 2005.

Overall, we found that NIST appears to be complying with export control regulations with respect to activities undertaken pursuant to the 1979 S&T Agreement. Specifically, we inspected 12 of the 129 EAR-controlled items at the Gaithersburg, Maryland campus to determine whether Chinese national visitors could have access to the controlled technologies. We found that although long-term Chinese foreign national visitors were not always vetted for security purposes prior to gaining access to some rooms or laboratories that contained EAR-controlled items, those items were locally secured such that they were restricted from access. In addition, NIST reported that all short-term Chinese foreign national visitors are escorted by NIST personnel at all times and are not allowed to access EAR-controlled technology. Further, NIST has instituted a program to conduct an "upfront" review of its research activities to determine whether technology used and/or created by NIST researchers and their staff (including foreign guest researchers) is subject to U.S. export control laws.

During the course of our fieldwork at NOAA, we found that it was in the process of conducting an inventory of EAR-controlled items at its facilities where foreign nationals (including some Chinese foreign nationals) were present or that contained critical infrastructure. NOAA completed its initial inventories of EAR-controlled technology at these facilities in December 2005 and made a preliminary determination that no deemed export licenses were required. According to NOAA, on February 16, 2006, BIS provided favorable feedback regarding NOAA's inventories and assessment, including NOAA's conclusion that there are no instances where deemed export licenses are needed for any foreign nationals working in NOAA facilities. In addition, NOAA presentations and publications developed under science and technology activities appeared to contain publicly available information and, therefore, would not be subject to dual-use export controls. Finally, Commerce's Office of Security informed us that no Chinese foreign national visitor or guest researcher is given unescorted access into NOAA facilities until after the completion and adjudication of a background investigation. While it appears that Chinese foreign nationals did not have access to EAR-controlled technology, we did not verify the controls in place limiting foreign national access (see page 36).

We also found that employees from both NIST and NOAA who traveled to China [redacted] We present our findings on this issue in a separate memorandum report, [redacted] scheduled to be issued in March 2006.

This report contains two appendices that contain classified information. Appendix C, as noted above, discusses end-use checks in China and is classified CONFIDENTIAL. Appendix D is classified SECRET/NOFORN and highlights concerns with the sharing of intelligence information between Export Enforcement's Office of Export Enforcement and its Office of Enforcement Analysis that could be helpful in targeting end-use checks in Hong Kong.

[redacted]

On page 42, we list a summary of the recommendations we are making to address our concerns.

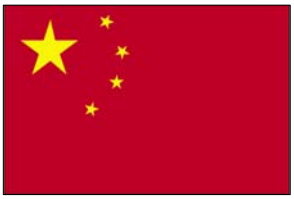
In its March 23, 2006, written response to our draft report, the Under Secretary for Industry and Security stated that BIS had taken or is in the process of taking steps to meet the report's recommendations. In addition, NOAA's written response to our draft report stated that it agrees with our overall findings and recognizes the continued need to heighten awareness within its research community to ensure compliance with the *Export Administration Regulations*. Where appropriate, we have made changes to the report and recommendations in response to both formal and informal comments from the two agencies. We discuss pertinent aspects of their responses in appropriate sections of the report. The complete responses from BIS and NOAA are included as appendixes to this report

BACKGROUND

The United States controls the export of dual-use items for national security, foreign policy, and nonproliferation reasons under the authority of several different laws. Dual-use items are goods and technologies determined to have both civilian and military uses. The primary legislative authority for controlling the export of dual-use commodities is the Export Administration Act (EAA) of 1979, as amended.[12]

Under the Act, the Department of Commerce's Bureau of Industry and Security (BIS) administers the Export Administration Regulations (EAR) by developing export control policies, issuing export licenses, and enforcing the laws and regulations for dual-use exports. In FY 2005, BIS had 361 full-time equivalent staff members and an appropriation of approximately $67.5 million. Its two operating units principally responsible for export controls are Export Administration and Export Enforcement.

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



China is a communist state with the world's largest population (approximately 1.3 billion) and one of the world's fastest growing economies. In the last 14 years, its economy has grown at an average rate of 10 percent; its gross domestic product (GDP) grew 9.5 percent in 2004 and the World Bank projected GDP growth of 9.3 percent in 2005. China has become the world's third largest trading nation behind the United States and Germany, and is an important trading partner of the United States. U.S. exports to China totaled $38.9 billion in FY 2005, making it the fifth largest export market for U.S. exports. However, Chinese imports to the United States in FY 2005 exceeded $232.9 billion.[13] The United States is also a significant investor in China, with its investment there growing from $2 billion in 1995 to $15 billion in 2004.[14]

China's export control system has been criticized in the past by many western nations for its insufficiency in controlling the exports of sensitive technologies and weapons to nations of global and regional security concerns. However, China has been trying to improve certain aspects of its export control system. For example, China is a signatory of the Nonproliferation Treaty, the Chemical Weapons Convention, the Biological Weapons Convention, and the Comprehensive Test Ban Treaty. Further, China became a member of the Nuclear Suppliers Group, a multilateral control regime for nuclear technologies, in 2004.[15]

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[12] Export Administration Act of 1979, as amended, sec. 3; 50 U.S.C app. sec. 2402(2). Although the Act expired on August 20, 2001, the Congress agreed to the President's request to extend existing export regulations under Executive Order 13222, dated August 17, 2001, thereby invoking emergency authority under the International Emergency Economic Powers Act.

[13] U.S. Census Bureau, Trade in Goods (Imports, Exports and Trade Balance) with China, available at www.census.gov/foreign-trade/balance/c5700.html, accessed January 18, 2006.

[14] U.S. Government Accountability Office. *China Trade: U.S. Exports, Investment, Affiliate Sales Rising, but Export Share Falling*, GAO-06-162, December 2005.

[15] China has submitted its application to join the Missile Technology Control Regime, but member states have been

China's Military Modernization Strategy and Acquisition of Foreign Technologies

Public statements by the Chinese government and a recent study by the U.S. Department of Defense support the understanding that China seeks to modernize its military through an aggressive program of domestic industrial reform and acquisition of key weapons and technologies from foreign sources that it currently lacks domestically.[16] Specifically, China's so-called "grand strategy" employs three main components: (1) "selective modernization" of its existing strengths in electronics and missile-related technologies to further develop its capabilities in command, control, communications, computers, intelligence, surveillance and reconnaissance (commonly referred to as C4ISR), and precision-strike weapons; (2) "civil-military integration" aimed at reforming China's defense industries; and (3) acquisition of advanced foreign technologies that can be used to enhance its military capabilities.[17]

Some Technologies Sought by China

- Information Technology
- Microelectronics
- Nanotechnology
- Space Systems
- Innovative Materials
- Propulsion Systems
- Missile Systems
- Computer-aided Manufacturing and Design

Source: U.S. Department of Defense

To achieve its military modernization plan, the Chinese government has employed its "Three-Ways Policy," which entails: (1) importation of foreign technologies, (2) joint development with foreign entities, and (3) domestic research and development.[18] As indicated in the Chinese government's outline for the *Tenth Five-Year Plan for National Economic and Social Development (2001-2005*), China still continues to seek a number of high technologies (see box above).[19]

U.S. Dual-Use Export Control Policies and Practice Toward China

The U.S. government's continuing concerns over China's human rights violations and the threat of proliferation of weapons of mass destruction have resulted in the maintenance of economic sanctions towards China even as U.S.-China economic relations continue to deepen. One of the prime sources of U.S. export controls toward China today are the Tiananmen Square sanctions,[20] which were enacted following the Chinese government's response to the demonstrations at

resisting China's admittance. In addition, China has begun participating in plenary sessions of the Wassenaar Arrangement—a multilateral control regime for conventional weapons and related dual-use technologies—at the urging of the United States, but is not a member.

[16] U.S. Department of Defense, Office of the Secretary, *The Military Power of the People's Republic of China*. Washington, DC: U.S. Department of Defense, 2005; Keith Crane, Roger Cliff, Evan Medeiros, James Mulvenon, and William Overholt, *Modernizing China's Military: Opportunities and Constraints*, MG-260. Santa Monica, CA: RAND Corporation, 2005.

[17] Keith Crane, *et al*, 154-157.

[18] U.S. Department of Defense Office of the Secretary, 23.

[19] Ibid.

[20] Section 902 of the Foreign Relations Authorization Act, FYs 1990 and 1991 (P.L. 101-246; 22 U.S.C. 2151 note).

Tiananmen Square in 1989. Some of the most pertinent sections include: (1) the prohibition of U.S. arms exports to China, (2) restrictions on certain U.S. exports of dual-use items (e.g., items controlled for crime control and regional stability), and (3) U.S. export and licensing restrictions on Chinese entities of concern that have been found to have engaged in proliferation of missiles and/or weapons of mass destruction.[21]

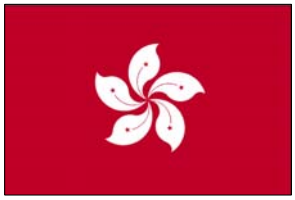
Further, the United States controls dual-use exports to China for reasons of national security, chemical and biological weapons proliferation, nuclear proliferation, missile technology, regional stability, and crime control. These controls are primarily derived from international multilateral export control regimes, and the lists of items controlled are mutually agreed upon between participating states. According to BIS, it generally practices a policy of denial for exports of dual-use items to Chinese military end users and other entities that have significant ties to the military.

Industry Concerns Over U.S. Dual-Use Export Controls for China

Despite recent increases in U.S. exports to China, the U.S. business community continues to have concerns about the U.S. government's dual-use export control policies toward China and their perceived impact. Some U.S. high technology industries cite export controls as significant barriers to reducing the $193.9 billion U.S. trade deficit with China in FY 2005 and increasing legitimate U.S. exports to China, which totaled $38.9 billion. That same fiscal year, the value of approved exports to China requiring export licenses totaled $2.4 billion (approximately 6.2 percent of total U.S. exports to China), while the value of denied export licenses equaled $12.5 million (less than 1 percent).[22] Applications returned without action totaled $587.4 million.

Nevertheless, it should be noted that certain sectors within the U.S. high-technology industry are impacted significantly more by dual-use export controls than others, as many companies in those sectors tend to develop and market specialized technologies and products that may be deemed sensitive for national security reasons and, thus, more strictly controlled. Further, the existence of U.S. export control regulations towards China can have a discouraging effect on potential U.S. exports to China that may lead to self-imposed restrictions by U.S. companies in order to avoid potentially lengthy license application processing times and license denials.

U.S. Export Control Policies and Practice Toward Hong Kong

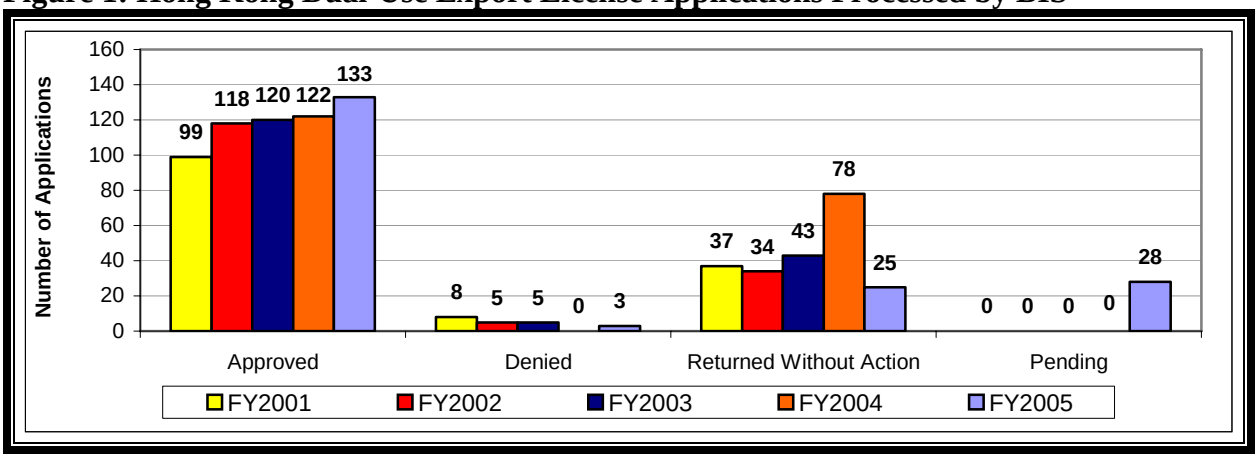


China and the United Kingdom agreed to the terms of Hong Kong's reversion from the United Kingdom back to China in their 1984 Joint Declaration. The declaration calls for Hong Kong to be a Special Administrative Region of China that "will enjoy a high degree of autonomy" except in the conduct of defense and foreign affairs. Under the "one country, two systems" formulation, Hong Kong is to remain a separate customs territory and retain its status as a free port for 50 years.

[21] Congressional Research Service, *China: Economic Sanctions*. Washington, DC: CRS, May 18, 2005: 1-2.
[22] Approval of a license does not necessarily mean that the export will occur within the same fiscal year or at all because licenses are valid for two years and many are not acted upon by the exporter for various reasons.

The United States-Hong Kong Policy Act of 1992 calls upon the U.S. government to continue to treat Hong Kong as a separate territory with respect to economic and trade matters and to support Hong Kong's continued access to sensitive technologies so long as such technologies are protected. Therefore, the current U.S. export control policy toward Hong Kong is less restrictive than that applied to China. Specifically, the U.S. government applies different licensing policies and standards to Hong Kong than it does to China, reportedly because of Hong Kong's ability to maintain an effective export control system and concerns over China's proliferation and military activities. Thus, Hong Kong receives preferential licensing treatment. For example, for many dual-use items (e.g., "composite structures" or laminates, certain types of ball bearings, and certain optical sensors), exporters do not need to submit license applications to obtain prior U.S. government approval for exports to Hong Kong, while those items would require a license for export to China. Further, approval is generally granted even when an export license to Hong Kong is required (see Figure 1).

Figure 1: Hong Kong Dual-Use Export License Applications Processed by BIS



Source: Export Administration, Bureau of Industry and Security

Dual-Use License Application Process for Exports to China

When BIS receives a license application, either manually or electronically, it is entered into the Export Control Automated Support System (ECASS).[23] ECASS screens all new applications to determine whether the listed parties (1) have registration numbers in ECASS or need numbers assigned and (2) raise concerns or Aflags@ that require the application to be referred to the Office of Export Enforcement (OEE).[24] Applications flagged by the system are simultaneously referred to OEE and the licensing officers (LOs) in Export Administration. Unflagged applications are referred only to the LOs for processing.

[23] ECASS is an unclassified system that processes and stores dual-use export licensing information for BIS.
[24] Generally, applications referred to OEE are those involving parties on BIS' watchlist, which lists parties identified as warranting increased scrutiny for export license purposes. OEE agents may also put flags on certain parties that they are interested in seeing, such as parties involved in an ongoing investigation.

According to Executive Order 12981,[25] BIS has nine days to conduct its initial review. During this review, the LO first verifies the export control classification number (ECCN) the applicant obtained from the Commerce Control List (CCL). The CCL lists commodities, software, and technology subject to the export licensing authority of BIS. Each ECCN contains a brief description of the item(s). Items that are subject to the EAR but not listed on the CCL are designated as AEAR99."[26]

After verifying the ECCN, the LO reviews the license requirements and license exceptions for that ECCN. The LO then (1) determines the reasonableness of the end use specified by the exporter, (2) documents the licensing history of the exporter, (3) documents the licensing history of the ultimate consignee or end user(s), (4) documents the reason(s) for not referring a license application to the other agencies (if applicable), and (5) provides a written recommendation on whether to approve or deny the application. After the LO's review is completed, the application is referred to the Departments of Defense, Energy, and State unless those licensing referral agencies have delegated their decision-making authority to Commerce.[27]

In addition, as of November 2003, BIS requires its LOs to forward all China export license applications to the Central Intelligence Agency's Weapons Intelligence, Nonproliferation, and Arms Control Center (WINPAC) for an end-user review. It should be noted that both agencies are currently working on a new protocol outlining the specific procedures for WINPAC's export license review process, including China applications.

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

Most export licenses for China are issued with conditions that require the exporter to abide by certain restrictions. The conditions are primarily used to control proliferation of the commodity by limiting the end-use or restricting access to the commodity to specific end users (see Chapter III for more discussion on license conditions).

Dispute Resolution Process for China Export License Applications

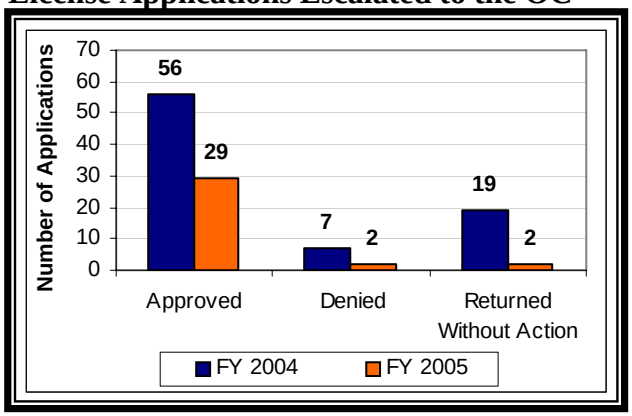
If there is disagreement on whether or not to approve a pending license application after the 30-day review period, the application is referred to a higher-level interagency working group called the Operating Committee (OC), which meets weekly. Under Executive Order 12981, the OC has

[25] Executive Order 12981, as amended—*Administration of Export Controls*, December 5, 1995.
[26] EAR99 essentially serves as a "basket" designation for items that are subject to the EAR but not listed on the CCL. EAR99 items can be shipped without a license to most destinations under most circumstances unless certain prohibitions apply (e.g., export to an embargoed destination). The majority of U.S. exports are EAR99 items.
[27] BIS refers licenses to the Department of Justice only when the item is controlled for reasons relating to the protection of encryption technologies.

representatives from the Departments of Commerce, Defense, Energy, and State. Non-voting members of the OC include appropriate representatives of the CIA and the Joint Chiefs of Staff. The Secretary of Commerce appoints the OC chairman who considers the recommendations of the referral agencies before making a decision. While the OC Chair has the authority to decide most cases at this level without having to reflect the recommendations of the majority of the participating agencies, we found that the OC Chair's decisions for China cases were generally based on interagency consensus.[28]

The number of China export license applications escalated to the OC dropped significantly between FYs 2004 and 2005 (see Figure 2 for a breakdown of the determinations for these licenses).

Figure 2: Determinations for China Export License Applications Escalated to the OC



Source: Bureau of Industry and Security

Within five days of the OC chair's decision, a licensing referral agency may appeal or escalate the decision to the Advisory Committee on Export Policy (ACEP). The ACEP meets monthly if there are applications to decide. It is chaired by the Commerce Assistant Secretary for Export Administration, and includes Assistant Secretary-level representatives from the Departments of Defense, Energy, and State. The ACEP also includes non-voting representatives from the CIA and the Joint Chiefs of Staff. The ACEP's decision is based on a majority vote. Of the 13 China export license applications escalated to the ACEP in FY 2004, 10 were approved and 3 were returned without action.[29] In FY 2005, only three China export license application were escalated to the ACEP, 2 were approved, and one was denied.

Within five days of an ACEP decision, any dissenting agency may appeal the majority decision to the Export Administration Review Board (EARB). The Secretary of Commerce chairs the EARB, and its members include the Secretaries of Defense, Energy, and State. The Chairman of the Joint Chiefs of Staff and the Director of Central Intelligence are non-voting members of the EARB. The EARB=s decision is based on a majority vote. Finally, within five days of the EARB decision, any dissenting agency may make a final appeal to the President. No export license applications for China were escalated to the EARB in FYs 2004 or 2005.

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

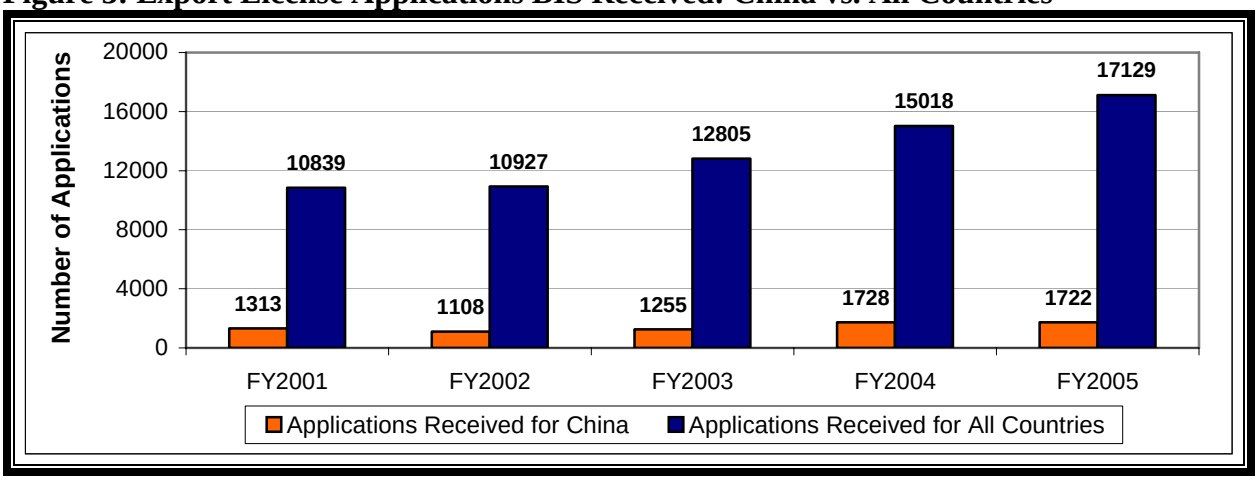
[29] According to the EAR, applications are typically "returned without action" by BIS for the following reasons: (1) the applicant has requested it, (2) a BIS export license is not required, (3) BIS has not received adequate information regarding the transaction, or (4) BIS is unable to contact the exporter to obtain additional information.

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

China Export License Application Trends

During FYs 2001 through 2005, the number of dual-use export license applications for China increased approximately 31 percent from 1,313 to 1,722. The total number of all export license applications (including deemed export license applications)[30] BIS received increased roughly 58 percent from 10,839 to 17,129 during the same period (see Figure 3).

Figure 3: Export License Applications BIS Received: China vs. All Countries

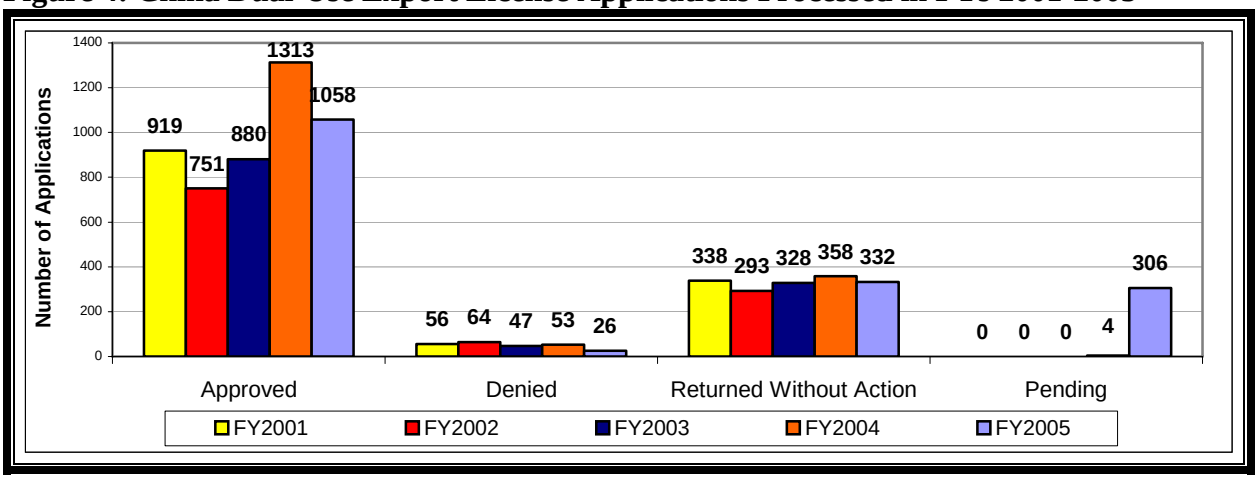


Source: Export Administration, Bureau of Industry and Security

Of the 17,129 export license applications BIS received during FY 2005, 1,722 (approximately 10.1 percent) were for exports to China. Of that number, 1,058 (approximately 61.4 percent) were approved, 26 (roughly 2.5 percent) were denied, and 332 (about 19.3 percent) were returned without action (see Figure 4 for a breakdown of BIS' determinations for these licenses).

[30] The total number of deemed export license applications for China has decreased over the past several years. Specifically, approximately 53 percent of all China export license applications was for deemed exports in FY 2001 compared to 18 percent in FY 2005.

Figure 4: China Dual-Use Export License Applications Processed in FYs 2001-2005[31]



Source: Export Administration, Bureau of Industry and Security

Trends in Technologies Sought by China Through Export Licensing Process

Most of the export license applications to China in FYs 2004 and 2005 involved technologies categorized under electronics, materials processing, computers, and telecommunications and information security (see Table 1 for a full listing of the number of export license applications BIS received for each CCL category). According to BIS, a significant part of these applications was for deemed exports.

Table 1: BIS License Applications for China by CCL Category, FYs 2004-2005

CCL Category	Description of Category	Applications* Received in FY2004	Applications* Received in FY2005
0	Nuclear Materials, Facilities, and Equipment	11	12
1	Materials, Chemicals, "Microorganisms," and Toxins	160	190
2	Materials Processing	503	520
3	Electronics	530	673
4	Computers	155	303
5	Telecommunications and Information Security	421	529
6	Lasers and Sensors	78	55
7	Navigation and Avionics	22	37
8	Marine	7	4
9	Propulsion Systems, Space Vehicles, and Related Equipment	13	32
EAR99	Classification used for items subject to the EAR but not on the CCL	97	139

***Note:** Because applications may contain a request to export more than one technology, the number of applications in this column does not equal the total number of China export applications BIS received during FYs 2004 and 2005.

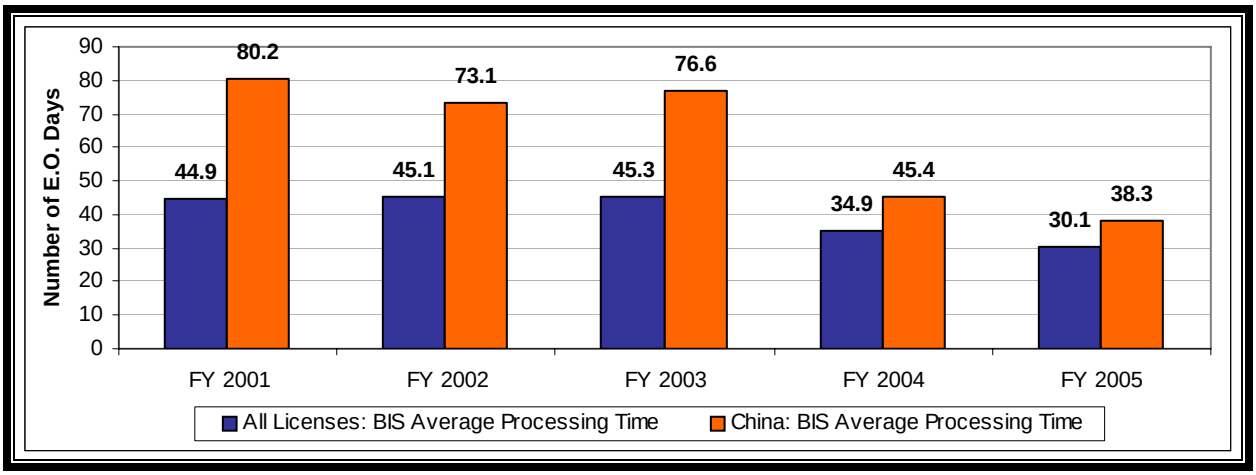
Source: Export Administration, Bureau of Industry and Security

[31] As of November 2005, 4 and 306 export license applications to China received by BIS in FY 2004 and FY 2005, respectively, remained *pending* and have not been *processed*. These include applications for deemed exports.

Export License Application Processing Times

According to BIS, average processing times for license applications involving China have fallen by almost 53 percent from 80.2 days in FY 2001 to 38.3 days in FY 2005 (see Figure 5 for BIS' average processing times in "Executive Order"[32] days for export license applications to China versus all countries).

Figure 5: BIS Average Processing Times in Executive Order Days: All Countries vs. China, FYs 2001-2005



Source: Export Administration, Bureau of Industry and Security

End-Use Checks in China and Hong Kong

End-use checks are an important part of the export licensing process that help determine whether the end users or intermediary consignees are suitable recipients of sensitive U.S. items and technology and would likely comply with applicable license conditions. End-use checks consist of pre-license checks (PLCs) and post shipment verifications (PSVs) and may be requested by any of the executive agencies involved in the interagency licensing process.[33] A PLC is conducted to establish the *bona fides* of a foreign entity involved in the export transaction while the license application is being reviewed. A PSV is conducted on a foreign entity after the license has been approved and the item has been shipped to help determine whether the licensed item(s) is being used in accordance with the license conditions.

End-use checks in China and Hong Kong are currently conducted by Export Control Officers (ECOs), one each based in Beijing and Hong Kong. ECOs are BIS export enforcement agents who hold the rank of commercial officer in the Commercial Section of U.S. embassies and

[32] Executive Order (EO) 12981 prescribes processing times and does not take into account the number of days an application is put on "hold without action". Thus, the term refers to the actual processing time in the license review and referral process, beginning with the day an export license application is received by BIS pursuant to the terms of Executive Order 12981.
[33] Pursuant to Executive Order 12981, these agencies are Commerce, Defense, Energy, and State.

consulates.[34] ECOs handle various in-country export control activities, including conducting end-use checks.

End-Use Check Trends in China

BIS end-use checks conducted in China have increased significantly since FY 2003 (see Figure 6). There are four main categories of end-use check results:

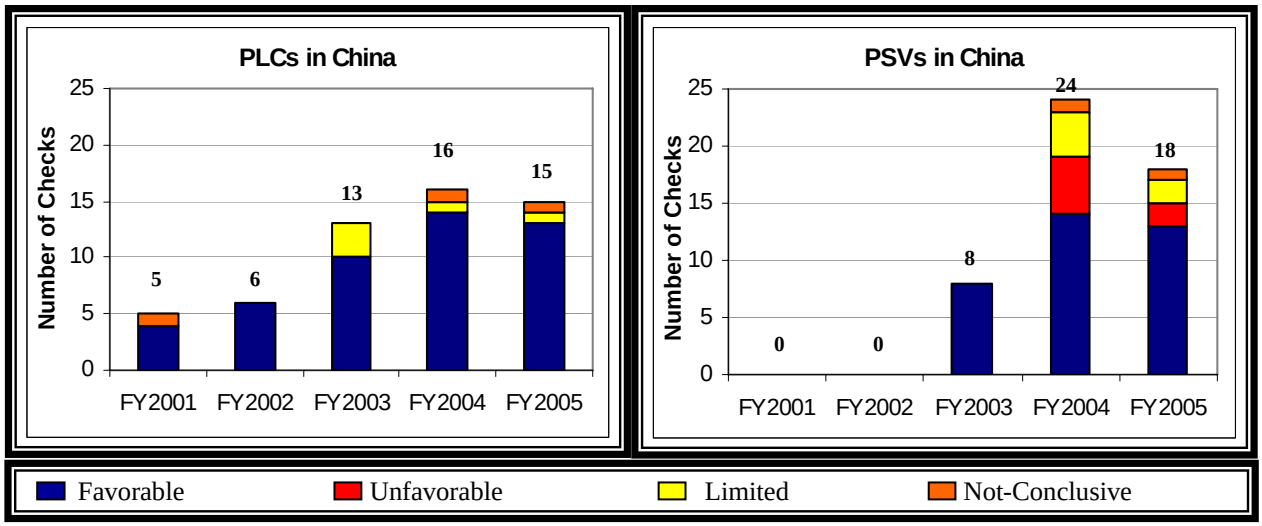
- **Favorable:** at the time the party of the transaction in question was visited, it appeared to be either a suitable recipient (for PLCs) or a reliable recipient (for PSVs) of the licensed commodities.

- **Unfavorable:** the subject of the transaction violated one or more license terms or conditions; or the subject refused to meet with the designated U.S. government personnel and allow the end-use check to be completed.

- **Limited:** the end-use check was conducted but was not completed consistent with all requirements stipulated in BIS' end-use check guidance. For a PSV, this could apply to situations where the bona fides of the end user and end use were verified, but certain license conditions were violated (e.g. intermediary was not supposed to take possession of the item but did).

- **Not-conclusive:** the end-use check was conducted but was not completed (e.g., a PSV was conducted but the stated end use could not be verified because the item was not in use yet).

Figure 6: PLCs and PSVs Conducted in China in FYs 2001-2005



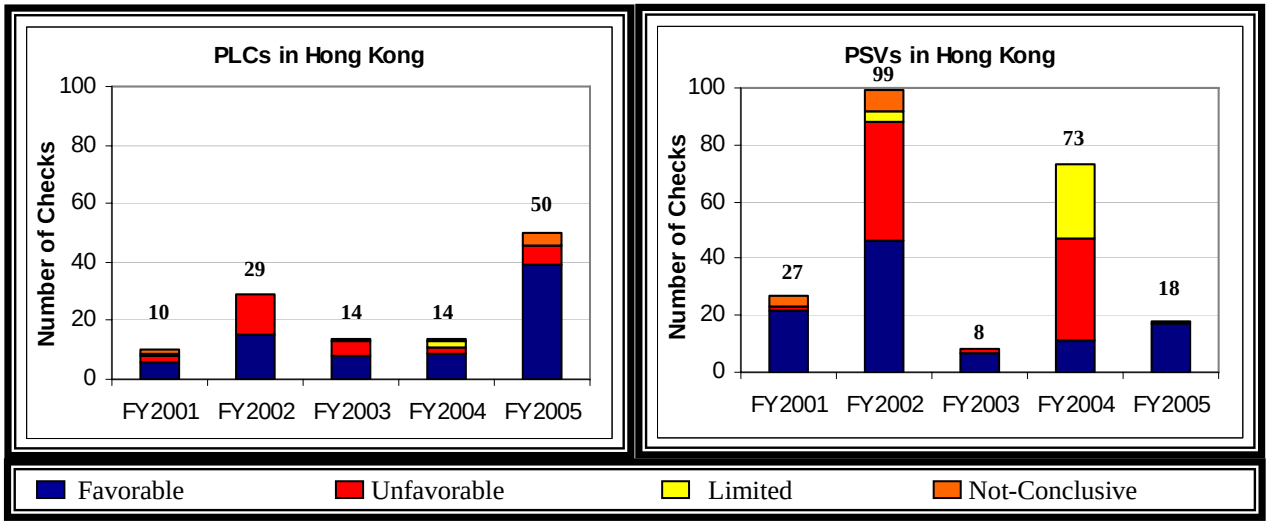
Source: Office of Enforcement Analysis, Bureau of Industry and Security

[34] BIS has additional ECOs stationed in Abu Dhabi, United Arab Emirates; Moscow, Russia; and New Delhi, India.

End-Use Check Trends in Hong Kong

End-use checks in Hong Kong were conducted by BIS' Sentinel teams[35] or Commercial Service officers at the U.S. consulate in Hong Kong until March 2004, when a BIS ECO was permanently stationed there. While the number of PLCs conducted in Hong Kong increased significantly in FY 2005, the number of PSVs conducted has decreased (see Figure 7).

Figure 7: PLCs and PSVs Conducted in Hong Kong, FYs 2001-2005



Source: Office of Enforcement Analysis, Bureau of Industry and Security

1979 U.S.-China Agreement on Cooperation in Science and Technology

On January 31, 1979, the governments of the United States and China entered into an agreement to promote cooperation in the field of science and technology (S&T Agreement).[36] Under the agreement, individual U.S. government agencies may sign protocols with their Chinese counterparts to promote exchange of information and expertise in specific areas of science and technology.[37] Cooperative activities under these protocols include (1) exchanges of information and data on technical developments and practices, (2) exchanges of scientists and engineers for training purposes, and (3) collaborative research and joint organization of symposia, seminars, and lectures.

[35] Sentinel teams, which are composed of domestic BIS special agents, are deployed to selected regions of the world to conduct end-use checks.

[36] The NDAA for FY 2003 [Public Law 106-398, Section 1207(d)(2)(F)] requires the Commerce Office of Inspector General to assess the extent to which programs and activities conducted under the *Agreement Between the Government of the United States of America and the Government of the People's Republic of China on Cooperation in Science and Technology,* signed in Washington, DC on January 31, 1979, as amended and extended are carried out in compliance with export control laws and regulations, especially those governing deemed exports. The term "deemed export" derives from Section 734.2(b)(2)(ii) of the EAR, which states "any release of technology or source code subject to the EAR to a foreign national… is deemed to be an export to the home country or countries of the foreign national."

[37] According to the Department of State, a total of six Cabinet-level Departments and four independent federal agencies maintained active protocols under this agreement as of April 2005.

The Commerce Department's National Institute of Standards and Technology (NIST) and National Oceanic and Atmospheric Administration (NOAA) maintain active protocols under the agreement. Specifically, during FYs 2004 and 2005, NIST had one active protocol covering metrology and standards.[38] During that same time period, NOAA had two protocols in effect, including one that covered atmospheric sciences and was managed by the National Weather Service (NWS). The other covered marine and fisheries sciences and was managed by the Office of Oceanic and Atmospheric Research (OAR).

[38] In September 2005, NIST entered into a second protocol covering chemistry, physics, materials, and engineering measurement sciences. However, this protocol was not active during the period of our review.

OBJECTIVES, SCOPE, AND METHODOLOGY

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

To comply with the NDAA's FY 2006 requirement, the Offices of Inspector General[39] (OIG) agreed to assess the effectiveness of the U.S. government's export control policies and practices with respect to preventing the unauthorized transfer of sensitive U.S. technologies and technical information to China. Although current U.S. export control policy treats Hong Kong as a non-sovereign entity distinct from China with less restrictive controls on licensed commodities, our review also focused on the risk of diversion of export-controlled commodities from Hong Kong to China.

Within Commerce, our objectives were to evaluate (1) the consistency of BIS' export control policies, practices, and procedures regarding China with relevant laws and regulations; (2) the effectiveness of coordination between the various federal licensing agencies during the dispute resolution process for export license applications involving China; (3) the potential for diversion of sensitive commodities from Hong Kong to China; (4) the effectiveness of BIS' end-use check program in China and Hong Kong; and (5) what activities Commerce bureaus are engaged in pursuant to the 1979 U.S.-China Science & Technology Agreement and, to the extent practicable, whether they are adhering to export control regulations.

We conducted our evaluation from May 2005 through January 2006, under the authority of the Inspector General Act of 1978, as amended. This evaluation also was carried out in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency in 2005. At the end of our review, we discussed our findings and conclusions with BIS' Under Secretary, Deputy Under Secretary, and other senior BIS officials. We also briefed other key Commerce officials from the National Institute of Standards and Technology, the National Oceanic and Atmospheric Administration, and the Office of the Secretary.

[39] This year's review also included the participation of the Department of Homeland Security's OIG.

Review of Export Controls Related to China and Hong Kong

Our methodology included the following activities:

U.S. Interviews. Within BIS, we spoke with the Deputy Under Secretary, Assistant Secretary and the Deputy Assistant Secretary for Export Administration, and the Deputy Assistant Secretary for Export Enforcement. Within Export Administration, we met with the Director of the Office of Exporter Services (OExS), the Directors of the Offices of Nonproliferation and Treaty Compliance and of Strategic Trade and Foreign Policy Controls, as well as staff from each office. Within Export Enforcement, we met with the Director of the Office of Export Enforcement, the Director of the Office of Enforcement Analysis (OEA), and their staff. We also met with both the current and a former chairperson of the Operating Committee and staff, as well as staff from BIS' Office of Chief Counsel. Within the International Trade Administration, we spoke with officials from the Commercial Service (CS), Market Access and Compliance, and Manufacturing and Services.

We also spoke with officials from federal agencies directly involved with or knowledgeable about U.S. dual-use export control policies and procedures related to China. Within the Central Intelligence Agency, we spoke with analysts from the Center for Weapons Intelligence, Nonproliferation, and Arms Control and the Office of Asian, Pacific, Latin American, and African Analysis. Within the Department of Defense, we spoke with officials from the Defense Technology Security Administration, the Air Force's Office of Special Investigations, the Naval Criminal Investigative Service, and the Counterintelligence Field Activity. Within the State Department, we interviewed staff from the Bureaus of East Asian and Pacific Affairs; Intelligence and Research; Nonproliferation; Oceans and International Environmental Scientific Affairs; and Political-Military Affairs.

In order to better understand the views of industry on U.S. export controls for China prior to our overseas visit, we met with several domestic U.S. industry associations, including the American Chamber of Commerce, the National Association of Manufacturers, and the U.S.-China Business Council. We also attended several meetings of BIS' technical advisory committees, specifically those dealing with information systems, materials processing and equipment, regulations and procedures, and sensors and instrumentation. We also met with officials from the Hong Kong Economic Trade Office in Washington, D.C.

Overseas Fieldwork. As part of our review, we traveled to Hong Kong and China to assess U.S. dual-use export control operations. We interviewed officials at the U.S. Consulate in Hong Kong, and the U.S. Embassy in Beijing, China. In Hong Kong, we met with the ECO and accompanied him on three end-use visits to Hong Kong entities. We also spoke with the CS Hong Kong's Senior Commercial Officer and Deputy Senior Commercial Officer. In addition, we met with the U.S. Consul General, the Deputy Principal Officer and the heads of the consulate's consular, economic, and political sections. Finally, we met with officials from the Department of Defense, Homeland Security's Immigration and Customs Enforcement (ICE), the Federal Bureau of Investigation's Legal Attaché, and other relevant U.S. agencies in Hong Kong.

While in Hong Kong, we also met with host government representatives from the Trade & Industry Department and the Customs & Excise Department. As part of these meetings, we visited the Lok Ma Chau Border Control Point between Hong Kong and Shenzhen, China, to observe Hong Kong's customs operations where we received a presentation and tour by the Control Points Command Chief Superintendent and his officers. We also met with a representative of the Hong Kong Trade Development Council to learn about this organization's efforts to promote export control compliance among Hong Kong companies.

Lok Ma Chau Border Control Point: Cargo traffic crossing from Hong Kong into Shenzhen, China

In China, we met with the ECO and accompanied her and officials from the Chinese Ministry of Commerce (MOFCOM) on a visit to a Chinese company in Guangzhou that was the subject of a prior end-use check in June 2005. We also met with CS' Senior Commercial Officer, the Deputy Senior Commercial Officer, the Commercial Representative who handled end-use visits for three months in FY 2005, and the Commercial Specialist who currently assists the ECO in her duties. Within the embassy, we spoke with the Deputy Chief of Mission and the heads of the U.S. embassy's consular; defense; economic; environment, science, technology, and health; and political sections. We also met with Homeland Security's ICE Attaché and other relevant U.S. government officials. In addition, the Inspector General and OIG staff met with the Director General of MOFCOM's Department of Scientific and Technological Development and Trade in Technology and his staff to discuss the progress of end-use visits in China and to assess the Chinese government's views on U.S. dual-use export controls.

While in China, we also met with representatives from U.S. companies in the aircraft manufacturing, computer technology and software, cooling equipment, electronics, petrochemicals, and telecommunications industries. In addition, we met with officials from several trade and industry associations in-country, including the American Chamber of Commerce, U.S.-China Business Council, Association for Manufacturing Technology, China Aerospace Science and Technology Corporation, Quality Brands Protection Committee, and Semiconductor Equipment and Materials International.

Following our overseas visit, we met with a former ECO to Beijing. We also briefed the Under Secretary and Deputy Under Secretary for Industry and Security on our preliminary findings.

Review of export control laws and regulations, relevant BIS guidance, and other documents. We examined current and prior legislation, executive orders, and related regulations, including the EAR, and prior OIG and GAO reports on export controls. In addition, we reviewed the following documents, covering the period of FYs 2004 and 2005 (unless otherwise indicated):

- Complete licensing histories for 146 China and Hong Kong cases processed at the OC and ACEP;
- ECASS China and Hong Kong end-use check summary data (FY 2001-2005);
- Response cables from post for 228 China and Hong Kong end-use checks that were initiated and/or completed in FYs 2004-2005 and their corresponding licensing histories;
- Export control documentation and program materials maintained by the export control officers in Hong Kong and China; and,
- BIS directives and procedures related to license monitoring.

Review of NIST and NOAA Activities under the S&T Agreement

Our methodology included the following activities:

Interviews at NIST and NOAA. At NIST, we interviewed key management staff from the Office of International Academic Affairs, the Chief Counsel's Office, Office of the Chief Information Officer, Emergency Services Division, and Commerce's Office of Security at NIST. In addition, we interviewed key management officials and staff members from five of the seven main NIST laboratories: Materials Science & Engineering; Electronics & Electrical Engineering; Manufacturing Engineering; Physics; and Information Technology Laboratories.

At NOAA, we spoke with employees from NWS and the National Ocean Service (NOS) in the metropolitan Washington, DC, area who had sponsored multiple Chinese foreign nationals during FYs 2004 and 2005.[40] In addition to NWS and NOS, we also spoke with managers and key representatives from OAR, the National Marine Fisheries Service, the National Environmental Satellite, Data, and Information Service, and the Office of Marine and Aviation Operations to ascertain their understanding of deemed export controls. We also talked with managers and staff from the Office of the Chief Administrative Officer, the Office of the General Counsel, and Commerce's Office of Security at NOAA.

Review of documentation related to the 1979 S&T Agreement. We reviewed the texts of the four protocols – two for each bureau – that were entered into by both NIST and NOAA with the Chinese government, lists of Chinese foreign national visitors and guest researchers who visited NIST and NOAA facilities, and lists of the NIST and NOAA employees who visited China under these protocols.[41] We also reviewed NIST and NOAA documentation regarding the 1979 S&T Agreement. Finally, we reviewed NIST and NOAA travel policies and regulations as well as Office of Security policies and regulations on foreign national access to Commerce facilities.

We also spoke with the Director of the Department's Office of Security and other OSY senior managers and staff concerning OSY's foreign national visitor clearance process and its counterintelligence briefing program for Commerce travelers to China.

[40] NOS employees sponsored Chinese foreign nationals who were located at either OAR or NWS facilities.
[41] NIST did not explicitly identify Chinese national visitors as participants of protocol-driven activities. Thus, our review included all Chinese citizens visiting NIST during FYs 2004-2005, excluding those who were permanent U.S. residents.

OBSERVATIONS AND CONCLUSIONS

I. Export Control Regulations and Procedures Related to China Should Be Strengthened

The current dual-use export control regulations do not prevent the Chinese military from receiving U.S. commodities that can be used in the development of conventional weapons. Specifically, according to BIS, there is no regulatory basis to deny an export license application for items the United States has determined should be controlled only for nonproliferation reasons that potentially could be used to enhance China's military capabilities solely on the basis of military end-use if the item is not controlled for "National Security" (NS) reasons. In addition, BIS' public statements about export policy for military end-users in China are not consistent with export control regulations. BIS publicly states that it has a policy of denial for exports to military end-users in China, but the regulations provide only a limited range of items subject to the denial policy.

A. BIS regulations raise some conventional weapons concerns

According to BIS, there is currently no basis in the EAR to deny an export license application solely on the basis of military end use if the exported item or technology is not controlled for NS reasons under the CCL. As a result, Chinese military end users may be receiving sensitive U.S. commodities that could be used in the development of conventional weapons. Specifically, based on our review of license applications escalated to the OC and the ACEP in FYs 2004 and 2005, we found two instances where licenses were approved even though *all* of the licensing review agencies agreed that there were significant concerns over the risk of diversion to unauthorized end users and/or end use.

Reasons for Export Control

The Export Administration Act (EAA) of 1979, as amended, provides for several categories of export controls, which include (1) national security, (2) foreign policy, and (3) short supply based controls, and provide the authority for the "reasons for control" used in the EAR. The foreign policy controls authorized by the EAA are not seen in the EAR as a specific "reason for control," but provide the statutory basis for other, specific reasons for control, such as missile technology, chemical and biological weapons, crime control, and anti-terrorism controls. National security and short supply are terms used by the EAA as a category of controls, as well as in the EAR as specific "reasons for control."

For each of these categories, the EAA imposes particular criteria and limitations. Consequently, when a term such as "national security" is used as a "reason for control," it has a very specific meaning that reflects statutorily prescribed conditions and limitations and does not necessarily coincide with general usage of the term. For example, the export of a particular item may raise national security concerns in the broad, general sense of the term, but "national security controls" cannot be placed on an item unless it meets specific requirements of the EAA. One such requirement for national security-based controls is that multilateral controls (i.e., Wassenaar Arrangement controls) must be in place if the controls are to be in effect longer than six months. By contrast, foreign policy-based controls may be imposed unilaterally, although other conditions may apply.

CCL Reasons for Control

- Anti-Terrorism (AT)
- Chemical and Biological Weapons (CB)
- Crime Control (CC)
- Chemical Weapons Convention (CWC)
- Encryption Items (EI)
- Firearms Convention (FC)
- Missile Technology (MT)
- National Security (NS)
- Nuclear Nonproliferation (NP)
- Regional Stability (RS)
- Short Supply (SS)
- United Nation Embargo (UN)

Source: *Export Administration Regulations*

Part 742 of the EAR sets forth the licensing requirements and policies for all reasons for control that are listed on the CCL for a particular export control classification number (ECCN) (see box above). Read in combination with the Commerce Country Chart, the reasons for control listed on the CCL for particular ECCNs indicate whether a license is required to export an item to a particular country. For each reason for control, the EAR provides a licensing policy that sets forth factors that will be considered before approving or denying a license application. NS is the only reason for control that would allow a license application for China to be denied solely on the grounds that the item may be intended for military end-use.

China Cases of Concern

During our review, we identified two export license applications that raised general national security concerns, which were approved because the items were not controlled for NS reasons in the EAR. Details of the two cases are outlined below:

Case 1. The first case involved exporting 100,000 pounds of hydrofluoric acid solutions and 55,000 pounds of metal acid etchant solution to be used in the manufacturing of semiconductor wafers. The chemicals are controlled for both chemical and biological (CB) weapons and anti-terrorism (AT) reasons on the CCL. Supplement No. 1 to Part 738 of the EAR (the Commerce Country Chart) provides that CB controls apply to China, but that AT controls do not. Section 742.4(b) of the EAR sets forth the licensing policy for CB reasons for control and provides that license applications will be considered on a case-by-case basis to determine whether the export would make a material contribution to the design, development, production, stockpiling or use of chemical or biological weapons.

Three of the four licensing review agencies (Commerce, Energy, and State) initially recommended approval because there was no specific chemical and biological weapons justification for denial. But Defense recommended denial so the case was automatically escalated to the OC. At the November 2004 OC meeting, Commerce, Energy, and State maintained their recommendations to approve the license application. Defense still had concerns about the risk of diversion to unauthorized end users and/or end uses and escalated the application to the ACEP. Derogatory intelligence presented at the December 2004 ACEP meeting ultimately led all four licensing review agencies to deny the license application.

After the ACEP decision to deny the application, Commerce's Office of Chief Counsel for Industry and Security prepared an analysis concerning the regulatory basis for denial of an export license for a CB-controlled item. The analysis summarized the licensing policy for CB-controlled items, including the bases upon which a license may be denied. It stated that, "[i]f the item is not controlled for national security reasons, it may not be denied solely on the grounds that it may be intended for military end-use."[42] As a result, during the May 2004 ACEP meeting, the four agencies reversed the decision to deny and instead recommended the license application be approved with conditions "in light of the current export control regulations."

Case 2. The second case involved the export of a gas analyzer to be used for analyzing combustion of burning gases. The analyzer is controlled only for AT reasons and can be shipped to China without a license.[43] However, the transaction raised national security concerns with all of the licensing review agencies.[44] The exporter also was unable to verify the bona fides of the end user, so BIS ultimately denied the license application in August 2003.

In September 2003, the U.S. exporter appealed the decision, arguing a license was not required for the transaction. The former Under Secretary for Industry and Security re-opened the case and sent it to the OC for further evaluation in January 2004. At the February 2004 OC meeting, Commerce and Energy voted to return the license application without action because no license was required, but Defense and State maintained their denials. Pursuant to authorities established in Executive Order 12981, the OC Chairman decided to return the license application without action because no license was required for the transaction.

The State Department formally objected to this decision and escalated the case to the ACEP. At the March 2004 ACEP meeting, three of the four license review agencies (Defense, Energy, and State) voted to deny this application but all agreed to have agency attorneys verify the legal basis for the denial. Subsequently, attorneys from the various license review agencies reportedly met and determined that there was no legal basis for requiring a license or for denying the license application. Ultimately, all four licensing review agencies agreed to return the license application without action.

[42] Memorandum for Operating Committee Chair from the Office of Chief Counsel's Senior Counsel for Regulation, May 21, 2004.
[43] The primary exception would be if there were concerns related to the Enhanced Proliferation Control Initiative (EPCI). However, EPCI was not a factor in this case.
[44] The specific national security concerns are classified.

Conclusion

While the two cases highlighted above had different licensing requirements, a denial on the grounds of "national security" could not be sustained in either of these situations because the items were not controlled for NS reasons under the CCL. Section 742.1(f) of the EAR provides that items on the CCL, other than those controlled for short supply reasons, may be reviewed for missile technology, nuclear nonproliferation, or chemical and biological weapons activities regardless of the stated reason for control under the EAR. This is commonly referred to as the "cross-over provision." Therefore, items controlled for CB reasons may also be reviewed for missile technology and nuclear nonproliferation reasons, but not for national security reasons. There is currently no cross-over provision for items on the CCL to be reviewed for NS reasons if they are not already controlled for such, and, as explained above, they cannot be controlled for NS reasons without corresponding multilateral controls.

To address the problems highlighted above, BIS officials initially informed us that they were proposing a new "catch-all" [45] rule or regulation that would address this weakness in the regulations. Specifically, the draft rule would reportedly require exporters to apply for a license for any exports to China whenever they knew the item was going to an end user or end use that could make a material contribution to the Chinese military capability. However, while the proposed "catch-all" rule was supposed to be based on the agreement reached in December 2003 by the Wassenaar Arrangement members, which was aimed at countries subject to arms embargos, it appeared that the United States was mostly alone in applying the restrictions for exports to China. Given the many complaints from U.S. industry concerning its intentions on this matter, BIS is currently working with its interagency partners to draft a rule that would meet the policy goal of denying U.S. exports to Chinese military end uses, while having the least impact on U.S. exporters and their efforts to increase legal exports to Chinese civilian end users.

In the current security environment, the U.S. government should give the interagency licensing review agencies explicit authority to deny licenses for items that can be used to enhance the military capabilities of countries of concern, including China. This will require adding a military "catch-all" similar to the proposed Wassenaar Arrangement catch-all rule or a "national security cross-over" provision to the EAR. A military "catch-all" for China also will help BIS fulfill its stated policy of denying "military-related" export license applications for exports to China.

RECOMMENDATION:

We recommend that BIS review the issue to determine whether it warrants regulatory revision, such as the addition of a military "catch-all" provisions to the EAR for items that could contribute to the development of conventional weapons but are not specifically controlled for national security reasons, and implement the revision, as appropriate.

[45] At the urging of the United States, the 33 members of the Wassenaar Arrangement agreed to a Statement of Understanding on the control of otherwise uncontrolled dual-use items in December 2003. The SOU requires member countries to take appropriate measures to ensure that a government authorization is required for exports of non-listed dual-use items for military end uses in destinations subject to (1) a binding United Nations Security Council arms embargo, (2) any relevant regional arms embargo that is binding, or (3) any relevant regional arms embargo to which a participating state has voluntarily consented to adhere.

In its written response to our draft report, BIS stated that it has completed its review of this issue and incorporated the results in a draft rule that BIS is preparing with respect to China in accordance with the Wassenaar Statement of Understanding regarding exports to countries subject to arms embargoes. BIS anticipates final interagency agreement on the draft rule and publication in proposed form for public comment by late spring 2006. We look forward to reviewing a copy of the proposed rule when it is completed.

B. BIS' public statements regarding licenses to China are inconsistent with the EAR

Section 742.4(b)(7) of the EAR sets forth the licensing policy for exports to China of items controlled for NS reasons on the CCL:

> For the People's Republic of China, the *general licensing policy is to approve applications*, except that those items that would make a direct and significant contribution to electronic and anti-submarine warfare, intelligence gathering, power projection, and air superiority receive extended review or denial. Each application will be considered individually. *Items may be approved even though they may contribute to Chinese military development or the end-user or end-use is military* [emphases added].

By contrast, BIS officials have repeatedly stated that BIS does not approve export licenses to military end users in China. In testimony presented to Congress in April 2005, the then-Acting Under Secretary for Industry and Security stated that "BIS . . . does not approve licenses for military end-users or end-uses within China."[46] Again in June 2005, testifying before the U.S.-China Economic and Security Review Commission, he stated that "we do not approve any licenses for military end-users or end-uses within China …"[47] Several BIS officials reiterated this policy to us during the course of our inspection.

As a result of this inconsistency, export control licensing policy for China is not transparent to exporters, who must rely on the regulations to know whether a license is required, if an application is likely to be approved, and what the regulatory standard will be for reviewing the application. The inconsistency may also cause difficulties in implementation and application of export controls and send mixed signals to our allies, trading partners, the U.S. Congress, and the public.

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[46] Testimony of The Honorable Peter Lichtenbaum, Acting Under Secretary for Industry and Security, United States Department of Commerce, Before the House Armed Services Committee and the House International Relations Committee on the "EU Arms Embargo Against China," April 14, 2005. Available at http://www.bxa.doc.gov/News/2005/PeterTmony4_14_05.htm, accessed March 7, 2006.

[47] U.S.-China Economic and Security Review Commission. *U.S.-China Trade Impacts on the U.S. Defense Industrial Base: Hearing Before the U.S.–China Economic and Security Review Commission*, 109th Cong., 1st sess., 23 June 2005. Washington, D.C.: GPO, 2005. Available at http://www.uscc.gov/hearings/hearingarchive.php#hearings2005, accessed March 13, 2006.

BIS agrees that the export licensing policy in the EAR may not fully reflect BIS' existing policy. BIS reported that it is aware of the issue and is examining the issue. BIS officials informed us that it is likely to be addressed in the pending regulation mentioned in section A above.

RECOMMENDATION:

We recommend that BIS develop one consistent policy regarding exports to military end users or for military end uses in China and amend the regulations as necessary to reflect that policy.

In its written response to the draft report, BIS stated that the draft rule implementing the Wassenaar Statement of Understanding with respect to China referred to in its response to recommendation one will also address this issue. Again, we look forward to receiving a copy of the proposed rule when completed.

II. BIS' End-Use Check Programs in China and Hong Kong Need to Be Improved

End-use checks can play an important role in helping to ensure that exported technologies are protected from diversion to unauthorized end users or end use. Given the importance of both China and Hong Kong in U.S. export control matters, BIS assigns one of its export enforcement agents to each of these posts to conduct end-use checks. While the reluctance of the Chinese government to allow end-use checks has historically precluded the U. S. government from performing many checks, agreement to the *End Use Visit Understanding*[48] by both countries in April 2004 afforded BIS the ability to conduct end-use checks on a wider spectrum of licensed goods and technologies. Nonetheless, a number of the terms for conducting end-use checks outlined in the agreement are restrictive. In addition, during the time of our review, we found many PLCs and PSVs to be untimely. A more extensive discussion of these issues is provided in the classified Appendix C.

Furthermore, while we believe the posting of an ECO in Hong Kong has served to strengthen the strong U.S.-Hong Kong cooperation on export control matters by providing consistency in U.S. government operations there, we determined that BIS is not aggressively monitoring potential diversions of export-controlled items from Hong Kong to China. Specifically, despite BIS' end-use check requirements for Hong Kong and the placement of an ECO in Hong Kong in March 2004, there were a low number of PSVs conducted in FY 2005. In addition, we determined that BIS was not adequately targeting PSVs for shipments that can be exported to Hong Kong without a license but that would require a license to China. Finally, we noted that BIS does not have a formal staffing plan in place to ensure continuity in its assignments of ECOs in Hong Kong and China.

A. End-use checks in China still face challenges

Due to the classified nature of the material discussed in this section, we offer our specific findings related to this topic in the classified Appendix C to this report.

B. BIS needs to more aggressively monitor potential diversions of export-controlled items from Hong Kong to China

As mentioned previously, the U.S.-Hong Kong Policy Act of 1992 calls upon the U.S. government to continue to treat Hong Kong as a separate territory with respect to economic and trade matters and to support Hong Kong's continued access to sensitive technologies so long as such technologies are protected. The Act also requires the Secretary of State to provide Congress with periodic reports on conditions in Hong Kong, including any significant problems in cooperation between Hong Kong and the United States on export controls. According to State's 2005 U.S.-Hong Kong Policy Act Report, end-use checks have been a key factor in evaluating the effectiveness of Hong Kong's export control system. Given the strategic

[48] The U.S. Department of Commerce and the Chinese Ministry of Commerce signed the *End Use Visit Understanding* on April 12, 2004.

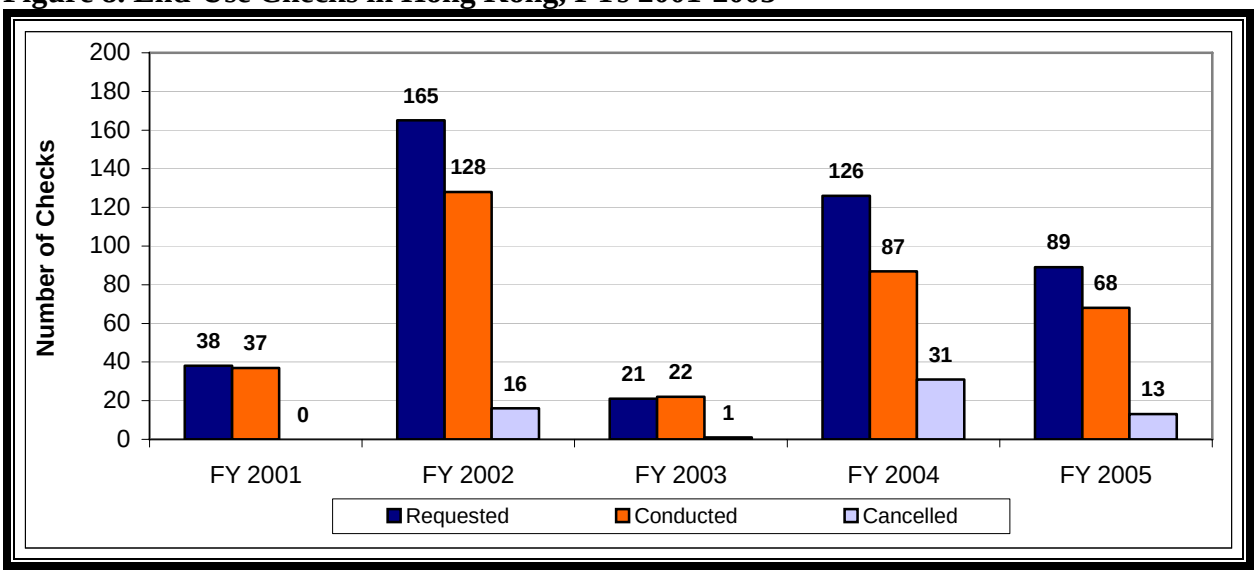
importance of Hong Kong as a key transshipment hub[49] for both China and other countries, BIS placed an ECO at the U.S. consulate in Hong Kong in March 2004.

However, based on our review of BIS' Hong Kong end-use check program, we determined that BIS is not aggressively enough monitoring potential diversions of export-controlled items from Hong Kong to China.

Number of PSVs conducted in Hong Kong did not meet BIS' requirement

In response to problems identified during previous OEE Sentinel trips, the former Under Secretary for Industry and Security approved a decision memorandum, dated January 2004, from the former Assistant Secretaries of Export Administration and Export Enforcement instituting various export enforcement policies related to Hong Kong. With regard to end-use checks, OEE and OEA were instructed, "to strive for at least two Hong Kong PSVs per week" once the ECO was stationed at post. In addition, OEA was instructed to initiate a PLC on any new non-governmental end user in Hong Kong.

Figure 8. End-Use Checks in Hong Kong, FYs 2001-2005



Source: Office of Enforcement Analysis, Bureau of Industry and Security

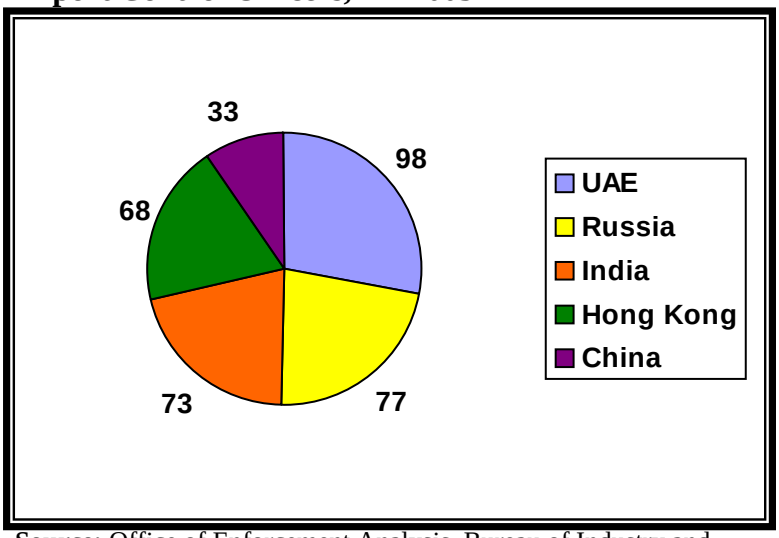
Although the ECO arrived at post in April 2004, only 68 end-use checks (including 50 PLCs and 18 PSVs) were conducted in FY 2005.[50] (See Figure 8 above for the total number of end-use checks completed in Hong Kong during FYs 2001-2005.) While OEA did initiate PLCs on new non-governmental entities associated with export license applications to Hong Kong during FY 2005, it did not fulfill the PSV requirement. OEA's Director for the China/Hong Kong Division

[49] A transshipment hub is a global commerce port that processes large volumes of shipments. Most transshipment hubs are located near countries of concern. The proximity of transshipment hubs to destinations of concern increases the risk of sensitive technologies being diverted or illicitly re-exported to those destinations.
[50] Of the 89 end-use checks initiated in FY 2005, 68 were conducted, 13 were cancelled, and 8 were pending as of September 30, 2005.

informed us that she did not learn of the Under Secretary's guidance on end-use checks in Hong Kong until July 2004. She also stated that her staff focused on meeting the PLC requirement immediately and they did not put as much emphasis on the PSV requirement.

It should be noted that at some point in FY 2006, BIS made the decision to require all of its ECOs, with the exception of China, to conduct at least 50 end-use checks a year. According to the Deputy Under Secretary for Industry and Security, the rationale behind the decrease in the number of end-use checks required for Hong Kong (as well as the other remaining posts where ECOs are stationed) is based on a "general rule of thumb." Specifically, the expectation is that the ECOs should at least be able to conduct one end-use check a week. Given that all of the posts, with the exception of China, conducted more than 50 end-use checks in FY 2005, it appears that this new performance metric may be rather low (see Figure 9).

Figure 9: Number of End-Use Checks Conducted per Export Control Officers, FY 2005



Source: Office of Enforcement Analysis, Bureau of Industry and Security

In a comparison of the five overseas posts where BIS has an ECO, Hong Kong ranks fourth in the number of end-use checks conducted in FY 2005. We noted that prior Sentinel[51] visits to Hong Kong usually resulted in the completion of a relatively large number of end-use checks in a short time period. For example, the most recent Sentinel visit to Hong Kong in October 2003 resulted in the completion of 70 end-use checks in a 12-day period. Furthermore, during our visit to Hong Kong in September 2005, we accompanied the ECO on three PSVs—all conducted on the same day. As such, it seems reasonable that the ECO could conduct more than 50 checks a year—particularly PSVs—if headquarters requested them.

Lack of PSVs on "No License Required" Shipments

There are some commodities controlled for export to China that do not require a license to Hong Kong. For example, exporters may export a range of items controlled for NS reasons, certain high-performance computers, and some items controlled for chemical and biological reasons to Hong Kong under the designation "No License Required" (NLR). By contrast, China is not entitled to obtain any NS-controlled items on a NLR basis.

[51] BIS' Sentinel program (formerly known as Safeguards) conducts on-site end-use check visits overseas using two-person teams comprised of OEE special agents.

Given the concern about diversions of sensitive U.S. technologies from Hong Kong to China, it seems reasonable that the U.S. government should target shipments for PSVs that may not require a license to Hong Kong but would require a license to China. Toward that end, 7 of the 18 PSVs initiated in FY 2005 involved NLR shipments. However, four of the PSVs were covered by a license exception and were eligible for re-export from Hong Kong to China without a license. As a result, these checks were an inefficient use of ECO resources. Specifically, the ECO ended up conducting checks on commodities that would not require a re-export license to China at the expense of doing more checks on items that would. There appear to be two main reasons for the poor targeting of NLR shipments to Hong Kong, including (1) inadequate upfront research by OEA and (2) inadequate intelligence sharing between OEE and OEA.

Inadequate Upfront Research by OEA. With regard to Hong Kong, OEA mainly focused its resources on reviewing actual export license applications submitted to BIS. OEA informed us that it attempted to target some NLR shipments to Hong Kong that would require a license (or re-export license from Hong Kong) to China, but had trouble doing so because of the limitations in the Automated Export System (AES).[52]

AES is the automated system that U.S. exporters use to file their Shipper's Export Declarations (SEDs). Each SED must be filled out with relevant export transaction information, including (1) the exporter's contact information, (2) a description of the commodity to be exported, (3) the consignee's contact information, and (4) the shipment's country of destination. If the commodity involved requires a BIS export license, AES requires that a valid ECCN of up to the first five digits be entered into one of the fields.[53] If a license is not required, then the exporter must note "NLR" or type in the applicable license exception on the SED. However, many ECCNs contain subparagraphs that describe varying parameters of the items that might determine whether NLR or a license exception may be used.

Because AES does not require (nor record) these subparagraphs, OEA is unable to definitively know whether an item would qualify for shipment under NLR or a license exception. Nevertheless, despite the known limitations in AES, OEA did not routinely contact U.S. exporters for more information about particular transactions to determine if the export met a license exception for China prior to initiating PSVs in Hong Kong.

We agree that having an expanded ECCN field within AES would allow OEA (or other export enforcement officials) to better target PSVs that could identify questionable export transactions whereby exporters might be misusing NLR or a license exception in attempts to divert the licensed items to third countries. Both Census and OEA officials stated that they are open to the

[52] AES was primarily developed in 1994 by the U.S. Census Bureau and the former U.S. Customs Service for U.S. exporters and authorized agents to electronically file their Shipper's Export Declarations (SEDs)—a Census form used to compile trade statistics and assist in export enforcement matters. The AES mainframe that processes the export information belongs to U.S. Customs and Border Protection (one of the successor agencies to the U.S. Customs Service) while AESDirect, the Internet based application that collects and sends export information to AES, belongs to Census. Census is the agency responsible for collecting, compiling, and publishing export trade statistics. AES is the primary media used for collecting export data.

[53] An ECCN typically consists of one number, followed by one letter and then three consecutive numbers (e.g., 4A101).

possibility of working together to modify AES by expanding the ECCN field. However, pending the outcome of any AES modification, OEA should obtain as much information upfront about a NLR transaction from the exporter prior to initiating a PSV request.

Inadequate Intelligence Sharing between OEE and OEA. During the course of our review, we found that OEE had information that may have been useful to OEA for targeting end-use checks (including NLR shipments) in Hong Kong. However, OEE did not forward that information to OEA until after our discussions with OEE about it. We have included this discussion in a classified appendix to this report (see Appendix D).

Conclusion

Based on discussions with BIS officials and various U.S. officials at the U.S. Consulate in Hong Kong, the United States has close and beneficial relations with the Hong Kong Customs & Excise Department and the Hong Kong Trade & Industry Department which provides the basis for Hong Kong's continued access to exports of controlled U.S. technologies. The U.S. government remains committed to continuing its existing export control policy toward Hong Kong, consistent with the provisions of the U.S.-Hong Kong Policy Act, as one means of demonstrating its support for Hong Kong's autonomy.

Nonetheless, some U.S. government officials have raised concerns about the actual and potential risk of diversion of sensitive technologies through Hong Kong. These concerns center on China's possible use of Hong Kong to obtain sensitive technologies illicitly and as a medium through which to ship controlled technologies to other countries of concern. While we believe the posting of an ECO in Hong Kong has served to strengthen the strong U.S.-Hong Kong cooperation on export control matters, it is important for the United States to aggressively monitor trade with Hong Kong to ensure that exported technologies are protected from diversion or misuse. Therefore, we believe BIS needs to use its available resources as effectively as possible to ensure that end-use checks reflect the full range of U.S. export control concerns in Hong Kong.

RECOMMENDATIONS:

We recommend that BIS take the following actions to improve its end-use check program in Hong Kong:

- Increase the number of end-use checks that should be conducted in Hong Kong based on past performance;
- Improve the targeting of end-use checks in Hong Kong through (a) adequate upfront research on no-license-required shipments prior to post shipment verification requests, (b) enhanced and continuing intelligence sharing between its Office of Export Enforcement and its Office of Enforcement Analysis; and (c) the utilization of intelligence information to help identify appropriate end-use checks; and,
- Work with the U.S. Census Bureau to modify the Automated Export System to expand the Export Control Classification Number field from the current five digits to eight digits.

In its written response to our draft report, BIS stated that it generally agreed with our recommendation to reevaluate the number of end-use checks that should be conducted in Hong Kong based on past performance. In addition, BIS' response stated that in December 2005 BIS Export Enforcement reassigned an analyst to assist on Hong Kong end-use check targeting. It also noted that the upcoming reorganization of BIS' Office of Enforcement Analysis, including the selection of a senior executive service-level director, would result in an increase in the quantity and quality of BIS resources supporting license reviews and end-use checks. The response further stated that quality is as important as quantity in selecting end-use checks and that it is important to target and select meaningful end-use checks that provide BIS with the most targeted and relevant information possible to assist in making license decisions or in detecting potential diversions to unauthorized end uses or end users. We agree that quality end-use checks are a critical component to BIS' end-use check program in Hong Kong and, as discussed below, are encouraged by BIS' commitment to focus on this matter. However, in addition to ensuring good quality end-use checks are conducted, it is also important for BIS to ensure that it conducts an appropriate number of end-use checks in Hong Kong given the placement of an ECO there and the need to monitor Hong Kong's ability to maintain an effective and transparent export control regime. As noted in our report, it appears that BIS' current performance metric of conducting 50 end-use checks a year may be rather low given past performance and as a result, we modified our recommendation in this area to encourage BIS to increase this number.

With regard to better targeting of end-use checks in Hong Kong, BIS' written response stated that it agreed with our recommendations and is already taking steps to improve efforts in this area. Specifically, the response stated that based on feedback received during a conference with all BIS Export Control Officers in October 2005, Export Enforcement revised its overall targeting and selection of end-use checks to the locations where its ECOs are located, including Hong Kong. In addition, BIS noted that the upcoming reorganization of OEA is designed in part to improve coordination between OEA and OEE on sharing intelligence information which will help to identify appropriate end-use checks in Hong Kong. To this end, and prior to the formal completion of the reorganization, OEA and OEE reportedly began joint weekly meetings in December 2005 to review all available export control intelligence information to ensure maximum coordination between the two offices.

Furthermore, BIS stated that it agrees with our recommendation for BIS to work with the Census Bureau to determine the applicability of modifying the Automated Export System to expand the Export Control Classification Number field from the current five-digits to eight-digits. Towards that end, BIS reported that it is drafting the regulatory changes necessary to implement this recommendation and will soon publish an Advance Notice of Proposed Rule Making in the *Federal Register* to solicit comments from industry on the impact of expanding the Automated Export System fields. BIS stated that it will also consult with the Census Bureau in developing this regulation. Again, as noted in our report, this modification should better enable OEA or other export enforcement officials to better target PSVs that could identify questionable export

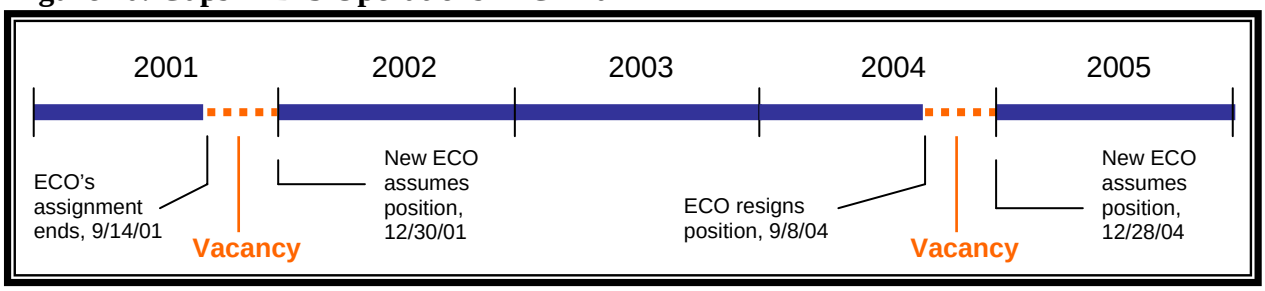
transactions whereby exporters might be misusing a license exception in attempts to divert the licensed items to third countries. We are encouraged by BIS' actions to date and look forward to reviewing the advance notice of proposed rule when complete.

C. BIS needs to improve staffing continuity for its operations in Hong Kong and China

BIS does not have a formal staffing plan to help ensure continuity in its ECO assignments in Hong Kong and Beijing, China.[54] Currently, there is no pool of talent within BIS (e.g., personnel with both Mandarin Chinese language skills and export enforcement experience) from which to draw replacement ECOs. The ECO position is a limited non-career position within CS. Normally, the ECO position is a two-year assignment (with possible extensions). BIS' first ECO in Hong Kong was originally scheduled to depart post in March 2006; however, he has recently extended his tour until May 2006, thus lessening the gap between the time he leaves and the placement of his successor. In addition, the term of the current Beijing ECO expires in December 2006.

Interruptions in carrying out in-country BIS operations have and may continue to occur without a plan to ensure continuous staffing of the ECO positions. With respect to China, end-use checks must be scheduled and conducted per the terms of the *End Use Visit Understanding*, making it important to continuously staff that position. Since 2001, there have been two gaps of 3-months duration in BIS operations in China (see Figure 10). Specifically, in September 2001, the first ECO's term in Beijing expired. Though BIS had already selected a special agent with Mandarin Chinese language skills from one of its domestic field offices, that agent was unable to assume his post immediately upon the ECO's departure. The second gap occurred in September 2004 when the second ECO resigned his post. In December 2004, BIS hired a special agent with Mandarin Chinese language ability from another federal agency already stationed at post. During both of these gaps, BIS relied on CS staff to conduct end-use checks.

Figure 10: Gaps in BIS Operations in China



Source: Bureau of Industry and Security and the U.S. & Foreign Commercial Service

ECOs stationed in Hong Kong and Beijing are normally required to have export control knowledge and skills needed to conduct end-use checks and handle other necessary export control responsibilities. In addition, it is highly desirable for these ECOs to have Mandarin

[54] While our review focused only on Hong Kong and China, this issue may also be applicable for the ECO assignments in Abu Dhabi, United Arab Emirates; Moscow, Russia; and New Delhi, India.

Chinese language ability. While CS informed us that both Hong Kong and Beijing are language-designated posts for its officers, the ECO positions are not language-designated positions.

However, the November 2005 vacancy announcement for the Hong Kong ECO position stated that "[a]pplicants proficient in the host country language, Chinese, are highly desired." However, it should be noted that for a candidate with no Mandarin Chinese language ability to attain the CS language requirement for either Hong Kong or Beijing would entail specialized language training of up to one year.

Prior to establishing the ECO position in Hong Kong, BIS relied on CS staff and Sentinel teams to conduct end-use checks there. However, as stated in section B of this Chapter, the posting of an ECO in Hong Kong has served to further strengthen the strong U.S.-Hong Kong cooperation on export control matters by providing consistency in U.S. government operations there. In addition, it may be difficult to use Sentinel teams to conduct end-use checks in China given the current terms of the *End-Use Visit Understanding* (see Appendix C for our assessment of end-use checks in China). Further, given the importance of conducting end-use checks in a timely manner by knowledgeable personnel, the use of occasional Sentinel teams may not suffice.

BIS knew of the Hong Kong ECO's planned departure since the summer of 2005; however, it did not post a vacancy announcement for this position until mid-November 2005. In February 2006, the Deputy Under Secretary for Industry and Security informed us that BIS had identified a candidate for the ECO position in Hong Kong. This individual is an attorney but does not have law enforcement experience or Mandarin Chinese language skills.[55] Given the 10 weeks of basic law enforcement training the new ECO will have to undertake and other pre-travel requirements (e.g., security and medical clearances), he is not expected to arrive at post until July 2006. While the process is moving forward, BIS needs to develop a plan to avoid future gaps in assignments in these two critical, overseas posts.

RECOMMENDATION:

We recommend that BIS develop a staffing plan to provide continuity in the stationing of qualified export control officers in Hong Kong and China to avoid interruptions in operations and initiate that plan at least 6 to 12 months before the end of the term of the departing export control officer.

In its written response to our draft report, BIS agreed with our recommendation and stated it will include as a critical element in the performance plan of the OEE coordinator of the ECO program a requirement to coordinate and prepare the necessary vacancy announcements 6 to 12 months prior to the end of each ECO's assignment. However, BIS noted that it may be difficult creating a pool of qualified ECOs for future assignments given the relatively small size of its personnel,

[55] In addition to seeking candidates with Mandarin Chinese language ability, the vacancy announcement called for candidates with specialized experience in conducting criminal investigations and a knowledge of U.S. export control laws and regulations.

and, therefore, cautioned that future gaps in coverage may still occur. However, BIS did state that in order to minimize the impact of any future gaps in assignments, it will ensure that there is coverage in place in case of such a vacancy. We acknowledge BIS' concerns in this regard and appreciate its commitment to ensure maximum coverage in future ECO assignments.

III. BIS' Monitoring of License Conditions Could Be Enhanced

The EAR states that an export license may be limited by conditions on the use of the export. The ability to place conditions on a license is an important part of the license approval process as well as an additional means to monitor certain shipments. Frequently, the conditions are the result of lengthy negotiations among the licensing referral agencies.

Of the 55 possible standard conditions, six require the exporter to submit documentation to BIS regarding the shipment. For example, two require the exporter to provide different types of delivery verification documents; one involves notification to BIS after the temporary demonstration of a U.S. item overseas; one requires notification to BIS after the return of an aircraft on temporary sojourn to a foreign country; one involves the submission of a post shipment report on exports of high-performance computers to certain countries; and one involves the submission of a shipper's export declaration (SED) following shipment of the item (so that a PSV can be initiated). A seventh condition – referred to as "Write Your Own" (WYO) – allows licensing officers (LO's) to formulate unique requirements, which may include reporting requirements for either the exporter or the end user. Licenses with reporting conditions are tracked in either Export Administration's or Export Enforcement's Conditions Follow-up Subsystem within ECASS.[56]

In our FY 1999 export licensing report and FY 2003 export enforcement report,[57] we found that Export Administration and Export Enforcement were not consistently monitoring licenses with reporting conditions and therefore were not following up with exporters to ensure compliance. In response to our recommendations, both EA and EE instituted procedures to (1) regularly monitor licenses with reporting conditions that are marked for follow-up by LOs and (2) follow-up with exporters to request any necessary reporting documentation.

Within EA, the Office of Exporter Services (OExS) is responsible for monitoring exporter compliance with five of the seven reporting conditions, including WYO conditions that have reporting requirements. Of these five conditions, four involve the submission of routine documentation, such as delivery verification, that do not require a level of technical expertise to verify. If an LO marks a license with any of these conditions, the license is automatically entered into EA's Follow-up Subsystem.

By contrast, WYO conditions may sometimes contain substantive reporting requirements, such as maintenance reports and technology control plans, which require some level of technical review. For these conditions, the LO must choose "yes" or "no" in the WYO screen indicating (1) whether the condition requires follow-up and (2) whether the documentation requires an LO's review. The license is only entered into EA's Follow-up Subsystem if the LO marks "yes" for "follow-up" required.

[56] Licenses requiring exporters to submit post shipment reports on high-performance computer exports to certain countries are monitored separately from Export Enforcement's Conditions Follow-up Subsystem.
[57] U.S. Department of Commerce Office of Inspector General (Commerce OIG), June 1999. Improvements Are Needed to Meet the Export Licensing Requirements of the 21st Century, IPE-11488; Commerce OIG, March 2003 Improvements Are Needed to Better Enforce Dual-Use Export Control Laws, IPE-15155.

Within EE, the Office of Enforcement Analysis (OEA) is responsible for monitoring licenses marked with the remaining reporting conditions— the submission of post shipment reports on high-performance computer exports to certain countries, referred to as "Condition 34," and of SEDs, which is referred to as "Condition 14." Licenses with Condition 14 require a PSV on a specific foreign entity following the first shipment made against the license. Exporters are required to submit a copy of the shipment's SED directly to OEA, which then initiates the PSV.

A. BIS should ensure that there is a technical review of technical documentation submitted by exporters or end users pursuant to license conditions

We reviewed all China export license applications processed at the OC and ACEP during FYs 2004 and 2005 and identified 15 that had WYO reporting conditions (excluding Condition 14). Of the 15 cases involving such reporting conditions, four involved the submission of documentation confirming the delivery of shipments, which could be verified by OExS staff. However, 11 cases involved license conditions with more technical reporting requirements, but none of them were marked for LO review. Aside from LO review, there is no procedure in place to provide technical review of the documentation to ensure that exporters or end users are in compliance with license conditions.

The reporting requirements, which were incorporated into the WYO condition of each license, were designed to address particular concerns that either BIS or other licensing referral agencies had about the parties to the transaction or about the transaction itself. In some cases, the condition was designed to address concerns about unauthorized exports or re-exports. Two licenses had conditions that required the end-user or consignee to develop and implement a technology control plan prior to shipment. In another situation, a licensing referral agency was concerned that the item would not be used for its stated purpose, prompting a condition addressing the specific nature of the risk addressed to the exporter, end-user, or both. Other conditions required the submission to BIS of (1) quarterly shipment reports of the exported commodity, (2) an annual report summarizing demonstrations of the item and any measures taken to ensure its security, or (3) a quarterly report on how the item was being utilized.

While these reporting conditions are placed on the exporter and/or end user, BIS does not require any form of technical review of the documentation submitted to ensure that it meets the requirements of the condition. In fact, OExS staff informed us that although LOs have the opportunity to review the documentation, they rarely mark them for review. Without a technical review to ensure compliance, the purpose of placing reporting conditions on the license is defeated.

RECOMMENDATION:

We recommend that BIS put procedures in place to provide for a technical review of technical documentation submitted by exporters and end users to ensure their compliance with license conditions.

In its written response to our draft report, BIS agreed that there may be instances where a technical review of documentation submitted pursuant to license conditions may be warranted. BIS stated that it would conduct an internal assessment, scheduled for completion by May 12, 2006, to determine an appropriate process for conducting technical reviews. We acknowledge BIS' effort and would appreciate a copy of the review results upon their completion.

B. China post shipment verification license conditions were not properly marked for follow-up

As noted earlier, licenses with PSV conditions are marked with Condition 14 and are automatically entered into EE's Conditions Follow-up Subsystem for subsequent monitoring. However, based on our review of China OC and ACEP licenses, we identified five licenses that required PSVs but were not properly marked by the LO with Condition 14. Instead, the text of the PSV condition for each license was recorded in the WYO condition, which, as discussed previously, does not automatically add a license to either EE's or EA's Conditions Follow-up Subsystem. These errors occurred despite the fact that each export license application is reviewed and signed off by a countersigner (typically a division director) to ensure that license applications are processed appropriately. For example, countersigners are responsible for ensuring that license conditions agreed upon at the OC are reflected accurately in the license application.

Of the five licenses, initial shipments were made against three of them – one in November 2004 and two in April 2005.[58] Although the LOs responsible for these licenses neglected to mark Condition 14 on the 5 licenses, it appears that the exporters were compliant in these three cases by submitting copies of their SEDs. Normally, under Condition 14, exporters are instructed to submit copies of SEDs to OEA. However, each of these three licenses contained language instructing the exporter to submit the documentation to OExS. As such, OEA staff stated that it was not aware that any of these licenses had a PSV condition. Had Condition 14 been marked for each license, standard language about the SED requirement (including instructions to submit the documents directly to OEA) would have been included automatically in the list of license conditions that is provided to the exporter. In addition, each license would have been placed in EE's Conditions Follow-up Subsystem for OEA to monitor.

According to "step-by-step procedures" instituted by OExS in response to a recommendation from our FY 2003 export enforcement report, OExS' staff are required to forward to OEA a copy of any license requiring a PSV that has been erroneously marked under the WYO condition along with a standardized memorandum addressed to the Director of OEA notifying him of the error. However, OExS could not find records of having forwarded to OEA copies of these five licenses. OExS staff informed us that if they receive follow-up documentation (which would

[58] Per OExS, exporters had not shipped against the remaining two licenses as of January 17, 2006. However, export licenses are normally valid for two years from the date of approval and at the time of our review, none of the five licenses had expired.

include SEDs) for a license that is not marked for follow-up, the documentation is scanned and archived in a document storage system separate from ECASS without a review. Subsequent to our inquiry, OExS forwarded copies of all five licenses and the three SEDs that had been submitted by exporters to OEA.

Without Condition 14 on a license, OEA staff members do not know that a PSV is required when it is written as a WYO condition and, as a result, a PSV cannot be initiated for the license. In addition, with regard to the specific cases cited above, because of the time that elapsed between the date of shipment and OEA's receipt of the aforementioned SEDs from OExS, OEA informed us it was not able to proceed with a PSV request for any of the Chinese end users associated with these three licenses because of the terms of the *End-Use Visit Understanding.* (See Appendix C for more information on this issue.)

RECOMMENDATIONS:

We recommend that BIS take the following actions to improve its efforts to monitor exporter compliance with license conditions:

- Review the process of marking and countersigning license applications with Condition 14 to identify and correct any weaknesses to ensure that these license applications are properly entered into Export Enforcement's Followup Subsystem and monitored by the Office of Enforcement Analysis.
- Ensure that the Office of Exporter Services promptly forwards to the Office of Enforcement Analysis any copies of shipper's export declarations that are submitted by an exporter.

In its written response to our draft report, BIS stated that on March 16, 2006, it had issued guidance to Licensing Officers and Counter Signers in the form of an email reminding them of the proper procedures for marking Condition 14 and other standard license conditions. While this action partially meets the intent of our recommendation, the response did not discuss whether BIS would review its current process of countersigning licensing applications to ensure that standard license conditions, including Condition 14 and other reporting conditions, are accurately recorded into ECASS and, if applicable, entered into the appropriate conditions follow-up subsystem for monitoring. We would appreciate receiving the results of BIS' review of its license countersigning process in its action plan.

With regards to our recommendation on forwarding SEDs to OEA, BIS' written response stated that staff in the Operations Support Division of the Office of Exporter Services was issued guidance in the form of an email on March 16, 2006, requiring them to forward such documents to OEA within 48 hours of receipt to ensure that PSVs are initiated promptly.

IV. NIST and NOAA Conduct Various Activities Pursuant to the 1979 U.S.-China Science and Technology Agreement

Pursuant to our mandate under the NDAA for FY 2003, we sought to determine what activities Commerce bureaus were engaged in pursuant to the 1979 U.S.-China S&T Agreement and, to the extent practicable, whether they are adhering to export control regulations. Within Commerce, there are two bureaus – NIST and NOAA – that maintained active protocols under the agreement during FYs 2004 and 2005.

We found that NIST appears to be complying with deemed export control regulations with respect to activities undertaken pursuant to the 1979 S&T Agreement. Specifically, the EAR-controlled items we reviewed at NIST appeared to be protected from Chinese foreign national visitors. We found that NOAA still is in the process of developing its export control compliance program; however, NOAA has reportedly placed access controls on all EAR-controlled technology where foreign nationals are present, including Chinese nationals.

We also found that employees from both NIST and NOAA who traveled to China [redacted] We present our findings on this issue in a separate draft memorandum report, [redacted] scheduled to be issued in March 2006.

A. NIST's Science and Technology exchange activities with China

One of NIST's core missions is to exchange information and collaborate on research with similar institutions all over the world to provide products and services of the highest quality. Thus, through its Foreign Guest Researcher Program, NIST offers foreign scientists, including Chinese foreign nationals, the opportunity to work collaboratively with NIST scientists. The Office of International and Academic Affairs oversees all of NIST's interactions with foreign entities and persons and collects information on foreign national visitors and guest researchers at NIST.

During FYs 2004 and 2005, NIST had one active protocol with China's General Administration of Quality Supervision, Inspection, and Quarantine in place.[61] Signed on December 9, 2003, this protocol supports cooperation in the fields of metrology and standards. However, the protocol is very general, and specific activities NIST conducts with its Chinese counterpart organizations and their researchers—such as conferences and joint research projects—are not always identified

[redacted]

[61] NIST signed a second protocol with the Chinese Academy of Sciences at the end of FY 2005, but did not conduct any activities under it during the period of our review.

in relation to it. Several NIST employees we interviewed were not even aware that the protocol is in place.

Many Chinese Foreign Nationals Visited NIST During FYs 2004 and 2005

As with all foreign nationals, NIST categorizes Chinese foreign nationals who visit its facilities into two main groups: short-term visitors who are at NIST for 10 days or less, and long-term visitors who are at NIST for 11 days or more.[62] NIST further segregates long-term visitors into four sub-categories: (1) "foreign guest researchers", (2) "facility users", (3) "contractors", and (4) "Cooperative Research and Development Agreement (CRADA) participants."[63] (See Table 3 for a breakdown of the number and types of Chinese foreign national visitors recorded by NIST during FYs 2004-2005.)

Long-Term Visitors. During FYs 2004 and 2005, a total of 209 long-term Chinese foreign national visitors were at NIST's Gaithersburg, Maryland, and Boulder, Colorado, campuses. NIST's Material Science and Engineering Laboratory hosted 146 of them. Of those, 50 were foreign guest researchers and 95 were facility users at the NIST Center for Neutron Research. The remaining one visitor worked as a CRADA participant at the NIST Center for Neutron Research.

Short-Term Visitors. NIST recorded a total of 352 Chinese foreign nationals visiting NIST facilities on a short-term basis during this same two-year period.[64] These Chinese visitors comprised approximately 11 percent of the 3,230 short-term foreign visitors from over 100 countries who came to NIST during FYs 2004 and 2005. Most of the Chinese short-term visitors came from China's General Administration of Quality Supervision, Inspection and Quarantine; the Chinese Academy of Sciences; other Chinese governmental organizations and laboratories; or universities.

[62] NIST did not explicitly identify Chinese foreign national visitors as participants of protocol-driven activities. Therefore, our review included all Chinese citizens visiting NIST during FYs 2004-2005, excluding those who were permanent U.S. residents.

[63] Foreign scientists who are invited to conduct research at NIST are called "foreign guest researchers". "Facility users" refers to researchers who come to NIST on a short-term basis—10 days or less—to utilize NIST facilities and equipment available for public use and include foreign citizens. (Although they are technically short-term visitors, NIST places them into the long-term category. If facility users require more than 10 days to complete their research, NIST will reclassify them to "foreign guest researcher" status, which requires additional security assurance reviews.) "Contractors" are researchers who are temporarily employed via a sole-source provider to conduct specific research tasks requested by NIST researchers. Finally, while NIST generally does not allow foreign nationals to participate in CRADAs—which may include publication restrictions that could subject the research to export controls—exceptions can be made.

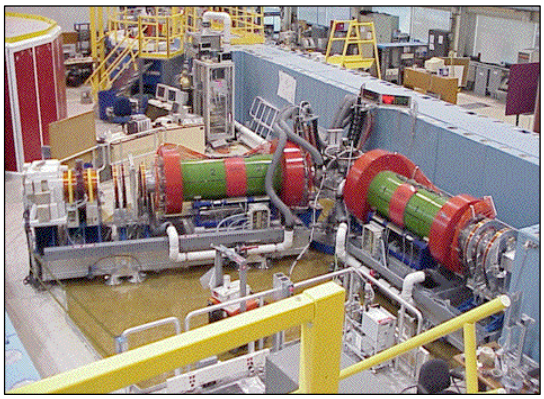
[64] NIST's Office of International and Academic Affairs and the Mountain Region Security Office—which maintains records of foreign national visitors to NIST's Boulder, Colorado, campus— stated that their records of short-term Chinese national visitors during FYs 2004-2005 might be incomplete because NIST's operating units may not always report these visitors to their offices. Further, this figure does not capture all conference attendees at NIST.

EAR-Controlled Items Appear to Be Protected

According to NIST, no Chinese foreign national visitors had access to EAR-controlled items in FYs 2004 and 2005 that would have required a deemed export license. Since the issuance of our FY 2004 report on deemed exports,[65] NIST's Emergency Services Division has developed and maintained an inventory of 129 EAR-controlled items. Most of the EAR-controlled items identified by NIST were controlled for "physical" exports to China, with some of them also controlled for "use" technology that would require a deemed export license.

We inspected 12 of the 129 EAR-controlled items at the Gaithersburg, Maryland, campus to determine whether Chinese foreign national visitors could possibly have access to the controlled technologies. NIST reported that all short-term Chinese foreign national visitors are escorted by NIST personnel at all times, minimizing the possibility that they would have undetected access to EAR-controlled technologies. Although long-term Chinese foreign national foreign guest researchers could gain access to some rooms or laboratories that contained EAR-controlled items, those items were locally secured [redacted]. In addition, although we found that Chinese foreign national facility users and a few Chinese foreign national foreign guest researchers did have access to certain laboratory equipment that involved EAR-controlled items, it appears that the technology remained protected.

For example, the Neutron Spin Echo Spectrometer at the NIST Center for Neutron Research (see photo to the right) contains three tri-axial fluxgate magnetometers that are controlled for "National Security" reasons by the EAR. However, we were told by the Director of the Center that the items—with the dimensions of approximately 3cm x 3cm x 20cm—are embedded deep inside the massive apparatus, and the entire floor area is under constant surveillance [redacted].[66] Moreover, although these items were controlled for exports to China, they were not controlled for "use" technology, and thus, deemed export controls were not applicable in this case.



The Neutron Spin Echo Spectrometer at the NIST Center for Neutron Research

In addition to the development of an inventory for its EAR-controlled equipment, NIST recently implemented a program to conduct "upfront" review of its research activities.[67] Specifically, NIST laboratory managers conduct reviews of NIST researchers' ongoing and foreseeable upcoming research to determine whether technology used and/or created by NIST researchers

[65] U.S. Department of Commerce, Office of Inspector General. *Deemed Export Controls May Not Stop the Transfer of Sensitive Technology to Foreign Nationals in the U.S.*, IPE-16176, March 2004.

[66] The NIST Center for Neutron Research is subject to the Nuclear Regulatory Commission's regulations for facilities with nuclear source material. NIST officials said that the entire facility is under 24-hour surveillance [redacted].

[67] This program was initiated in response to the OIG's 2004 report on deemed exports.

and their staff (which includes foreign guest researchers) are subject to U.S. export control laws. These findings are then recorded in the NIST researchers' performance plans by their managers. If it is determined that any of the technology to be used and/or created during NIST research activities is controlled for export control purposes, NIST would either seek a deemed export license or protect the technology from disclosure to foreign nationals, as appropriate. However, with two cycles of performance reviews conducted in the spring and fall of 2005, NIST informed us that it did not identify any instances where a deemed export license would be required for on-going or upcoming research.

B. NOAA's Science and Technology exchange activities with China

Staff at five of NOAA's line offices[68] collaborate internationally on many projects and issues. Pursuant to the 1979 U.S.-China S&T Agreement, Chinese foreign nationals may visit or work at NOAA research facilities or data centers to undertake joint research projects. Conversely, NOAA scientists and other staff may travel to China to promote the exchange of scientific or technical information through activities such as lectures, collaborative projects, and participation in workshops and conferences.

NOAA has entered into two protocols pursuant to this agreement. The first protocol, with the China Meteorological Administration, is managed on the U.S. side by the National Weather Service (NWS) and covers the field of atmospheric science and technology (subsequently referred to as the atmospheric protocol). The second protocol, with China's State Oceanic Administration, is managed on the U.S. side by the Office of Oceanic and Atmospheric Research (OAR) and covers the field of marine and fishery science and technology (subsequently referred to as the marine and fisheries protocol). We surveyed a sample of U.S.-China S&T activities at NOAA's Silver Spring and Camp Springs, Maryland facilities in order to assess the bureau's compliance with export controls. Although our survey focused on export compliance as it relates to Chinese foreign nationals, we found that NOAA has made progress in fulfilling the recommendations made in our March 2004 deemed export report.

<u>Chinese Nationals Visit NOAA Within and Outside the Protocols</u>

To facilitate our survey, OAR and NWS provided us with lists of Chinese foreign national visitors and guest researchers with access to their facilities both within and outside of the S&T protocols. During FYs 2004 and 2005, 73 Chinese foreign nationals visited NWS facilities under the atmospheric protocol, while 48 Chinese foreign nationals visited OAR facilities under the marine and fisheries protocol. An additional 77 Chinese foreign nationals visited the NWS and OAR facilities for activities outside the protocols.

[68] The five NOAA line offices referred to above include the National Ocean Service, the National Weather Service, the National Marine Fisheries Service, the Office of Oceanic and Atmospheric Research, and the National Environmental Satellite, Data, and Information Service. NOAA's sixth line office, Program Planning and Integration, does not engage in international projects.

We interviewed six officials who, together, had sponsored 27 current and former Chinese foreign national visitors and guest researchers. Based on our interviews, it appears that most of these particular individuals were involved with computer and software development, operations, and support, rather than laboratory research. Much of their work involved routine activities to support daily NOAA operations, such as writing computer programs using publicly available information and open source software to translate daily weather satellite data. Similarly, those who did conduct research, reportedly worked with publicly available information only, such as weather and climate data, and published all of their results. However, it should be noted that NOAA plans to develop a process in FY 2006 to review all of its research to determine the applicability of deemed export control issues.

EAR-Controlled Equipment and Technologies at NOAA Have Been Partially Inventoried

In response to our FY 2004 deemed export recommendations, NOAA established a Deemed Export Steering Committee in mid-2005 to coordinate compliance with dual-use export controls. The Steering Committee, which is composed of senior NOAA managers and staff, instructed each of NOAA's line offices plus the Office of Marine and Aviation Operations to (1) conduct a NOAA-wide inventory review of technology and software, (2) develop technology control plans governing access to export-controlled technologies, and (3) identify all foreign nationals with access to their facilities.

With its operations encompassing over 800 physical locations (including NOAA's ships and airplanes), NOAA divided its export compliance review into two phases, beginning with Priority 1 sites, defined as any location that either has foreign nationals present or contains critical infrastructure. This included any NOAA facilities where research is conducted and foreign nationals are present. By December 2005, NOAA had completed its inventory of equipment and technology at Priority 1 sites, and specifically identified 132 EAR-controlled items in various locations, including some in which Chinese foreign nationals were present.[69] NOAA made a preliminary determination that no deemed export licenses were required, but also submitted this assessment to BIS for a final review. According to NOAA, on February 16, 2006, BIS provided favorable feedback regarding NOAA's inventories and assessment, including NOAA's conclusion that there are no instances where deemed export licenses are needed for any foreign nationals currently working in NOAA facilities. NOAA managers at these locations have reportedly secured their EAR-controlled equipment to prevent foreign national access, pending the implementation of formal access control plans, which were submitted to NOAA's Office of the Chief Administrative Officer on December 12, 2005, for review.[70] According to the hosts we interviewed, none of the Chinese foreign nationals they were hosting had access to EAR-controlled "use" technology.

[69] Officials at one location reported having items controlled under ECCN 4A994 but did not provide a specific count of the items involved. However, they also reported no foreign nationals present at that location.
[70] According to a January 2006 status report in response to our FY 2004 deemed export report, NOAA is formulating a strategy to conduct inventories at its remaining facilities, known as "Priority 2" sites, and intends to carry out those inventories in FY 2006.

Employees involved in the inventory review process attended a two-day, intensive export control training session provided by BIS. Although NOAA has not yet implemented export-control awareness training for all employees, those we interviewed, including those who hosted Chinese foreign nationals or traveled to China, had at least a general awareness of export controls.

NOAA Presentations Reviewed by OIG Appear to Involve Publicly Available Information

NOAA Administrative Order (NAO) 201-32G states that each line office is "responsible for the scientific and technical quality of materials they originate and provide for the scientific review of manuscripts prior to releasing them for publication in NOAA and non-NOAA media." Staff we interviewed said that their managers do review their presentations before they are released to ensure technical accuracy and consistency with NOAA policies. Furthermore, they stated that the information contained in those presentations involved publicly available information; therefore, export controls would not apply. We reviewed several NOAA presentations that had been delivered at public forums in China as part of S&T activities and found that they appear to contain only publicly available information.

Chinese Foreign National Access to NOAA Facilities Appears to Adhere to Departmental Policy

OSY officials at NOAA and Commerce headquarters said that Chinese foreign national visitors and guest researchers are allowed unescorted access into NOAA facilities only after the completion and adjudication of a background investigation. Those who have not been cleared by OSY are required to sign in daily, receive and wear visitor stickers, and be escorted by their respective hosts. According to OSY, one-day foreign national visitors or open conference attendees at NOAA facilities normally are not required to undergo background investigations prior to receiving access because those foreign nationals are supposed to be either escorted by their hosts or prevented by the guard force from accessing areas where only authorized NOAA employees or contractors are allowed. According to OSY, NOAA is complying with the escort requirement; however, due to time constraints, we were unable to verify whether these procedures were being followed for Chinese foreign nationals at NOAA facilities.

SUMMARY OF RECOMMENDATIONS

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

1) We recommend that BIS review the issue to determine whether it warrants regulatory revision, such as the addition of a military "catch-all" provision to the EAR for items that could contribute to the development of conventional weapons but are not specifically controlled for national security reasons, and implement, as appropriate (see page 17).

2) We recommend that BIS develop one consistent policy regarding exports to military end users or for military end uses in China and amend the regulations as necessary to reflect that policy (see page 21).

3) Increase the number of end-use checks that should be conducted in Hong Kong based on past performance (see page 23).

4) Improve the targeting of end-use checks in Hong Kong through (a) adequate upfront research on no-license-required shipments prior to post shipment verification requests, (b) enhanced and continued intelligence sharing between its Office of Export Enforcement and its Office of Enforcement Analysis; and (c) the utilization of intelligence information to help identify appropriate end-use checks (see page 23).

5) Work with the U.S. Census Bureau to modify the Automated Export System to expand the Export Control Classification Number field from the current five-digits to eight-digits (see page 23).

6) We recommend that BIS develop a staffing plan to provide continuity in the stationing of qualified export control officers in Hong Kong and China to avoid interruptions in operations and initiate that plan at least 6 to 12 months before the end of the term of the departing export control officer (see page 29).

7) We recommend that BIS put procedures in place to provide for a technical review of technical documentation submitted by exporters and end users to ensure their compliance with license conditions (see page 33).

8) Review the process of marking and countersigning license applications with Condition 14 to identify and correct any weaknesses to ensure that these license applications are properly entered into Export Enforcement's Followup Subsystem and monitored by the Office of Enforcement Analysis (see page 34).

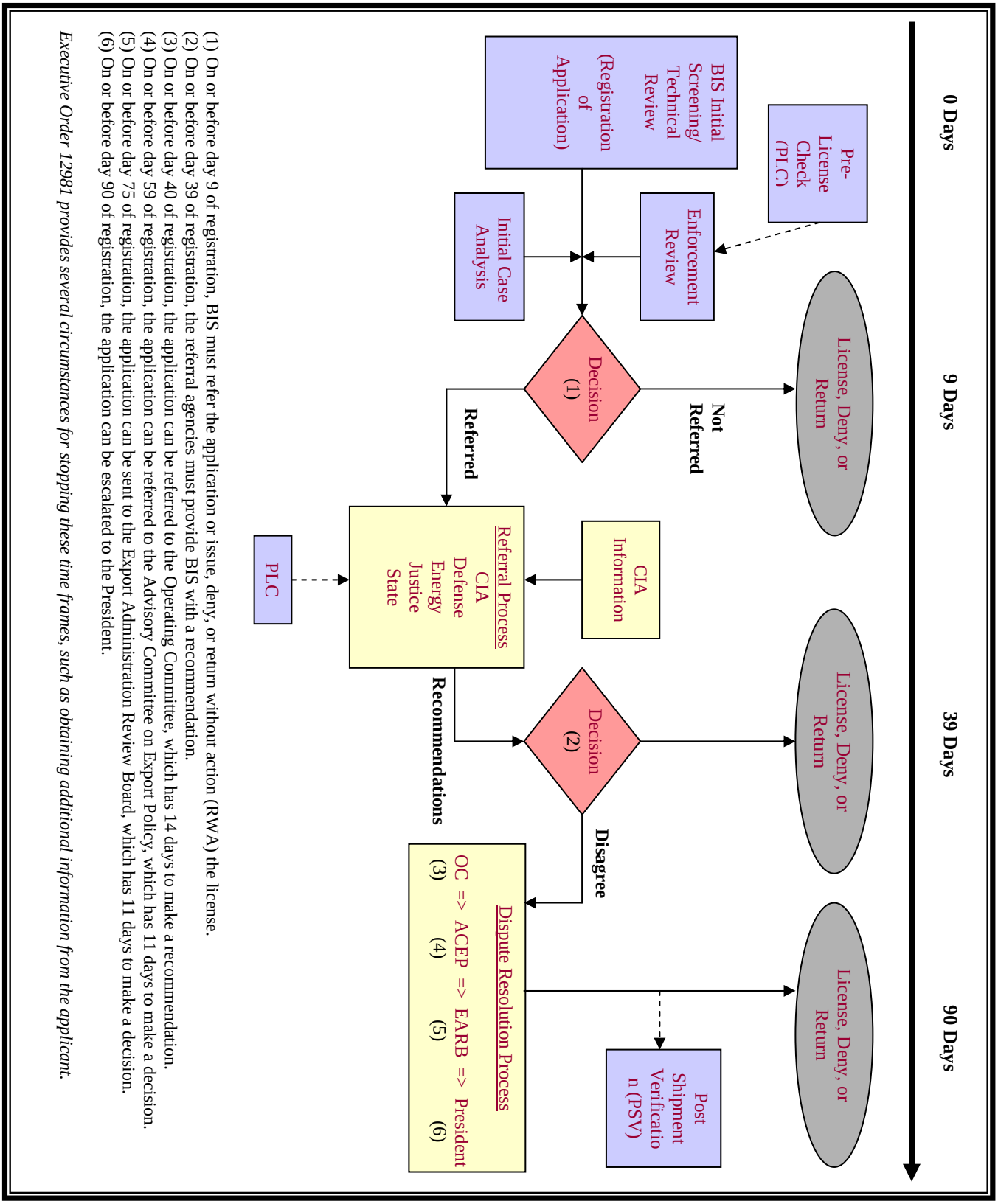
9) Ensure that the Office of Exporter Services promptly forwards to the Office of Enforcement Analysis any copy of a shipper's export declaration that is submitted by an exporter (see page 34).

APPENDICES

Appendix A: Acronyms

ACEP	Advisory Committee on Export Policy
AES	Automated Export System
AT	Anti-Terrorism
BIS	Bureau of Industry and Security
CB	Chemical/Biological
CCL	Commerce Control List
CIA	Central Intelligence Agency
EAR	Export Administration Regulations
ECASS	Export Control Automated Support System
ECCN	Export Control Classification Number
ECO	Export Control Officer
FY	Fiscal Year
IPE	Inspections and Program Evaluations
LO	Licensing Officer
MOFCOM	Ministry of Commerce, People's Republic of China
NDAA	National Defense Authorization Act
NAO	NOAA Administrative Order
NIST	National Institute of Standards and Technology
NLR	No License Required
NOAA	National Oceanic and Atmospheric Administration
NS	National Security
NWS	National Weather Service
OAR	Office of Oceanic and Atmospheric Research
EA	Export Administration
EE	Export Enforcement
OEA	Office of Enforcement Analysis
OC	Operating Committee
OIG	Office of Inspector General
OSY-NIST	(Commerce) Office of Security at NIST
PLC	Pre-License Check
PSV	Post shipment verification
WINPAC	Center for Weapons Intelligence, Nonproliferation, and Arms Control
S&T	Science and Technology
SED	Shipper's Export Declaration

Appendix B: Interagency Dual-Use Export Licensing Process



(1) On or before day 9 of registration, BIS must refer the application or issue, deny, or return without action (RWA) the license.
(2) On or before day 39 of registration, the referral agencies must provide BIS with a recommendation.
(3) On or before day 40 of registration, the application can be referred to the Operating Committee, which has 14 days to make a recommendation.
(4) On or before day 59 of registration, the application can be referred to the Advisory Committee on Export Policy, which has 11 days to make a decision.
(5) On or before day 75 of registration, the application can be sent to the Export Administration Review Board, which has 11 days to make a decision.
(6) On or before day 90 of registration, the application can be escalated to the President.

Executive Order 12981 provides several circumstances for stopping these time frames, such as obtaining additional information from the applicant.

Source: Office of Inspector General

Appendix C: End-Use Checks in China

This appendix classified at the CONFIDENTIAL level
and is available separately from the Office of Inspector General.

Appendix D: Intelligence Sharing Issues for End-Use Check Targeting

This appendix is classified at the SECRET/NOFORN level
and is available separately from the Office of Inspector General.

Appendix E: BIS Management Response

UNITED STATES DEPARTMENT OF COMMERCE
Under Secretary for Industry and Security
Washington, D.C. 20230

March 23, 2006

MEMORANDUM FOR JOHNNIE FRAZIER
INSPECTOR GENERAL

FROM: David H. McCormick

SUBJECT: Response to Audit Report No. IPE-17500/March 2006
Draft Report Date: March 9, 2006
Audited Entity: Bureau of Industry and Security

Attached are the Bureau of Industry and Security's comments addressing the recommendations in the draft report entitled U.S. Dual-Use Export Controls for China Need to Be Strengthened, IPE-17500, March 2006.

There are two attachments to this memo, one unclassified and one classified at the Confidential level, relating to the unclassified report and the two classified appendices. The unclassified attachment describes the steps BIS is already taking or will take to meet the report's recommendations. The classified attachment provides an elaboration on BIS's response to Recommendation 4 and a comment on the classified text.

If you have any questions, please call me at (202) 482-1455.

Attachments

BUREAU OF INDUSTRY AND SECURITY COMMENTS:
U.S. Dual-USE Export Controls for China Need to be Strengthened
Draft Inspection Report No. IPE-17500, March 2006

Part I – Response IG Recommendations

Prior to publication of this report, the Bureau of Industry and Security (BIS) had already and independently taken steps to meet many of the report's recommendations. BIS will also begin steps to meet the remaining recommendations.

Recommendation 1: We recommend that BIS review the issue [of changing the regulations to permit denial solely on the basis of military end-use if the exported item or technology is not controlled for NS reasons] to determine whether it warrants regulatory revision, such as the addition of a military "catch-all" provisions to the EAR for items that could contribute to the development of conventional weapons but are not specifically controlled for national security reasons (see page 17).

BIS Response: BIS has completed its review of the issue and incorporated the results in a draft rule that BIS is preparing in order to implement with respect to China the Wassenaar Statement of Understanding regarding exports to countries subject to arms embargoes. BIS anticipates final interagency agreement on the draft rule and publication in proposed form for public comment by late spring 2006.

Recommendation 2: We recommend that BIS develop one consistent policy regarding exports to military end users or for military end uses in China and amend the regulations as necessary to reflect that policy (see page 21).

BIS Response: The draft rule referred to in the response to Recommendation 1 will also address this issue.

Recommendation 3: Reevaluate the number of end-use checks that should be conducted in Hong Kong based on past performance (see page 23).

BIS Response: BIS generally agrees with this recommendation and is already taking steps consistent with it. For example, on December 15, 2005, BIS's Export Enforcement reassigned an analyst to assist on Hong Kong end-use check targeting. In addition, the upcoming reorganization of BIS's Office of Enforcement Analysis (OEA), including the selection of an SES-level director, will result in an increase in the quantity and quality of BIS resources supporting license reviews and end-use checks.

Quality is as important as quantity in selecting end-use checks. It is important to target and select meaningful end-use checks that provide BIS with the most targeted and relevant information possible to assist in making licensing decisions or in detecting potential diversions to unauthorized end-uses or end-users. Therefore, BIS focuses on the quality of checks to ensure maximum security benefit.

The report also highlights a limitation BIS faces in targeting and selecting meaningful post-shipment verifications (PSVs) in Hong Kong due to the lack of sub-paragraph Export Control Classification Number (ECCN) information in the Automated Export System. BIS's response to this constraint is detailed below in response to Recommendation 5.

Recommendation 4: Improve the targeting of end-use checks in Hong Kong through (a) adequate upfront research on no-license-required shipments prior to post shipment verification requests, (b) enhanced and continued intelligence sharing between its Office of Export Enforcement and its Office of Enforcement Analysis; and (c) the utilization of intelligence information to help identify appropriate end-use checks (see page 23).

BIS Response: BIS agrees with the IG recommendation and is already taking steps to improve targeting of end-use checks. Based on feedback received during a conference with all BIS Export Control Officers (ECOs) in Washington, D.C., in October 2005, Export Enforcement revised its overall targeting and selection of end-use checks to the locations where our ECOs are located, including Hong Kong.

In addition, the upcoming reorganization of OEA is designed in part to improve coordination between OEA and the Office of Export Enforcement (OEE) on sharing intelligence information which will help to identify appropriate end-use checks in Hong Kong and elsewhere. To this end, and prior to the formal completion of the reorganization, OEA and OEE began joint weekly meetings in December 2005 to review all available export control intelligence information to ensure maximum coordination between the two offices.

Please see the Confidential attachment for additional comments on this recommendation.

Recommendation 5: Work with the U.S. Census Bureau to determine the applicability and costs associated with modifying the Automated Export System to expand the Export Control Classification Number field from the current five-digits to eight-digits (see page 23).

BIS Response: BIS agrees with the IG recommendation and is already taking steps to fill this gap. BIS is drafting the regulatory changes necessary to implement this recommendation and will soon publish an Advance Notice of Proposed Rule Making in the Federal Register to solicit comments from industry on the impact of expanding Automated Export System fields. BIS will also consult with the Census Bureau in developing this regulation.

Recommendation 6: We recommend that BIS develop a staffing plan to provide continuity in the stationing of qualified export control officers in Hong Kong and China to avoid interruptions in operations and initiate that plan at least 6 to 12 months before the end of the term of the departing export control officer (see page 28).

BIS Response: BIS agrees with this IG recommendation. OEE will specifically include as one of the critical elements of the performance plan for the OEE coordinator for BIS ECOs a requirement to coordinate and prepare the necessary vacancy announcements 6 to 12 months prior to the end of each ECO's assignment.

However, it is important to note that no staffing plan can cover every contingency. BIS currently has fewer than 400 personnel, so is unlikely to be able to create a ready pool of language-qualified ECOs that can be deployed on short notice. Thus, it is reasonable to assume that, despite the best efforts of BIS, gaps in ECO coverage will occasionally occur. In order to minimize the impact of such gaps, BIS will ensure that there is coverage in place in case of such a vacancy.

Recommendation 7: We recommend that BIS put procedures in place to provide for a technical review of technical documentation submitted by exporters and end-users to ensure their compliance and license conditions (see page 31).

BIS Response: BIS agrees that there may be instances where technical review of documentation submitted pursuant to a license condition is warranted. BIS plans to complete an internal assessment by May 12, 2006, to determine the appropriate process for conducting these reviews.

Recommendation 8: Review the process of marking and countersigning license applications with Condition 14 to identify and correct any weaknesses to ensure that these license applications are properly entered into Export Enforcement's Follow-up Subsystem and monitored by the Office of Enforcement Analysis (see page 32).

BIS Response: On March 16, 2006, BIS issued guidance to Licensing Officers and Counter Signers reminding them of the proper procedures for marking Condition 14 and other Standard Conditions. A copy of that guidance is attached.

Recommendation 9: Ensure that the Office of Exporter Services promptly forwards to the Office of Enforcement Analysis any copy of a shipper's export declaration that is submitted by an exporter (see page 32).

BIS Response: On March 16, 2006, the Operations Support Division (OSD) of Export Enforcement's Office of Exporter Services was issued guidance requiring staff to forward Shipper's Export Declaration/Automated Export System (SED/AES) documents to OEA within 48 hours of receipt. OSD was also instructed to place a copy of the documents and the transmittal memo in the Multipurpose Archival Records Retrieval System (MARRS), which is the permanent record retention system for documents related to export applications and classifications. A copy of this guidance is attached.

Appendix F: NOAA Management Response

UNITED STATES DEPARTMENT OF COMMERCE
National Oceanic and Atmospheric Administration
CHIEF ADMINISTRATIVE OFFICER

MAR 27 2006

MEMORANDUM FOR: Jill Gross
Assistant Inspector General for Inspections and Program Evaluations

FROM: William F. Broglie
Chief Administrative Officer

SUBJECT: NOAA's Comments to the Office of Inspector General's (OIG) Draft Report—*Bureau of Industry and Security: U.S. Dual-Use Export Controls for China Need to Be Strengthened*
Draft Report No. IPE-17500/March 2006

Thank you for the opportunity to comment on the OIG draft report on China export controls. Attached are the comments from the National Oceanic and Atmospheric Administration.

Attachment

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Office of Inspector General

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NOAA Comments on the Draft OIG Report Entitled
"Bureau of Industry and Security:
U.S. Dual-Use Export Controls for China Need to be Strengthened"
(IPE-17500/March 2006)

General Comments

Thank you for the opportunity to review and comment on the Office of Inspector General (OIG) draft report on China export controls. The National Oceanic and Atmospheric Administration (NOAA) agrees with the OIG overall findings and recognizes the continued need to heighten awareness within its research community to ensure compliance with the Export Administration Regulations (EAR). NOAA appreciates the OIG's recognition that NOAA has made progress in fulfilling the recommendations made in their March 2004 deemed export report. NOAA is committed to continued progress in this area and to collaborating with both the Bureau of Industry and Security (BIS) and the National Institute of Standards and Technology (NIST) where applicable.

Recommended Changes for Factual/Technical Information

Cover letter to Vice Admiral Conrad C. Lautenbacher, Jr.;
Executive Summary, Page V, first full paragraph, line 6;
and
Page 38, second full paragraph, line 7:

The OIG draft report noted, in the three instances above, that the BIS has not completed its review of NOAA's preliminary assessment. However, on February 16, 2006, BIS provided favorable feedback regarding NOAA's inventories and assessment, including NOAA's conclusion that there are no instances where deemed export licenses are needed for any foreign nationals working in NOAA facilities.

Page 37, second paragraph, last line:
Amend sentence as follows: ". . . through activities such as lectures, **(insert)** collaborative projects, and participation in workshops and conferences."

Page 37, third paragraph, second line:
Amend sentence as follows: "The first protocol, with the China Meteorological Administration, is managed **(insert)** on the U.S. side by the National Weather Service. . ."

Page 37, third paragraph, third line:
Amend sentence as follows: "The second protocol, with China's State Oceanic Administration, is managed **(insert)** on the U.S. side by the Office of Oceanic and Atmospheric Research. . ."

Editorial Comments
None.

NOAA Response to OIG Recommendations
This report contains no recommendations for NOAA.

1

Appendix C. Department of Defense Report

March 30, 2006

Export Controls

Controls Over Exports to China
(D-2006-067)

Department of Defense
Office of Inspector General

Quality *Integrity* *Accountability*

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Acronyms

DTSA	Defense Technology Security Administration
USXPORTS	US Exports System

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

March 30, 2006

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

SUBJECT: Report on Controls Over Exports to China
(Report No. D-2006-067)

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

We requested and received comments from the Acting Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy, who is also the Director of the Defense Technology Security Administration.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Deputy Under Secretary's comments were responsive; however, we request additional comments on Recommendation 2.a. by May 2, 2006. We revised, redirected, and renumbered Recommendation 1.a. to the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy, based on the Deputy Under Secretary's comments.

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

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Dennis L. Conway (703) 604-9172 (DSN 664-9172) or Mr. Jerry H. Adams at (703) 604-8775 (DSN 664-8775). The team members are listed inside the back cover. See Appendix D for the report distribution.

By direction of the Deputy Inspector General for Auditing:

Wanda A. Scott
Assistant Inspector General
Readiness and Operations Support

Department of Defense Office of Inspector General

Report No. D-2006-067 **March 30, 2006**
(Project No. D2005-D000LG-0220.000)

Controls Over Exports to China

Executive Summary

Who Should Read This Report and Why? Personnel who are responsible for advising DoD management on releasing exports to China should read this report because it discusses the effectiveness of the DoD process for reviewing applications to export technology to China.

Background. Public Law 106-65, "National Defense Authorization Act for FY 2000," requires the Inspectors General of the Departments of Commerce, Defense, Energy, and State to conduct annual reviews on the transfer of militarily sensitive technology to countries of concern. For 2006, the Inspectors General decided to review controls over exports to China.

According to the Export Administration Regulation, the Department of Commerce can consult with other Federal departments, including DoD, on reviews of export license applications. Within DoD, the Director of the Defense Technology Security Administration is responsible for reviewing license applications and making decisions on export license applications, to include documenting the analytical basis of the decisions. If the other departments disagree with DoD decisions, DoD can appeal.

Results. The Defense Technology Security Administration (the Administration) had controls in place and operating for its application review process. The Administration was reviewing and processing 97 percent of its export applications related to China exports within the 30-day regulatory time limit. However, improved controls were needed in:

- documenting its analyses on export applications. Of the 90 applications[1] reviewed, 69, or 76.6 percent, did not have sufficient analyses documented to support Administration decisions,

- inserting documents into its automated system to support its analyses. Of the 90 applications reviewed, 62, or 68.8 percent, did not contain documents supporting the analysis on applications, and

- elevating disagreements with its decisions. Of 21 denial decisions, 13, or 61.9 percent, of the export denial decisions were overturned and approved by the Department of Commerce; those decisions were not elevated in the appeal process.

[1] Judgment sample percentages do not generalize to the universe export applications processed by the Administration in FY2004.

As a result, the Administration made some unsupported decisions and other decisions were not elevated to the full extent. The Administration decisions could allow the export of technology that could threaten U.S. efforts to maintain regional stability; hinder nonproliferation of nuclear, chemical, and biological weapons; and adversely effect national security. The Director, Defense Technology Security Administration needs to record analyses and documentation supporting reviews in the export automated system. (See the Finding section of the report for the detailed recommendations.)

Management Comments and Audit Response. The Acting Deputy Under Secretary for Technology Security Policy and National Disclosure Policy concurred or partially concurred with five of the seven recommendations and nonconcurred with the other two recommendations. The Acting Deputy Under Secretary concurred with updating export review process guidance; informing users to maintain access with the automated export application processing system; and providing written responsibilities, as well as recording training, for the management control program.

The Acting Deputy Under Secretary partially concurred with adjusting her program for assessing the effectiveness of management controls, but during the audit, she revised the management control plan and issued it in March 2006. We consider this action as meeting the intent of this recommendation. The Acting Deputy Under Secretary also agreed to elevate decisions as much as the appeal process will allow, which meets the intent of the recommendation.

The Deputy Under Secretary stated that she nonconcurred with recording additional analyses and documents to support decisions on some export applications. However, the Export Administration Regulation requires any analyses to be recorded that includes the factual and analytical basis supporting the advice, recommendations, or decisions made on an export application. Therefore, we request the Acting Deputy Under Secretary reconsider her position and provide additional comments by May 2, 2006.

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Background

Annual Review of Technology Transfers. In FY 2000, Congress passed Public Law 106-65,[1] requiring that transfers of sensitive technology to countries of concern be reviewed starting in 2000 and ending in 2007. For 2006, six Inspectors General decided to review controls over exports to China. The six Inspectors General represented the Departments of Commerce, Defense, Energy, Homeland Security, State, and the Central Intelligence Agency. This audit report addresses the DoD portion of the 2006 interdepartmental review.

Legislative Controls Over Exports. The primary legislative authority for controlling the export of goods and technologies with both civilian and military uses (dual-use) is the Export Administration Act of 1979, as amended (section 2401, title 50, United States Code.)[2] The Export Administration Regulation states that the Export Administration Act authorizes the Secretary of Commerce to issue procedures for exporting dual-use items.

Department of Commerce. The Export Administration Act authorizes the Bureau of Industry and Security, Department of Commerce to oversee the export of dual-use items. The Export Administration Regulation implements the requirements of the Export Administration Act and includes the Commerce Control List of dual-use items—goods and technologies—that are subject to the export review process.

U.S. Export Process. All items on the Commerce Control List must have an approved license, or an exception granted by the Department of Commerce, to be exported from the United States. The type of item being exported, the country of final destination, and the end-use of the item determines whether an export license is needed or an exception can be granted.

DoD Role in the Export Process. Within DoD, the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy is responsible for developing and issuing policies controlling exports. The Deputy Under Secretary also serves as the Director of the Defense Technology Security Administration (DTSA), who is responsible for coordinating reviews of license applications and reporting decisions on those reviews to the Department of Commerce. DTSA processed 1,719 applications amounting to more than $811 million in FY 2004 for exports to China.

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

[2] The Export Administration Act expired in August 1994. However, the President, under the authority of the International Emergency Economic Powers Act (50 U.S.C. 1702), continued the provision of the Export Administration Act through Executive Orders 12924 and 13222, "Continuation of Export Control Regulations," August 19, 1994, and August 17, 2001, respectively. Each year thereafter, and most recently on August 2, 2005, the President issued a notice, "Continuation of Emergency Regarding Export Control Regulations," continuing the emergency declared by Executive Order 13222.

Objectives

The overall audit objective was to determine whether controls over exports to China were in place and operating as intended. Specifically, we determined whether DoD assessed applications for exports to China in accordance with the requirements of the Export Administration Regulation. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology and Appendix B for prior coverage related to the objectives.

Managers' Internal Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the management controls over the export application review process, and we also reviewed the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. DTSA established a management control program that included:

- maintaining an inventory of assessable areas (or units) based on its organizational functions;
- evaluating the effectiveness of its controls in those assessable units; and
- publishing an annual statement of assurance on the adequacy of its controls.

DTSA had established 11 assessable units. Of the 11 units, 3 (policy development, export license application processing, and technology security assessments), were controls for processing export applications. However, we identified weaknesses in the DTSA self-assessment of its controls for processing export applications. The recommendations in this report, if implemented, should correct the identified weaknesses and could result in preventing exports of potentially militarily sensitive technology to China. A copy of this report will be provided to the senior official responsible for management controls in the Office of the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy.

Adequacy of Management's Self-Evaluation. DTSA did not always support its decisions on export applications because it did not fully achieve requirements in

the export administration regulation and the self-assessment of its internal controls did not detect weaknesses in:

- providing complete analyses on export applications, and
- inserting documents into its automated system to support its analyses.

In addition, we determined that the senior management control official was not held responsible in writing for administering the program. Further, DTSA did not have evidence to show that operating and assessable unit managers were trained to perform their management control duties.

Controls Over Exports to China

The DTSA controls were in place and operating for reviewing applications to export to China. Specifically, the DTSA reviewed and processed 97 percent of its export applications for China within the 30-day regulatory time limit. However, improved controls were needed in:

- documenting its analyses on export applications. Of the 90 judgmentally selected applications[3] reviewed, 69, or 76.6 percent, did not have sufficient analyses documented to support DTSA decisions,

- inserting documents into its automated system to support its analyses. Of the 90 applications reviewed, 62, or 68.8 percent, did not contain documents supporting the analysis on applications,

- elevating disagreements with its decisions. Of 21 decisions, 13, or 61.9 percent, of export denial decisions, were overturned and approved by the Department of Commerce; those decisions were not always elevated in the appeal process, and

- assigning management control responsibilities in writing and recording management control training.

These conditions existed because the DTSA did not fully achieve requirements in the Export Administration Regulation and because management's assessment of its internal controls did not detect weaknesses in the application review process.

As a result, DTSA made some unsupported decisions that could allow the export of technology that could threaten U.S. efforts to maintain regional stability; hinder nonproliferation of nuclear, chemical, and biological weapons; and adversely effect national security.

Controls Over the Export Application Process

DTSA controls were in place for reviewing applications for exports to China. However, DTSA analyses were not always sufficient and its decisions on those applications were not always supported with documents. DTSA processed 1,719 applications for export licenses to China during FY 2004.

Processing Export Applications. DTSA generally processed applications for exports to China in a timely manner. The Export Administration Regulation states that an agency such as DoD that is reviewing export applications must provide the Department of Commerce with a recommendation either to approve

[3] Judgment sample percentages do not generalize to the universe of export applications processed by DTSA in FY 2004.

(with or without conditions) or deny a license application within 30 days of receipt. In FY 2004, DTSA processed 1,719 applications for exports to China and 1,668 of the 1,719 applications, 97 percent, were processed in 30 days or less.

License Review and Analysis Process. DTSA pre-screens applications from the Department of Commerce and decides whether to refer them to other DoD organizations for review. DTSA did not refer the applications to other DoD organizations if the applications could be processed in a thorough, responsive, and consistent manner, and complied with guidance. If the pre-screen criteria were not met, DTSA referred applications to other DoD organizations for review. The export application review process is shown in the following figure.

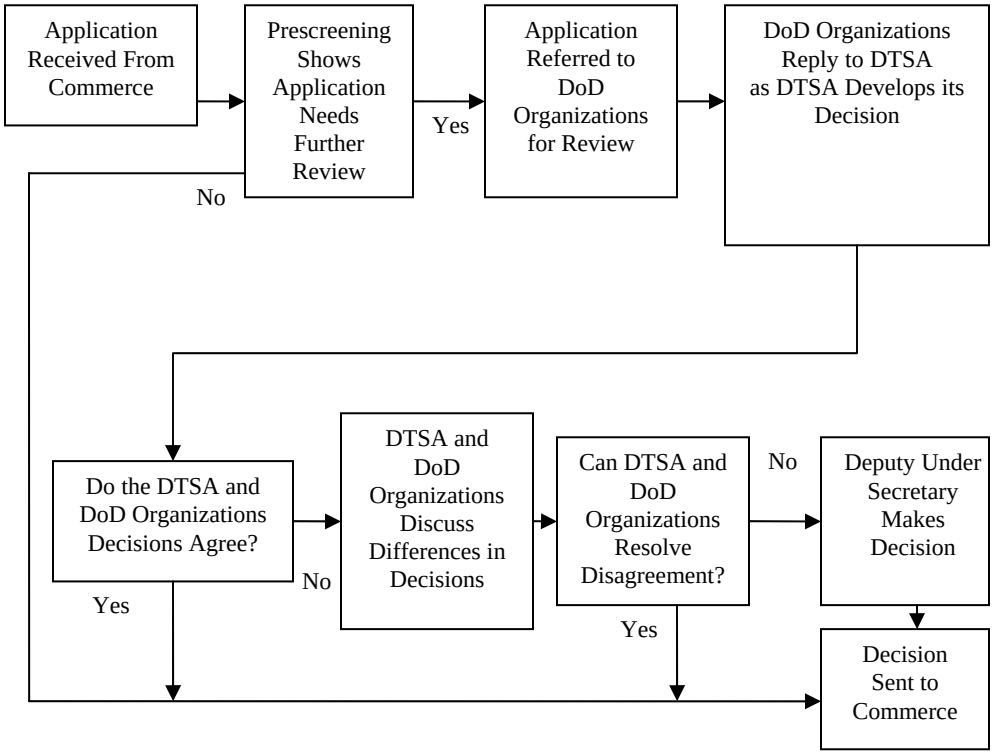

Figure 1. License Application Review and Analysis Process

Role of DoD Organizations in Review Process. The Deputy Secretary of Defense issued a memorandum on October 4, 1999, which directed DoD organizations to follow the review process for DoD export licenses. Subsequently, the Deputy Under Secretary of Defense for Technology and Security Policy (currently the Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy) issued a memorandum on November 18, 1999, which provided detailed guidance to DoD organizations for reviewing export applications. In that guidance, the Deputy Under Secretary cited 18 DoD organizations that were responsible for reviewing export applications.

We compared the names of those 18 DoD organizations with a list that DTSA provided of 42 organizations with access to the U.S. Exports System (USXPORTS)—USXPORTS is the DTSA automated system for processing export applications. We determined that 4 of the 18 organizations in the Deputy Under Secretary's guidance did not have access to the USXPORTS system; therefore, those organizations, such as the International Security Affairs' office for Asia and the Pacific, were unable to electronically review export applications. Therefore, DTSA should provide the 4 DoD organizations with access to USXPORTS to facilitate reviews of export applications.

In addition, we noted that the Deputy Under Secretary for Technology and Security Policy memorandum was not updated to reflect current DoD responsibilities or organizations processing export applications. For example, the memorandum states that the Defense Threat Reduction Agency will develop the final DoD decision on export applications with input from DoD reviewing organizations even though DTSA currently has this responsibility.

In addition, the memorandum cites organizations, such as the Ballistic Missile Defense Organization, which is now the Missile Defense Agency. Therefore, the Deputy Under Secretary of Defense for Technology and Security Policy and National Disclosure Policy should update the guidance in the November 1999 memorandum to reflect the current organizations and responsibilities in the DoD application review process.

Developing Decisions on Export Applications. DTSA established a process for developing decisions on export applications, but the analyses and documentation supporting those decisions needed improvement. Table 1 shows DTSA decisions on applications requesting export licenses to China during FY 2004. Also, Table 1 shows that DTSA made decisions (with conditions) to approve 1,400 export applications and to deny 253 applications. Those 1,653 applications represented 96.1 percent of the 1,719 applications processed in FY 2004. We judgmentally selected 30 of the 1,400 applications that DTSA approved (with conditions) and 60 of the 253 applications that DTSA denied and reviewed them for sufficient documentation and analyses supporting the DTSA decisions.

Documentation and Analysis Supporting Decisions on Export Applications. Although export applications were generally processed timely, 69 of the 90 applications in our judgment sample, 76.6 percent, lacked either a sufficient written analysis or documentation supporting the DoD decision. According to the Principal Statutory Authority for the Export Administration Regulation:

> Recordkeeping.--The Secretary [of the Department of Commerce], the Secretary of Defense, and any other department or agency consulted in connection with a license application under this Act or a revision of a list of goods or technology subject to export controls under this Act, shall make and keep records of their respective advice, recommendations, or decisions in connection with any such license application or revision, including the factual and analytical basis of the advice, recommendations, or decisions.

Table 1. Decisions Made on Applications for Export Licenses in FY 2004							
Type of Export	Approve	Approve with Conditions	Deny	Returned without Action	Split[4]	No Decision	Total Types
Nuclear Materials	0	2	2	0	0	0	4
Chemicals and Toxins	0	128	14	8	4	0	154
Materials Processing	0	419	47	7	3	0	476
Electronics	0	356	84	18	8	1	467
Computers	0	80	4	2	0	0	86
Telecommunications	1	332	26	6	1	1	367
Sensors and Lasers	0	54	62	3	0	0	119
Navigation and Avionics	0	15	1	1	0	0	17
Marine	0	4	2	0	0	0	6
Propulsion Systems	0	4	2	0	1	0	7
Other Types of Exports	0	6	9	1	0	0	16
Total Applications	1	1,400	253	46	17	2	1,719

In addition, DoD Directive 5010.38 states that each DoD field activity—DTSA is a DoD field activity—must implement management controls that provide reasonable assurance that programs, as well as administrative and operating functions, are efficiently and effectively carried out in accordance with applicable laws and management policy. Further, the Government Accountability Office, "Standards for Internal Control in the Federal Government," November 1999, state that:

> Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation.

DTSA used the USXPORTS system to store documents that supported analyses of export applications; however, USXPORTS did not contain documents that supported the analysis of 62 of the 90 applications, 68.8 percent, in our review. For example, USXPORTS did not contain documents such as intelligence reports to support some analyses. For those 90 applications, DTSA approved 30 with conditions and denied the 60 other applications. For 69 of the 90 applications, 76.6 percent, in our review, the analysis recorded in USXPORTS was not sufficient to support the DTSA decision on the application. For example, DTSA

[4] DTSA personnel informed us that split decisions involve approving and/or denying certain elements within the same license application. For example, DTSA might approve (with conditions) some end users on a license application but deny some of the other end users on that same application.

did not record any analyses for some items, but decided to approve the items (with conditions) for export.

During our review, we determined that DTSA returned some applications to the Department of Commerce that were not reviewed by other DoD organizations. In FY 2004, DTSA returned 276[5] of the 1,719 applications, 16.1 percent, that it processed during pre-screening to the Department of Commerce without referring them to other DoD organizations. DTSA returned those applications to the Department of Commerce in an average of 5 days (25 days before the required time limit). We reviewed each of the 276[6] applications and determined that DTSA did not record its analyses as well as documents did not exist that could support any of those applications in USXPORTS.

Although DTSA generally processed applications for exports to China timely, it should have recorded its analyses and documentation in USXPORTS to support the basis for its decisions. Previously documented analyses with supporting documentation from an identical application could be copied from prior application files and inserted into the current application file if no new information is received.

Also, in cases where an application is similar to a prior application, an analysis should be performed on the differences between the old and the new application and the results recorded in USXPORTS, along with the applicable analysis and documentation from the prior application. Those actions could help DTSA to comply with the Export Administration Regulation and DoD Directive 5010.38.

Elevating Decisions in the Export Application Review Process. The Export Administration Regulation requires the Departments of Commerce, Defense, Energy, and State to recommend decisions on reviewed applications to the Department of Commerce within 30 days. If all the decisions are the same, for example, if each Department recommends approval of an export application, the Department of Commerce generally makes a final decision that reflects the consensus of all the departments.

If the departments' decisions differ, the application is automatically elevated to the Department of Commerce Operating Committee[7] for resolution. The Chairman of the Operating Committee considers the recommendations of each department and any information provided by the applicant before making a decision on the application.

Each department is informed of the chairman's decision and, if any department disagrees, that department may elevate the decision within 5 days by appealing to the Chairman of the Advisory Committee on Export Policy. This committee has assistant Secretariat-level membership.

[5] Our sampling of 90 applications includes prescreened applications included in the 276 applications which were returned to the Department of Commerce without further review.

[6] Sixteen of the 90 applications in our initial sample were also present in the sample of 276 applications.

[7] The Operating Committee's membership includes representatives from the Departments of Commerce, State, Defense, Energy, the Arms Control and Disarmament Agency, the Joint Chiefs of Staff, and the Director of the Nonproliferation Center of the Central Intelligence Agency.

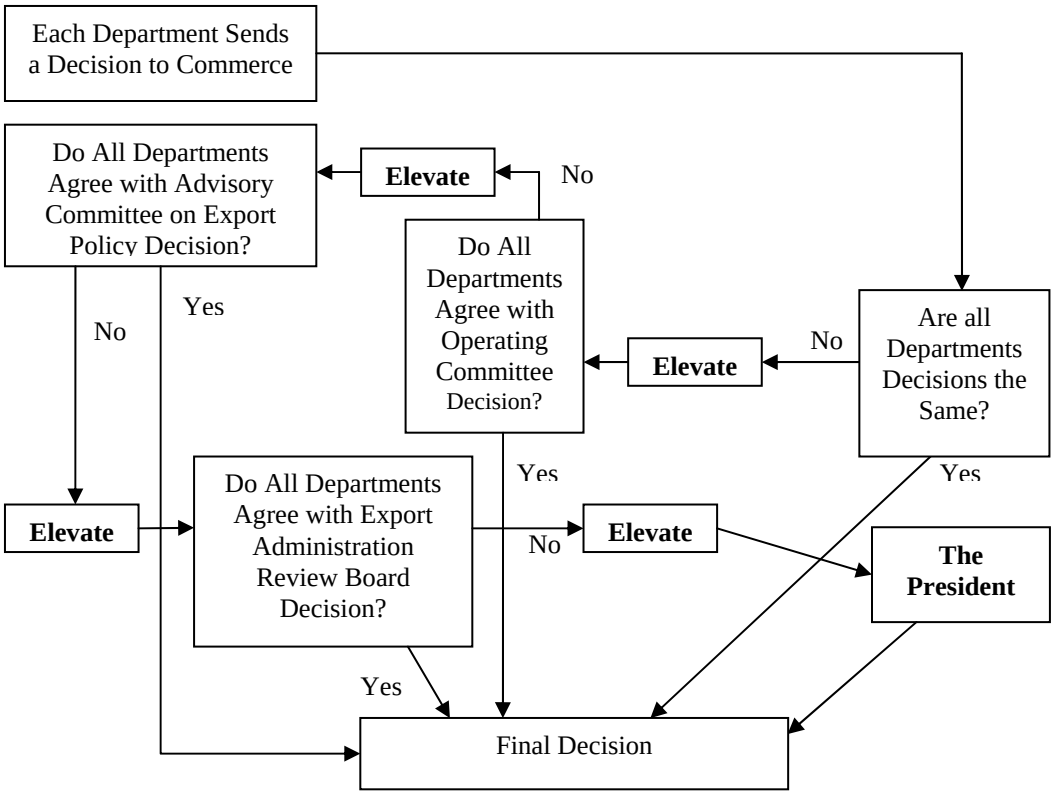

Figure 2. Export Application Appeal Process

DTSA did not always exercise its option to elevate decisions overturned by the Operating Committee. We determined that 13 of 21 DTSA denial decisions had sufficient analysis and documentation in USXPORTS, but that the Operating Committee overturned the decisions. DTSA decided not to appeal and elevate these decisions to the Advisory Committee; however, its records did not disclose why these decisions were not elevated in the appeal process.

If the Advisory Committee had not approved its decision, DTSA could have appealed to the Export Administration Review Board. This Board has Secretariat-level membership. If the Board disagreed with DTSA's decision, DTSA could elevate its decision to the President of the United States. See Appendix C for details on the membership and responsibilities of the committees and board in the application appeal process.

DTSA Actions to Gain Agreement with its Decisions to Deny Applications. During the audit, DTSA took action to gain agreement on some of its denial decisions. For example, in September 2005, DTSA sent a memorandum to the Department of Commerce requesting a change in the Export Administration Regulation. DTSA requested the Department of Commerce to change the Export Administration Regulation to deny exports to China if an approval would have an effect on national security. To emphasize its concerns, DTSA provided the following examples:

> . . . at the March 26, 2004 ACEP [Advisory Committee on Export Policy meeting], the agencies voted 3-1 to deny a gas analyzer to a Chinese end-user. . . . However, a denial could not be issued because the item was not controlled for NS [National Security] reasons.
>
> A similar case, . . . for CB [Chemical and Biological] controlled hydrofluoric acid and nitric acid to a Chinese end-user was initially denied 4-0 at the December 19, 2003 meeting of the Advisory Committee on Export Policy. Commerce issued an approval, as the interagency could not legally sustain an NS [National Security]-based denial for CB [Chemical and Biological]-controlled items, despite serious concerns that this item was being used by the Chinese military.

Thus, DTSA took positive actions to appeal the final decision on these applications. However, for the 13 applications that DTSA denied and were subsequently approved, DTSA could have taken further actions toward appealing and elevating its decisions.

In FY 2004, DTSA made decisions to deny 253 of the 1,719, 14.7 percent, export applications it processed for China. We reviewed 60 of those 253 denial decisions, which represented all the DTSA denial decisions in our sample of 90 applications, to determine whether DTSA appealed and elevated its decisions. According to data recorded in USXPORTS, DTSA appealed and elevated one decision above the Operating Committee level.

Further review showed that 21 of the 60 decisions to deny applications had sufficient analysis and documentation in USXPORTS. The other 39 denial decisions may have been justifiable, but insufficient analysis or documentation in the USXPORTS system did not allow us to determine their validity. For 13 of the 21 decisions, 61.9 percent, DTSA decided not to elevate its denial decisions. Of the 13 decisions, 1 application was approved to export chemicals that may be used as precursors for toxic chemical agents. The other 12 applications were approved to export thermal imaging systems, which could potentially be used for military purposes by China.

In response to our findings, DTSA stated that the greatest obstacle to elevating decisions is a system bias that favors approving licenses. In addition, DTSA contended that DoD was burdened with the responsibility for elevating decisions because it was rendering a decision to deny a license. Further, DTSA responded to a draft of this report and stated that:

> . . . DTSA has consistently made sound decisions about escalation based upon the relative importance of national security concerns, prior precedent, effectiveness of mitigation measures, and the likelihood of success, carefully weighting the collective judgment of licensing officers, technical experts, policy advisors, and threat assessment officers with years of experience in the export licensing business. . . .

While DTSA cited concerns that the Export Administration Regulation was written to promote the approval of export licenses, the regulation also establishes controls over exports to countries of concern to the United States. We coordinated with the Inspector General, Department of Commerce on potential

recommendations that could modify the current export policies, practices, and regulations related to China and focus on denying items that potentially contribute to China's military development. However, until the export rules for China change, DoD assumes part of the risk that exports may have an adverse effect on the United States when valid denial decisions are overturned and not elevated in the appeal process. The Department can mitigate this risk by elevating decisions to the fullest extent possible when the appeal process does not produce a decision that supports the national security posture.

Assessment of Controls for Export Applications

DTSA did not adequately document its decisions on applications for making exports to China because its program for assessing the adequacy of internal controls was not fully effective. DoD Instruction 5010.40 states that each DoD Component must establish and maintain a process that identifies, reports, and corrects management control weaknesses.

DTSA Management Control Program. The DTSA management control program included:

- maintaining an inventory of assessable areas or units based on its organizational functions;
- evaluating the effectiveness of its controls in those assessable units; and
- publishing an annual statement of assurance on the adequacy of its controls.

DTSA had established 11 assessable units. Three of the 11 units (policy development, export license application processing, and technology security assessments) were controls for processing export applications.

DTSA Assessment of Controls. The DTSA self-assessment of its internal controls for the three assessable units responsible for processing export applications, was not fully effective. An effective self-assessment program should have found the weaknesses in documenting analyses on export applications and inserting documents into USXPORTS to support analyses.

DTSA management did not provide written responsibilities to the senior management control official for administering the program. In addition, DTSA could not provide documentation showing that operating and assessable unit managers were trained to perform their duties. DTSA needs to adjust its self-assessment program to monitor more closely the analyses and documentation recorded in USXPORTS.

Impact of DoD Decisions on Exports

DTSA made some decisions that it did not support with sufficient documentation in USXPORTS. Also, DTSA accepted some risks to national security when it did not elevate valid denial decisions, which had been overturned and approved by the Department of Commerce. Those overturned decisions could allow exports of technology that may threaten U.S. efforts to maintain regional stability; hinder nonproliferation of nuclear, chemical, and biological weapons; or adversely affect national security. Table 2 shows the number of applications with insufficient analyses or documentation for the four types of exports in our review.

Table 2. Types of Items Approved for Export to China Without Sufficient Analysis or Documentation and their Potential Impact

Type of Export	Regional Instability	Proliferation of Nuclear Weapons	National Security/ Regional Instability	Chemical and Biological Weapons	Total Applications Reviewed
Chemicals and Toxins	0	0	0	2	2
Materials Processing*	23	0	0	0	23
Electronics	0	7	0	0	7
Sensors and Lasers	0	0	37	0	37
Total	23	7	37	2	69

*Materials processing includes nuclear materials handling and processing.

The Acting Under Secretary for Industry and Security, Department of Commerce, testified on the potential effects of exports to China at the June 23, 2005, U.S.-China Economic and Security Review Commission hearing.

The Acting Under Secretary is responsible for overseeing the Bureau of Industry and Security's mission to advance U.S. national security, foreign policy, and economic interests by regulating the export of sensitive dual-use goods and technologies. The Bureau of Industry and Security works with other U.S. Government agencies, including the Departments of State, Defense, Energy, Homeland Security, and Justice to protect the national security of the United States.

The Acting Under Secretary testified to the following:

> China poses particular challenges for U.S. dual-use export control policy, because there are immense potential benefits from expanding trade, but, there are also serious security concerns . . .
>
> U.S. exports to China have continued to rise for the past 20 years, and in 2004, U.S. exports to China went up over 22 percent. The increase in U.S. exports, not surprisingly, has included some dual-use goods,

> such as semiconductor manufacturing equipment, chemicals, chemical manufacturing equipment, and high performance computers.
>
> From a security standpoint, the U.S. Government remains concerned about China's modernization of its conventional military forces and the risk of diversion of sensitive dual-use items and technology to Chinese military programs. . . . Advanced telecommunications equipment–if illegally diverted to military end-users–could provide the Chinese missile, nuclear weapons and other military programs with the means to enhance performance capabilities in military radar applications. . . .
>
> In conclusion, it serves our common security, foreign policy, and economic interests for the United States and China to expand our economic relationship. At the same time, we continue to have significant differences with China on security and foreign policy issues that dictate a cautious way forward in our overall political, economic, and strategic relationship. While this may slow the entry of certain sensitive U.S. industry sectors into the Chinese marketplace, we must protect U.S. national security and foreign policy interests.

This testimony clearly depicts the potential adverse effects of exporting militarily sensitive items to China. Therefore, DTSA needs to record its analyses and insert documentation in USXPORTS to support its decisions. DTSA should also consider elevating decisions to the fullest extent possible when the appeal process does not produce a decision that supports the national security posture. These actions may help to reduce unjustified exports to China and strengthen U. S. efforts to maintain regional stability; hinder proliferation of nuclear, chemical, and biological weapons; and offset adverse effects on national security.

Recommendations, Management Comments, and Audit Response

Revised, Redirected, and Renumbered Recommendation. As a result of management comments from the Deputy Under Secretary of Defense for Technology and Security Policy and National Disclosure Policy, we revised, redirected, and renumbered Recommendation 1. in the draft report to the Director, Defense Technology Security Administration, shown as Recommendation 1.a. below. Draft Recommendations 2. and 3. have been renumbered as Recommendations 1.b. and 2., respectively.

1. We recommend that the Deputy Under Secretary of Defense for Technology and Security Policy and National Disclosure Policy:

a. Grant access privileges to the four DoD organizations, currently without access to USXPORTS, to facilitate reviews of export applications.

b. Update the guidance for the export review process to reflect current organizations and responsibilities.

Management Comments. The Deputy Under Secretary of Defense for Technology and Security Policy and National Disclosure Policy concurred and stated that they would inform users, within 60 days of becoming disconnected from USXPORTS, of the need to maintain access. In addition, the Deputy Under Secretary concurred with reflecting organizational changes accurately in the export review process guidance.

2. We recommend that the Director, Defense Technology Security Administration:

a. Prepare written analyses to support decisions on export applications and maintain documents in USXPORTS to support those decisions.

b. Elevate decisions to the extent possible when the appeal process does not produce a decision that supports the national security posture.

Management Comments. The Acting Deputy Under Secretary of Defense for Technology and Security Policy and National Disclosure Policy nonconcurred with Recommendations 2.a. and b., stating that the conclusions forming the basis of the recommendations were supported by incomplete and untimely data.

Although the Acting Deputy Under Secretary generally agreed that complete analysis was a necessary and proper part of the licensing process, she did not agree that inclusion of every facet of analysis was necessary in every application case file. Further, she stated that the need to augment application cases with additional documentation was unwarranted and demonstrated a lack of understanding of the review and decision process.

In addition, the Acting Deputy Under Secretary stated that USXPORTS was designed to avoid redundancy and to permit data retrievals via searches in USXPORTS. Further, the Acting Deputy Under Secretary stated she had a highly professional staff of engineers with advanced degrees and experience in DoD laboratories, as well as analysts with intelligence, policy, and licensing experience. This staff enabled DTSA to make most decisions without relying on outside experts or needing to extensively document analyses performed.

Audit Response. The comments were partially responsive. In regard to Recommendation 2.a., the Export Administration Regulation requires DoD to make and keep records of advice, recommendations, or decisions in connection with any license application or revision to include the factual and analytical basis of the advice, recommendations, or decisions.

Although DTSA recorded and documented thorough analyses for some decisions, other decisions either had no recorded analyses or needed additional analyses or documentation recorded to support the DoD recommended decisions. In addition, if supporting documentation exists in USXPORTS, DTSA should ensure that cross-references are placed within the case files to link the analyses to the stored or archived supporting documentation. Therefore, we request the Acting Deputy Under Secretary reconsider Recommendations 2.a. and provide additional comments by May 2, 2006, on this final report.

In regard to Recommendation 2.b., although the Acting Deputy Under Secretary non-concurred with our finding, she agreed to elevate decisions on applications to the extent possible; which meets the intent of the recommendation.

c. Provide written responsibilities to the senior management control official for administering the management control program.

d. Maintain documentation of training that managers of operating and assessable units receive.

Management Comments. The Acting Deputy Under Secretary concurred with Recommendations 2.c. and d. and stated that DTSA's management control plan, signed in March 2006, accomplished these recommendations.

e. Adjust the internal management control program to more effectively assess internal controls for recording analyses and documentation in USXPORTS.

Management Comments. The Acting Deputy Under Secretary partially concurred with Recommendation 2.e., stating that adjustments were made to the management control plan in March 2006 to accomplish the recommendations. Specifically, she stated that the plan was revised and updated to include standard operating procedures and position descriptions that assigned clear responsibilities, roles, and duties concerning the processing of licenses. This action met the intent of the recommendation.

Appendix A. Scope and Methodology

We reviewed the following documents to determine DoD responsibilities in the export license application review process. We reviewed Executive Orders and Federal laws and regulations, including the Export Administration Act and the associated Export Administration Regulation. In addition, we evaluated the adequacy of DoD directives, policies, and regulations related to the transfer of militarily sensitive technology to countries of concern.

We performed this audit from June 13, 2005, through March 15, 2006, in accordance with generally accepted government auditing standards.

We interviewed personnel in the following organizations:

- Department of Commerce;
- Immigrations and Customs Enforcement, Department of Homeland Security;
- Bureau of Economic and Business Affairs, Department of State;
- Department of the Army;
- Department of the Navy;
- Office of the Deputy Under Secretary of Defense for Technology Security Policy;
- Office of Export Controls and Conventional Arms Nonproliferation Policy;
- Washington Headquarters Services, Office of the Secretary of Defense;
- Defense Security Service;
- DTSA;
- Air Products and Chemicals, Incorporated;
- FLIR Systems, Incorporated; and
- Princeton Instruments, Incorporated.

Our contacts with personnel in these organizations included discussions on the export license application review process and their roles and responsibilities.

We assessed the effectiveness of the DoD export license application review process to determine that militarily sensitive goods and technology were not exported to countries of concern. To complete this assessment, we judgmentally selected a total of 350 items[1] from the 1,719 applications for China exports that the DTSA processed during FY 2004.

We reviewed the applications to determine whether the DTSA was properly analyzing, documenting, and opining on export license applications. Also, we compared the DTSA final decisions on the applications with the Department of Commerce final decisions on the applications to identify discrepancies.

For our sample, we obtained a database from the DTSA of all export license applications for exports to China. The database showed the Department of Commerce received 1,719 dual-use license applications requesting to make exports to China. We judgmentally designed a sample for reviewing 90 of the applications from the database. We judgmentally selected export applications which were approved with conditions or that DTSA denied. These two categories of applications represented 96.1 percent of the applications that DTSA processed in FY 2004. We reviewed these applications for the existence of documentation and the sufficiency of analyses supporting the DTSA decisions.

Use of Computer-Processed Data. We relied on computer-processed data from the USXPORTS system. We summarized detailed data contained within this automated export licensing system. We did not find any material errors that would preclude our use of the computer-processed data to meet the audit objectives or that would change the conclusions in this report. We concluded that the system controls were adequate for our purposes in conducting this audit.

Use of Technical Assistance. We received technical assistance from the DoD Office of Inspector General's Quantitative Methods Division, which advised us on the selection of the sample size. We also received technical assistance from the General Counsel and Assistant Inspector General for the Office of Legal Counsel on the Tiananmen Square sanctions.

[1] We initially selected 90 export applications to assess whether analyses were recorded and documents existed to support those analyses. We determined that DTSA was returning some applications to the Department of Commerce without review by other DoD organizations and that 276 of the total 1,719 applications were returned to the Department of Commerce without review by other DoD organizations. We reviewed each of the 276 applications to determine whether analyses were recorded and documents existed to support those applications. Of the 90 applications in our initial sample, 16 were also in the sample of 276 applications.

Appendix B. Prior Coverage

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

GAO

GAO Report No. GAO-01-528, "Export Controls: State and Commerce Department License Review Times are Similar," June 14, 2001

DoD IG

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

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

DoD IG Report No. D2003-070, "Export Controls: DoD Involvement in Export Enforcement Activities," March 28, 2003

DoD IG Report No. D-2003-021, "Security: Export Controls Over Biological Agents (U)," November 12, 2002

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

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

Interagency Reviews

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

Inspectors General of the Departments of Commerce, Defense, Energy, Homeland Security, and State and the Central Intelligence Agency Report No. D-2004-062, "Interagency Review of Foreign National Access to Export-Controlled Technology in the United States," April 16, 2004

Inspectors General of the Departments of Commerce, Defense, State, and the Treasury; the Central Intelligence Agency; and the United States Postal Service Report No. D-2003-069, "Interagency Review of Federal Export Enforcement Efforts," April 18, 2003

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

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

Appendix C. Export Application Appeal Process

Operating Committee. The Operating Committee's voting members include representatives of appropriate agencies in the Departments of Commerce, State, Defense, Energy, and the Arms Control and Disarmament Agency. The appropriate representatives of the Joint Chiefs of Staff and the Director of the Nonproliferation Center of the Central Intelligence Agency are non-voting members. The Department of Commerce representative, appointed by the Secretary, is the chairperson of the Operating Committee and serves as the Executive Secretary of the Advisory Committee on Export Policy.

The Operating Committee may invite representatives of other Government agencies or departments (other than those identified in this definition) to participate in the activities of the Operating Committee when matters of interest to such agencies or departments are under consideration.

Advisory Committee on Export Policy. Voting members of the Advisory Committee on Export Policy include the Assistant Secretary of Commerce for Export Administration, and Assistant Secretary-level representatives from the Departments of State, Defense, Energy, and the Arms Control and Disarmament Agency. The appropriate representatives of the Joint Chiefs of Staff and the Director of the Nonproliferation Center of the Central Intelligence Agency are non-voting members. The Assistant Secretary of Commerce for Export Administration is the chairperson.

An acting Assistant Secretary, Deputy Assistant Secretary, or equivalent of any agency or department may serve instead of the Assistant Secretary. Such representatives, regardless of rank, will speak and vote on behalf of their agencies or departments. The Advisory Committee on Export Policy may invite Assistant Secretary-level representatives of other Government agencies or departments, other than those identified above, to participate in the activities of the Advisory Committee on Export Policy when matters of interest to such agencies or departments are under consideration. Decisions are made by majority vote.

Export Administration Review Board. The Export Administration Review Board's voting members are the Secretary of Commerce, the Secretary of State, the Secretary of Defense, the Secretary of Energy, and the Director of the Arms Control and Disarmament Agency. The Chairman of the Joint Chiefs of Staff and the Director of Central Intelligence are non-voting members. The Secretary of Commerce is the chairperson of the Board.

No alternate Export Administration Review Board members may be designated, but, the acting head or deputy head of any agency or department may serve instead of the head of the agency or department. The Export Administration Review Board may invite the heads of other Government agencies or departments, other than those identified in this definition, to participate in the activities of the Export Administration Review Board when matters of interest to such agencies or departments are under consideration.

Appendix D. Report Distribution

Office of the Secretary of Defense

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

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

Under Secretary of Defense for Intelligence

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

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

Director, Program Analysis and Evaluation

Joint Staff

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

Department of the Army

Inspector General, Department of the Army

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

Department of the Navy

Naval Inspector General

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

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

Non-Defense Federal Organizations

Office of Management and Budget
Inspector General, Department of Agriculture
Inspector General, Department of Commerce
Inspector General, Department of Energy
Inspector General, Department of Health and Human Services
Inspector General, Department of Homeland Security
Inspector General, Department of State
Inspector General, Central Intelligence Agency

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Select Committee on Intelligence
Senate Committee on Foreign Relations
Senate Committee on Banking, Housing, and Urban Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform
House Committee on International Relations
House Permanent Select Committee on Intelligence

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

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OFFICE OF THE UNDER SECRETARY OF DEFENSE
2000 DEFENSE PENTAGON
WASHINGTON, DC 20301-2000

POLICY

MAR 29 2006

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR READINESS AND LOGISTICS SUPPORT

Beth M. McCormick

FROM: Beth M. McCormick, Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy (Acting)

SUBJECT: Response to Draft DoD/IG Report on "Controls Over Exports to China," Project No. D2005-D000LG-0220.000

In response to the draft Office of Inspector General (OIG) report dated March 15, 2006, as Deputy Under Secretary of Defense for Technology Security Policy and National Disclosure Policy (Acting) and Director (Acting), Defense Technology Security Administration (DTSA), the following comments are submitted. While we recognize this draft represents an improvement over earlier versions, we still have significant concerns with certain findings, nonconcurring with two recommendations. Of the remaining recommendations, we partially concur with one and concur with four. Our detailed comments follow.

The OIG report cites DTSA for not adequately documenting license determinations and analyses. However, we were able to show that documentation for our analyses does exist in USXPORTS, the automated export licensing system. The discrepancy in interpretations appears to revolve around a primary factor, i.e., that the information in USXPORTS is not consolidated in an "audit-friendly" way. To outsiders, without export control expertise or USXPORTS experience, it does not provide an easy audit trail. However, to persons experienced in export licensing within DTSA and other DoD offices, USXPORTS serves its intended purpose. These persons are expert in their fields, be they engineers, licensing officers or policy experts. They are experienced in the relevant laws and regulations related to export licensing, as well as national security concerns. While USXPORTS may not be "audit friendly," it does meet the needs of those technical, licensing and policy experts reviewing license applications. Nonetheless, we continue to make improvements and are working towards additions which will make USXPORTS even more user friendly and transparent. USXPORTS is aimed at making the license determination process even more efficient through automation, in keeping with the President's "e-government" initiative.

CORRECTED COPY

Final Report Reference

DTSA COMMENTS ON REPORT RECOMMENDATIONS

DTSA concurs with the following recommendations:

1. *We recommend that the Under Secretary of Defense for Policy direct the organizations responsible for reviewing export applications to maintain access to USXPORTS.*

Redirected, renumbered, and revised to Recommendation 1.a.

This action will serve as a timely reminder that USXPORTS is the automated system from which licensing information is readily available and that its use will both increase efficiency, as well as ensure all relevant licensing information is considered. However, it is more appropriate for the Deputy Under Secretary, Technology Security Policy and National Disclosure Policy, with responsibility for export license review, to ensure that the most efficient means of analysis are available to all users. The OIG staff informally advises that responsibility will be transferred. Based upon their assurance, ***we will concur with the recommendation.***

However, we would like to point out that the report could leave the impression that the only method for review of export applications is electronic. Organizations may receive hard copy, e-mails or be otherwise informed of the contents of the license application and the requirement for comment. Nonetheless, the recommendation for USXPORTS use embraces DTSA's goal and we will inform users within 60 days.

2. *We recommend that the Deputy Under Secretary of Defense for Technology and Security Policy update the guidance for the export review process to reflect current organizations.*

Renumbered to Recommendation 1.b.

This action is required to ensure that the recent organizational changes to the Defense Technology Security Administration are accurately reflected in current guidance. **We concur with this recommendation** and the Deputy Under Secretary for Technology Security Policy and National Disclosure Policy, serving also as the Director, Defense Technology Security Administration, will ensure this action is completed within sixty days.

3. *We recommend that the Director, Defense Technology Security Administration:*

c. Provide written responsibilities to the senior management control official for administering the management control program.

d. Maintain documentation of training that managers of operating and assessable units receive.

Renumbered to Recommendation 2.c. and 2.d., respectively

Our Management Control Plan, which was signed by the Director (Acting), Defense Technology Security Administration, in March 2006, accomplishes these recommendations. **We concur with this recommendation** and note that the recommended action has already been completed.

Final Report Reference

DTSA respectfully nonconcurs with the following recommendations:

3. *We recommend that the Director, Defense Technology Security Administration:*

a. Prepare written analyses to support decisions on export applications and maintain documents in USXPORTS to support those decisions.

b. Elevate decisions to the extent possible when the appeal process does not produce a decision that supports the national security posture.

Renumbered to Recommendation 2.a. and 2.b., respectively

DTSA comments on recommendation 3.a., prepare written analyses and maintain documents in USXPORTS:

Providing complete analyses on export applications: From our perspective, the OIG viewed a very narrow sample (e.g., limited to four ECCNs); did not look at all materials related to a case or all case files; looked only at licenses adjudicated in FY2004 – the "sample"—which were done prior to the current, robust, automated data system, USXPORTS; failed to acknowledge that a main purpose of USXPORTS is to serve as a repository of data relevant to the case and to eliminate the need for repetitive data entry; and did not recognize that the Tiger Team Standard Operating Procedures (SOP) address analysis requirements. Consequently, conclusions –which formed the basis of the recommendations—are unfounded because they are based on incomplete and untimely data.

- The report places great emphasis on the importance of providing, in each individual case file, complete analyses addressing recommendations as part of the export licensing process. Although we are in general agreement with the proposition that complete analysis is a necessary and proper part of the licensing process, we do not agree that inclusion of every facet of analysis considered in making a licensing determination is necessary to be included in every individual case file. We have an automated licensing system, USXPORTS, specifically designed to make such redundancy unnecessary as data can readily be identified through such features as the search process.
- USXPORTS, itself, is an automated licensing system that makes it unnecessary to repeat all information considered in each single case. For example, information regarding precedent cases and end users is easily searched in USXPORTS by those reviewing licenses. This information in turn is used to inform licensing determinations. To copy that information into the license application under consideration would be redundant and wasteful of US government resources.
- Further, there are certain fundamental assumptions that are expressly or implicitly provided by the Export Administration Regulations (EAR) or other regulatory guidance such as Executive Order 12981. For example, we believe it would be redundant to repeat the EAR-listed reasons for control, (i.e., Regional Stability (RS), Missile Technology (MT), Nuclear Nonproliferation (NP), etc.) for each item requested for export in each case file. That criterion is already included in the license file, which identifies the Export Commodity Classification Number (ECCN) for each item. Since the reason for control is the basis for requiring a license, it must be --and always is--considered during the license application review.

Additionally, the report does not take into account the inclusion in the license record of minutes from the interagency Operating Committee (OC) and Advisory Committee on Export Policy (ACEP). This information clearly outlines agency positions, statements and recommendations, as well as the final US Government decision for the license. This information is already included in each relevant case file. Repeating this information in another section of a case's file would be wasteful and inefficient. It should be noted that part of the design and implementation of USXPORTS is to ensure that OC and ACEP minutes and findings can be electronically entered into the license record.

- The report's finding that electronic documentation supporting analysis in USXPORTS was insufficient fails to take into consideration the incremental progress made in bringing a new automated system on-line. This report examines only FY 2004 cases. It was not until December 04 (FY05) that DTSA had the capability to incorporate electronically all supporting documents and information into the license file. DTSA continues to maintain that all license -related documents required to properly evaluate the license application are documented within the USXPORTS database.
- The report asserts that of "*90 judgmentally selected applications reviewed, 69, or 76.6 percent, did not have sufficient analyses documented to support DTSA decisions*." Of the 69 cases, 46 were staffed for review sometime during the age of the case. 27 of these cases actually went to the OC for adjudication. All involved the same issue, a problematic intermediate consignee that was eventually removed from these license applications and replaced by another. Of the remaining 19 licenses in this group, 16 of them were actually returned without action at the request of the applicant or by the Department of Commerce due to a lack of information. (The DoD position on these cases was a denial recommendation.) However, because there was no license decision made on these cases, no harm to national security or regional stability was incurred since no export was made.
- The act of staffing the cases internally within DoD (in this example, 46 of the 90 cases judged to have insufficient analysis documentation) indicates that insufficient information was available to the Tiger Team to warrant a decision. This staffing action itself is evidence of consideration of possible diversion risks and policy concerns.
- Of the remaining 23 cases, the Tiger Team process, as outlined in the DTSA Tiger Team Standard Operating Procedures (SOP), found insufficient grounds for denial or returning the license without action. Consequently, the license met the approval criteria outlined within the SOP. This SOP criteria requires an evaluation of the bona fides of the license, e.g., the technology, relevant policies, end user and end use concerns, risk of diversion, the basis for control, and other relevant EAR considerations. In this way, adjudication at the Tiger Team is in accordance with the EAR and relevant Executive Order (EO), as well as internal DTSA SOP.

- It is important to note that the Tiger Team evaluation and approval position submitted by DoD on four of the 23 licenses was validated at a later date by the OC. All 23 of these licenses involved the same type of controlled equipment (ECCN 2A983) going to the same related end use. Therefore, the database already provided the support precedent case documentation to authorize approval of the licenses and adequately and appropriately documented the required analyses.
- A subject matter expert demonstration was provided to show how DTSA analysts and DoD license reviewers are able to point to data in the case file and/or USXPORTS that provided evidence of the documentation the OIG audit team was seeking. While the licensing system may not be transparent to a person unfamiliar with the intricacies of the system, it does provide a robust capability to confirm and document the bona fides of the license applications to the actual users of the database.
- It appears that the OIG requirement for additional documentation and analysis was based on the flawed conclusion that the analysis provided by the staffing points, both internal and external to DTSA, was insufficient. DTSA consists of a highly professional staff of engineers with advanced degrees who are selected for their vast experience in DOD laboratories and program management specifically to provide thorough evaluations and recommendations. Likewise analysts assigned to DTSA have been selected based on their expertise and experience with all facets of intelligence, policy and licensing issues. A suggestion that the input contained in the USXPORTS data would need to be augmented, in all cases, by "additional documentation" is unwarranted and demonstrates a lack of understanding of the review and decision process involved in over 30,000 cases a year.
- Further, accepting the OIG finding that additional, sufficient analysis and documentation is needed requires the acceptance of a potentially flawed assumption of the applicability of DoC controls to DoD recommendations. The OIG standard cited in the report refers to the 15 CFR 742, Control Policy – CCL Based Controls. These controls provide the DoC justifications for assignment of technologies to an entry on the Commodity Control List. Likewise, it provides that a review will "generally include" various factors. To suggest that analysis and documentation mirror DoC's licensing policy is antithetical to DTSA mission as contained in DoDD 5130.72 and not required by the CCL itself.
- The report asserts that lack of license documentation could potentially harm US national security or contribute to proliferation or regional destabilization. As defined in the SOP that covers the review and evaluation of license applications, the reasons for control of the commodities such as national security, regional stability, or nuclear proliferation, are addressed during the licensing determination process that takes place at the Tiger Team or after the license is staffed for review. Since the report failed to review the results of license decisions, any perceived harm to national security cited by the report due to lack of documentation is not supported by any evidence of diversion or proliferation. Even if we were to agree –and we do not—that there is a lack of documentation, it would be the export license decision itself – not the lack of documentation—that could be faulted. For all these reasons, there is no basis for alleging potential harm.

Final Report Reference

Maintaining Documents: The USXPORTS database maintains a summary of the license applications, the DoD final position, and in all applicable cases, a record of the recommendations by other DoD agencies and departments. It is DTSA's opinion that the USXPORTS database fully complies with the requirements to retain "appropriate documentation." Likewise, repetition of applicable analysis and documentation from prior applications is not only unnecessary, but would be wasteful of US government resources. USXPORTS was designed to improve efficiency and to preclude the need to repeat database information that is readily available. USXPORTS provides DTSA the capability to incorporate all supporting documents and information into the license database.

- The Departments of State (DoS) and Commerce (DoC), not DTSA, have the ultimate responsibility for maintaining permanent records of US Munitions List (USML) and Commerce Control List (CCL) license applications. DTSA has coordinated with the US National Archives and Records Administration (NARA) and DoD's Directives and Records Branch and developed a record retention plan. The DoD Directive and Records Branch has DTSA's record retention plan and will forward it to NARA with other DoD retention plans. In the meantime, DTSA has complied with NARA's previous guidance with regard to record retention.
- Regarding concerns that DTSA does not retain needed licensing documentation, during the period of the OIG review, hardcopies of license information were retained as input documents for reference on both munitions and dual-use license applications. With USXPORTS, DTSA is able to scan hard copies of license related documents into the system. All record keeping is done in accordance with the General Records Schedule (Section 20). Note that both DoS and DoC are planning to implement requirements for applicants to provide all documentation electronically rather than via hardcopy. Once this data is in electronic form, it will be maintained in accordance with DTSA's records retention schedule.
- Improvements continue to be made to USXPORTS. As one example, prior approvals of similar exports are identified by using a search function. While this identifies the necessary information, it is more cumbersome than we would like. Consequently, a field of "precedent cases" is being developed in USXPORTS that is intended to identify similar cases, end users and end uses by use of a single search function. We expect this to be operational in the next several months.

DTSA comments on 3.b., elevate disagreements.

Renumbered to Recommen-dation 2.b.

Elevating Disagreements: While not every license that DTSA had concerns with was elevated to the OC by the Commerce Department, at least 50% of cases in 2005 and 45% in 2004 were at the OC due to DoD denials. Similarly, 76% of licenses in 2005 that went to the ACEP were escalated by the Department of Defense. Historically, the Defense Department escalates over 75% of the licenses to the ACEP, a far greater percentage than any other agency.

- This report does not adequately evaluate factors that influence the dispute resolution process. The dispute resolution process, like the overall license review process, places the burden of proof on those advocating denial of licenses rather than those advocating approval.
- We disagree with the tenor of the report, which questions DTSA's decisions about when it is productive to escalate cases in the interagency, without any analysis of relevant factors. In reaching these decisions, the relative importance of national security concerns, prior precedent, effectiveness of mitigation measures, and the likelihood of success are carefully weighed using the collective judgment of licensing officers and technical experts with years of experience in the export licensing business.
- Moreover, it appears that modifications to a license developed during the escalation process may mitigate DoD concerns, and result in DoD acceding to approval of the license were not considered. DoD frequently develops these conditions. They will not be reflected in the original DTSA license recommendation, but in the follow-on versions and will be incorporated into the final position of the license formally approved by DoC. One of the 21 licenses which the IG report recommended further escalation was actually approved by DoD after extensive discussion at the OC. The interagency crafted license conditions allowed the export to move forward, but with conditions and provisos that mitigated DoD diversion concerns. The minutes of the Operating Committee, which contain agency comments and positions, and the resultant licensing decisions are documented in USXPORTS, but the OIG viewed this as inadequate because certain OC information was not repeated in another part of the case file.
- In determining the likelihood of escalation success, DTSA also considers whether the ACEP has decided a precedent case in opposition to the DoD position. If this is the case, it may well be prudent for DTSA to maintain its denial at the OC to indicate its position, but to choose not to escalate the case in recognition that other agencies will not support the denial. One of the cases cited in the OIG report as requiring additional escalation was just such a case. In fact, this license file actually documented the prior ACEP case where DoD concerns were overruled on regulatory grounds. Consequently, although concerns remained, there was no legal basis, at that time, for a denial.
- The report considered none of these factors, nor that the elevation determination is made at the Assistant Secretary level. Instead, the report noted a difference between the ingoing DoD position and the final USG position and cited this as the basis for the recommendation to escalate more cases.
- Of the 21 licenses cited by the OIG that should have been elevated further, 13 of the licenses were actually returned without action at the request of the applicant or by the Department of Commerce due to a lack of information. Since there was no license decision made on these cases, escalation was unnecessary. In addition, no harm to national security or regional stability could have, by definition, occurred since no export was possible.

Final Report Reference

- Of the remaining 8 cases cited by the OIG as requiring escalation, as noted above, DoD actually approved one license after the OC crafted conditions that mitigated our original concerns and maintained a denial recommendation on another in light of the prior precedent ACEP cases, which indicated that the regulatory process trumped national security concerns.
- The remaining 6 licenses all involved the same issue, a problematic intermediate consignee that was eventually removed from these license applications and replaced by another. Although DoD maintained a denial recommendation on these cases, this action at the OC level, documented in all the licenses, was done at the OC at the behest of the ACEP. In these instances, the system worked at the lower levels to adjudicate the licenses in a way that alleviated diversion risks.
- In all cases where DTSA has concerns, we will escalate the case as far as the process will reasonably allow, considering the likelihood of success, which is dependent upon carrying the votes of at least two other departments. In our opinion, national security would be better served by requiring unanimous decisions on these cases (e.g., a consensus approach). Given the small percentage of such cases that this represents in relation to the overall number of licenses reviewed, this would be a limited burden to applicants and the USG.

DTSA partially concurs with the following recommendation:

3. *We recommend that the Director, Defense Technology Security Administration:*
e. Adjust the internal management control program to more effectively assess internal controls for recording analyses and documentation.

Renumbered to Recommendation 2.e.

Adjust management control program: The report states that our self-assessment program did not detect "weaknesses" with:
-- providing complete analyses on export applications,
-- inserting documents into its automated system to support its analyses; and
-- elevating disputed decisions to achieve agreement.
Per our presented critique, we cannot agree with the findings, which form the basis for the report's contention that this reflects an inadequacy of our self-assessment program. However, **we partially concur with this recommendation**. We do acknowledge that there were revisions and updating required in the Management Control Plan which we had been working on at the time of the OIG review and which was issued in March 2006.

- We do agree there was no letter appointing the Director of the Management Directorate with responsibilities for the program, and our revised Management Control Plan rectifies this. However, as specifically concerns licensing, the Chiefs of both the Dual-Use Licensing Division and the Munitions Licensing Division were "held accountable in writing" for duties specifically related to the management control plan in their employee performance plans and results report (DD Form 2799), and Management Controls are an evaluated element in the performance appraisals of DTSA's senior managers.

- DTSA provided Standard Operating Procedures and position descriptions that assigned clear responsibilities, roles, and duties concerning the processing of licenses in accordance with the Management Control Program. Additionally, the directors of the Licensing Directorate and Technology Directorate have signed AU 9, which implements management controls on licensing and Management Controls and are an evaluated element in the performance appraisals of DTSA's senior managers.)

In summary, our Management Control Plan, which was signed by the Director (Acting), Defense Technology Security Administration, in March 2006, ensures that every management official is responsible for the relevant areas of responsibility, which include analysis and documentation of licenses. Consequently, the revisions we have made meet the recommendations of the report. Additionally, we are in the process of upgrading our internal licensing Standard Operating Procedures, which will further clarify responsibilities. This will be completed within sixty days.

We appreciate your consideration of our comments and anticipate that you will find them useful as you revise this report. If we can be of further assistance or if you have questions regarding these comments, please call Dr. Cheryl Opacinch at 703-325-3455.

Team Members

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

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Appendix D. Department of Energy Report

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

Inspection Report

The Department of Energy's Review of Export License Applications for China

DOE/IG-0723

April 2006

Department of Energy
Washington, DC 20585

April 5, 2006

MEMORANDUM FOR THE SECRETARY

FROM: Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Inspection Report on "The Department of Energy's Review of Export License Applications for China"

BACKGROUND

The Fiscal Year 2000 National Defense Authorization Act provides that beginning in the year 2000, the President shall annually submit to Congress a report by the Inspectors General of the Departments of Energy (Energy), Commerce, State, and Defense on their policies and procedures with respect to the export of technologies and technical information with potential military application to countries and entities of concern. The People's Republic of China is one of the world's largest trading nations, whose trade includes the substantial import and export of technologies. For 2006, an interagency working group comprised of the Inspectors General of the previously identified agencies chose to review the export of sensitive United States technologies and technical information to China. The Inspectors General of the Department of Homeland Security and the Central Intelligence Agency also participated in the effort.

The objective of our portion of this multi-agency effort was to determine if Energy appropriately participated in the export license review process to control the export of critical technologies to China. Additionally, we reviewed the status of recommendations set forth in our previous reports on the general subject of Energy's export control program.

RESULTS OF INSPECTION

We concluded that Energy's participation in the export license review process to control the export of critical technologies to China was appropriate and consistent with existing procedures. We found that Energy's export control office: (1) conducted reviews of all escalated export license applications relevant to China referred to that office in Fiscal Year 2004; and, (2) coordinated effectively with the formal interagency entities mandated by Executive Order 12981 for the conduct of export license reviews. We observed that access by Energy officials conducting license reviews to end-user review information maintained by the Lawrence Livermore National Laboratory could be improved and we have included a recommendation to address this concern. Also, we observed that access by these officials to intelligence information within Energy's Office of Intelligence and Counterintelligence had recently been enhanced.

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Regarding the status of recommendations set forth in previous Office of Inspector General reports on Energy's annual export control reviews, we determined that 12 of the 15 recommendations have been closed. Details regarding all recommendations can be found in Appendix B.

We made two recommendations to management designed to enhance Energy's export control review process.

MANAGEMENT REACTION

In responding to our draft report, management agreed with our recommendations and indicated that it will implement corrective actions. Management's comments, which are provided in their entirety in Appendix D, were responsive to our recommendations.

Attachment

cc: Deputy Secretary
Administrator, National Nuclear Security Administration
Under Secretary for Energy, Science, and Environment
Chief of Staff
Director, Office of Intelligence and Counterintelligence
Director, Office of Internal Review (CF-1.2)
Director, Policy and Internal Controls Management (NA-66)

THE DEPARTMENT OF ENERGY'S REVIEW OF EXPORT LICENSE APPLICATIONS FOR CHINA

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Overview

INTRODUCTION AND OBJECTIVES

The National Defense Authorization Act (NDAA) for Fiscal Year 2000 provides that beginning in the year 2000 and ending in the year 2007, the President shall annually submit to Congress a report by the Inspectors General of, at a minimum, the Departments of Energy (Energy), Commerce (Commerce), Defense (Defense), and State (State) of the policies and procedures of the United States Government with respect to the export of technologies and technical information with potential military application to countries and entities of concern. The NDAA for Fiscal Year 2001 also requires the Inspectors General to include in each annual report the status of the implementation or disposition of recommendations that were set forth in previous annual reports.

The People's Republic of China (China), which since 1997 has included Hong Kong, is one of the world's largest trading nations. China's trade includes the substantial import and export of technologies. An interagency working group comprised of representatives from the Offices of Inspector General (OIGs) for Energy, Commerce, Defense, State, the Department of Homeland Security, and the Central Intelligence Agency (CIA) selected the export of sensitive U.S. technologies and technical information to China as the topic for its 2006 review.

The objective of our inspection was to determine if Energy appropriately participated in the export license review process to control the export of critical technologies to China. Within Energy, the Office of International Regimes and Agreements (OIRA), which is part of the National Nuclear Security Administration's, Office of Defense Nuclear Nonproliferation, is the primary entity responsible for export control issues and is the focus of our review. To accomplish this objective, we examined:

- Energy's roles and responsibilities relevant to the review of escalated export license applications regarding China. Escalated export license applications are those applications that were appealed to higher levels of agency review when the reviewing agencies could not come to agreement after their initial reviews; and

- Coordination by Energy officials with other Federal agencies regarding cases escalated to the dispute resolution process.

Additionally, we reviewed the status of recommendations set forth in previous Energy OIG reports on annual export control reviews conducted pursuant to the NDAA for Fiscal Year 2000.

OBSERVATIONS AND CONCLUSIONS

We concluded that Energy appropriately participated in the export license review process to control the export of critical technologies to China. Specifically, we found that:

- OIRA conducted reviews of all escalated export license applications referred to them during Fiscal Year 2004 that were relevant to China; and

- OIRA effectively coordinated with the formal interagency entities mandated by Executive Order 12981 for the conduct of its license reviews.

We observed that access by Energy officials conducting license reviews to end-user review information maintained by the Lawrence Livermore National Laboratory (Livermore) could be improved. We also observed that access by OIRA to intelligence information within the Energy Office of Intelligence and Counterintelligence (IN) has recently been enhanced.

Regarding the status of recommendations set forth in previous Energy OIG reports on annual export control reviews conducted pursuant to the NDAA for Fiscal Year 2000, we determined that 12 of the 15 recommendations have been closed. Details regarding the recommendations can be found in Appendix B.

The Energy OIG has conducted numerous reviews related to the topic of export controls. A listing of these reports is contained in Appendix C.

Details of Findings

BACKGROUND

The principal legislative authorities governing the export control of nuclear-related, dual-use[1] items are the Export Administration Act of 1979 and the Nuclear Non-Proliferation Act of 1978. The provisions of the Export Administration Act have been updated by Executive Order, most recently by Executive Order 12981, which grants the Secretary of Commerce the authority to refer export license applications to other agencies for review and gives agencies such as Energy the authority to look at any export license application submitted to Commerce. This Executive Order also establishes the Operating Committee (OC) and the Advisory Committee on Export Policy (ACEP). This Executive Order stipulates that the OC examines all license applications in which the reviewing departments are not in agreement and that if a department disagrees with an OC decision, they may appeal to the ACEP for resolution.

Energy's export control efforts, as coordinated by OIRA, includes the review of licenses for nuclear, chemical, biological, and missile-related commodities. OIRA utilizes the expertise of Energy officials at headquarters and the Department's field sites to conduct end-user reviews (analysis of intelligence information relevant to the final user of an item) and technical reviews (analysis of a specific item by a subject matter expert). In addition to reviewing licenses, OIRA participates in working level groups for licensing and nonproliferation activities that include China-related issues; represents Energy at meetings of the Nuclear Suppliers Group, an informal international regime that works to prevent the misuse of nuclear materials for military reasons; and leads an outreach effort that trains Federal officials at the nation's borders on how to recognize proliferation items and potential weapons of mass destruction.

ENERGY REVIEW OF LICENSES

We found that Energy conducted reviews of all escalated export license applications relevant to China referred to them during Fiscal Year 2004.

We and the OIG interagency group examined 102 cases relevant to China and Hong Kong that were addressed by the OC and/or ACEP during Fiscal Year 2004[2]. We determined that Energy officials conducted required end-user reviews for each case. However, we found that the end-user review for one case was not

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

[2] 104 separate China cases were examined by either the OC and/or the ACEP in Fiscal Year 2004. Two of these 104 cases were withdrawn by the applicant, resulting in a total of 102 cases analyzed by the OIG. Of these 102 cases, three were reviewed by both the OC and ACEP in Fiscal Year 2004.

completed in time for the relevant OC meeting. Although the review was not timely, the results of that review did not alter the position already established by Energy and the other reviewing agencies or effect the processing of that application.

INTERAGENCY COORDINATION

Energy effectively coordinated with the formal interagency entities mandated by Executive Order 12981 for the conduct of its license reviews. Energy has participated in the OC and the ACEP since 1965. The OC and the ACEP include senior officials from Energy, Commerce, Defense, and State, which are voting members, and the CIA, which is a non-voting member. We determined that Energy officials participated in the review of all 102 cases relevant to China and Hong Kong addressed by the OC and the ACEP in Fiscal Year 2004. Export control officials with Commerce, Defense, State, and the CIA advised that Energy coordinated with them on all export license applications, including those for China, and that Energy provided them with analysis relevant to the export license review process.

OBSERVATIONS

We observed that access by Energy officials conducting license reviews to end-user review information maintained by Livermore could be improved. Currently, technical reviewers must wait until an end-user review is completed by Livermore before being able to access this end-user information. Several field officials who perform technical reviews indicated that it would be an improvement if they could access end-user information at any time instead of waiting until the end-user review is completed. Livermore officials said that they are developing a new database that will allow any technical reviewers at Energy to have real-time access to end-user information. An OIRA official indicated that had this database been in place for the one late end-user review addressed above, that review would have likely been completed in time for the OC meeting. We believe that the implementation of this new Livermore database will help expedite Energy's export license reviews.

We also observed that access by OIRA to intelligence information within IN has recently been enhanced. Specifically, IN controls the access for Energy officials to Sensitive Compartmented Information (SCI), which includes intelligence information that can be used by OIRA to conduct their license reviews. During our review, OIRA officials advised that they could not access IN's SCI computers or hand-carry SCI documents and relied upon: an IN employee who dedicated part of his time to OIRA efforts; field officials at IN's Field Intelligence Elements; or other Federal agencies.

An IN official informed us that based on established Energy policy on the use of and access to SCI, only Federal Energy employees that are part of IN can have direct access to SCI computers and be able to hand-carry SCI documents. The official added, however, that his office could arrange for OIRA-affiliated management and operating contractor officials who are members of a Field Intelligence Element, to access SCI at IN headquarters because Field Intelligence Element members are managed by IN for intelligence purposes.

We learned that IN had previously sponsored direct SCI access by one OIRA-affiliated management and operating contractor stationed at Energy headquarters, but that the relevant contract ended in July 2005. In recognition of this problem and concurrent with our review, in February 2006, IN management granted three OIRA-affiliated management and operating contractors access to IN and is processing them to have SCI computer and hand-carrying access. We believe that this improved access should enhance OIRA's analysis of export control issues, including those relevant to China. Because this type of arrangement between IN and OIRA had lapsed before, we believe that actions need to be taken to ensure that OIRA representatives continue to have access to SCI computers and be able to hand-carry SCI documents.

RECOMMENDATIONS

We recommend that the Deputy Administrator, Defense Nuclear Nonproliferation;

1. Expedite the development and implementation of the new Lawrence Livermore National Laboratory database for processing end-user reviews; and

2. Coordinate with the Director, Office of Intelligence and Counterintelligence, to ensure personnel affiliated with the Office of Defense Nuclear Nonproliferation who conduct export license reviews have continual access to Sensitive Compartmented Information computers and be able to hand-carry Sensitive Compartmented Information documents.

MANAGEMENT COMMENTS

In comments on our draft report, management agreed with our report recommendations and will implement corrective actions. These comments are included in their entirety at Appendix D.

INSPECTOR COMMENTS

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

Appendix A

SCOPE AND METHODOLOGY

We interviewed Federal and contractor Energy officials at headquarters and field facilities, including personnel who perform end-user reviews and technical reviews. We reviewed Energy and Commerce documentation for 102 export license applications to China and Hong Kong that were addressed by the Operating Committee and the Advisory Committee on Export Policy in Fiscal Year 2004. We also reviewed relevant export control regulations.

As part of our review, we evaluated Energy's implementation of the "Government Performance Results Act of 1993." We did not identify any performance measure issues regarding the review of export license applications for China and Hong Kong.

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

STATUS OF RECOMMENDATIONS FROM PRIOR
NATIONAL DEFENSE AUTHORIZATION ACT REPORTS

Section 1204 of the NDAA for Fiscal Year 2001 amended Section 1402(b) of the NDAA for Fiscal Year 2000 to require the specified Offices of Inspectors General (OIGs) to include in each annual report the status of the implementation or other disposition of recommendations that have been set forth in previous annual reports under Section 1402(b). To date, six reports have been completed by the Energy OIG under this requirement. Two reports: "Inspection of Status of Recommendations from the Office of Inspector General's March 2000 and December 2001 Export Control Reviews," INS-L-03-07, May 2003, and "Inspection of the Department of Energy's Role in the Commerce Control List and the U.S. Munitions List," INS-O-01-03, March 2001, did not contain recommendations. The following is the status of the recommendations from the other reports. Of 15 total recommendations, 12 have been closed.

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

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

Energy management reported that Commerce promised to provide support to the office as needed. Currently, new National Nuclear Security Administration (NNSA) staff are completing new registration forms to receive their passwords. Energy management is awaiting response from Commerce on the NNSA letter requesting training on accessing ECASS.

The Energy OIG determined that this recommendation should remain open until all corrective actions are completed.

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

Energy management reported that Commerce promised to provide support to the office as needed. Currently, new NNSA staff are completing new registration forms to receive their passwords. Energy management is awaiting response from Commerce on the NNSA letter requesting training on accessing ECASS.

The Energy OIG determined that this recommendation should remain open until all corrective actions are completed.

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

Recommendation 1. We recommended that the Director, Office of Security and Safety Performance Assurance, expedite issuance of a draft unclassified foreign visits and assignments

Order 142.X that addresses training requirements and responsibilities for hosts of foreign nationals.

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes the principal roles and responsibilities for hosts of foreign national visitors and assignees. The Energy OIG determined that DOE Order 142.3 includes training requirements and responsibilities for hosts of foreign nationals.

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the updated DOE "Guidelines on Export Control and Nonproliferation" were undergoing review at Energy headquarters through August. In September they were transmitted to the Department's Executive Secretary for final review and signature. Subsequently, DOE General Counsel (GC) performed a second review and presented their comments in November, and the DOE Office of Nuclear Energy, Science, and Environment (NE) also sent a comment. NNSA management is reviewing and coordinating comments with GC and NE to finalize the Guidelines in January 2006. In the First Quarter of Fiscal Year 2006, Energy management began developing elements of a training module to help strengthen contractor compliance with deemed export controls. The goal of the training is to specifically address the needs of employees serving as foreign national hosts who are actively initiating visits. Energy management tasked a national laboratory with drafting a training program, which was subsequently briefed in September 2005 to export compliance representatives from five sites for comment. Comment incorporation was being finalized in the First Quarter of Fiscal Year 2006, with pilot implementation at a national laboratory planned for Second Quarter of Fiscal Year 2006. In the Second Quarter of Fiscal Year 2006 work will commence on designing a survey to gain insight of the export control programs at laboratories/sites with the goal of making preliminary assessments in the Third Quarter of Fiscal Year 2006. Assuming the satisfactory resolution of any management and operating contractual issues that may arise, on-site surveys may begin as early as the Fourth Quarter of Fiscal Year 2006.

The Energy OIG determined that this recommendation should remain open until all corrective actions are completed.

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

Recommendation 1. We recommended that the Assistant Deputy Administrator for Arms Control and Nonproliferation coordinate with Commerce and Treasury to ensure access by Energy to information within the Automated Export System regarding the purchase and/or

shipment of commodities under an approved export license, and develop guidelines for Energy's access to the information.

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

The Energy OIG agreed to close this recommendation. The Energy OIG will continue to follow up on these issues through the interagency OIG group.

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

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

The Energy OIG agreed to close this recommendation. The Energy OIG will continue to follow up on these issues through the interagency OIG group.

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

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

The Energy OIG agreed to close this recommendation. The Energy OIG will continue to follow up on these issues through the interagency OIG group.

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

Recommendation 1. We recommended that the Acting Deputy Administrator for Defense Nuclear Nonproliferation ensure that senior Energy officials work with senior Commerce

officials to assure clear, concise, and reliable guidance is obtained in a timely manner from Commerce regarding the circumstances under which a foreign national's visit or assignment to an Energy site would require an export license.

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

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes the principal roles and responsibilities for hosts of foreign national visitors and assignees.

The Energy OIG agreed to close this recommendation.

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

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

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

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

Energy management reported that to ensure requests for foreign national visits and assignments at the Oak Ridge National Laboratory receive appropriate export license consideration, Oak Ridge National Laboratory initiated a system of reviews. Under the system, requests are

reviewed by five separate disciplines (Cyber Security, Export Control, Classification, Counterintelligence, and Security). In addition, requests associated with concerns are referred for resolution to the Non-citizen Access Review Committee. Energy management further reported that while each of the reviews can involve the National Security Program Office, the Oak Ridge National Laboratory Export Control Officer is responsible for referring requests to the National Security Program Office as necessary.

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes clear identification of requirements for foreign national visits and assignments, and identifies responsible officials and organizations.

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes the principal roles and responsibilities for hosts of foreign national visitors and assignees.

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes the requirement for documentation in FACTS for all visit and assignment requests in a timely manner.

The Energy OIG agreed to close this recommendation.

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

Energy management reported that the Office of Security has incorporated all required changes into DOE Order 142.3, "Unclassified Foreign Visits and Assignments Program," which was approved on June 18, 2004. This Order includes the requirement that all sites having foreign national visitors or assignees are required to enter information regarding the visits and assignments into FACTS.

The Energy OIG agreed to close this recommendation.

Appendix C

PRIOR EXPORT CONTROL RELATED REPORTS

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

Department of Energy
National Nuclear Security Administration
Washington, DC 20585

March 30, 2006

MEMORANDUM FOR Alfred K. Walter
Assistant Inspector
for Inspections and Special Inquiries

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

SUBJECT: Comments to Draft Report on China Export License Applications Review; S05IS034/2005-21199

The National Nuclear Security Administration (NNSA) appreciates the opportunity to have reviewed the Inspector General's (IG) draft inspection report, "The Department of Energy's Review of Export License Applications for China." We understand that this inspection was conducted in accordance with the Defense Authorization Act of 2000 which directed the IG to conduct annual reviews of policies and procedures with respect to the export of militarily sensitive technologies and information to countries of concern.

NNSA appreciates the IG acknowledging the positive aspects of the program. In regards to the recommendations, we agree with those recommendations and will address them appropriately. We specifically want to note that, as part of the "Interagency Coordination" section of the report, we, through the Department and its predecessor organizations, have been a member of the Operating Committee and the Advisory Committee on Export Policy since 1965 as part of the Limited Test Ban Treaty. The report mentions 1977 as the start of that participation. Additionally, we want to point out that, while members of the Office Of International Regimes and Agreements have hand carry authorizations for Special Compartmented Information to meetings, we will work with the Office of Intelligence to extend that hand carry authorization into the work spaces.

Programmatic comments to the various reports contained in Appendix B are updated on a quarterly basis through the Department's Audit Reports Tracking System. Should you have any questions related to this response, please contact Richard Speidel, Director, Policy and Internal Controls Management.

cc: Jerald Paul, Principal Deputy Administrator

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Department of Energy
Washington, DC 20585

MAR 22 2006

MEMORANDUM FOR ALFRED K. WALTER
ASSISTANT INSPECTION GENERAL FOR INSPECTIONS AND SPECIAL INQUIRIES

FROM: ROLF MOWATT-LARSSEN
for DIRECTOR
OFFICE OF INTELLIGENCE AND COUNTERINTELLIGENCE

SUBJECT: Draft Report on "The Department of Energy's Review of Export License Applications for China"

The Office of Intelligence and Counterintelligence (formerly Office of Intelligence) agrees with Recommendation 2 that the Director ensure that personnel affiliated with the Office of Defense Nuclear Nonproliferation who conduct export license reviews have access to Sensitive Compartmented Information (SCI), and the ability for cleared staff personnel to courier necessary documents to meetings.

Members of the Office of International Regimes and Agreements (OIRA) hold Top Secret/Sensitive Compartmented Information (TS/SCI) clearances, and are listed on a cleared visitors list to enter the Office of Intelligence. They may request briefings and coordinate with Office Intelligence Research Specialists regarding emerging issues and items of specific interest. Additionally, to assist with the flow of required information, in February 2006 the Office of Intelligence and Counterintelligence instituted a program to address OIRA requests for improved intelligence support. With mutual concurrence, the Office of Intelligence provides access for 3 management and operating M&O support contractors assigned to the OIRA to have staff-like access to the Office of Intelligence and Counterintelligence to include computer access and the ability to courier classified materials. This process appears to have resolved many issues regarding access, and should remain in place as long as the OIRA desires this degree of access, and the Senior Intelligence Officer is comfortable that an appropriate level of oversight is maintained.

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IG Report No. DOE/IG-0723

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Appendix E. Department of State Report

United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Office of Audits

Review of Export Controls

Report Number AUD/IP-07-01, October 2006

IMPORTANT NOTICE

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SUMMARY

Sound export controls and licensing operations are essential to preventing the spread of weapons of mass destruction technologies and to provide conventional technologies only to those entities that will use them responsibly. The Department of State (Department) registers U.S. companies and universities and issues licenses for the export of defense articles and defense services, including sensitive technical information, on the U.S. Munitions List (USML). The Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (PM/DDTC), in accordance with the Arms Export Control Act and the International Traffic in Arms Regulations,[1] is charged with controlling the export and temporary import of defense articles and defense services covered by the USML. It has among its primary missions taking final action on license applications for defense trade exports and handling matters related to defense trade compliance, enforcement, and reporting.

In response to requirements of the National Defense Authorization Act for FY 2000,[2] the Office of Inspector General (OIG) conducted a review of the Department's export licensing process. OIG's objective was to assess the effectiveness of the export control policies and practices with respect to preventing the transfer of sensitive U.S. technologies and technical information to the People's Republic of China (P.R.C.), which includes Macau and Hong Kong. OIG evaluated the program's effectiveness by (1) determining whether PM/DDTC executed licensing responsibilities in accordance with established policies and procedures, and (2) reviewing PM/DDTC's "end-use" monitoring program, known as Blue Lantern.

OIG found that although PM/DDTC followed its procedures and policies before issuing a license, there were cases where its end-use checks, conducted either before or after issuing the licenses, resulted in "unfavorable determinations." Unfavorable means that PM/DDTC found derogatory, incomplete, or inaccurate information in the license application or there was a violation of export control policies and procedures. PM/DDTC's 12 end-use checks for Hong Kong in FY 2004 resulted in three unfavorable ones.[3] In one case, the recipient may have actually

[1] 22 U.S.C. 2778 and 22 CFR Parts 120-30.
[2] Pub. L. No. 106-65.
[3] PM/DDTC did not conduct end-use checks for P.R.C. or Macau in FY 2004

received the item before PM/DDTC approved the license application. In the second case, a company received technical data without the required PM/DDTC registration. In the third case, the Licensing Division denied a license because the purported end user was not, in fact, to be the end user.

Although OIG's original objective was to focus on the People's Republic of China, Macau, and Hong Kong, as a result of the unfavorable determinations cited above, OIG expanded its scope and reviewed all of the 132 postlicense end-use checks that PM/DDTC completed worldwide during FY 2004. OIG selected postlicense checks because the militarily sensitive items had been exported before PM/DDTC conducted its indepth review. PM/DDTC reported 19 unfavorable checks, including seven cases where the purported recipient of the shipments did not order the items. The seven cases included such items as aircraft cargo C-130 spare parts and aircraft gyroscopes.

PM/DDTC adhered to its export licensing policies and procedures before issuing licenses. However, PM/DDTC still made unfavorable postlicense determinations. For example, in the seven cases cited above, PM/DDTC reviewed the license applications against a number of factors, including the purported recipient. However, during the postlicense end-use checks, the recipients denied placing the orders. As a result of all the unfavorable postlicense checks, PM/DDTC needs to reassess its licensing policies and procedures to prevent the unauthorized transfer of militarily sensitive items. OIG recommended that PM/DDTC reassess its licensing policies and procedures and report to OIG within 60 days of report issuance the changes it plans to make to reduce and eliminate unfavorable postlicense end-use checks.

During this review, OIG found that PM/DDTC did not have performance measures that detail how it plans to reduce and eliminate unfavorable end-use checks. OIG recognizes that it is a challenge to balance an export program to provide allies the necessary military items while preventing the acquisition of sensitive U.S. technology by countries and entities of concern. Performance measures could be an important tool in addressing this challenge by helping PM/DDTC improve its licensing policies and procedures. As a result, OIG recommended that PM/DDTC establish performance measures within 60 days of report issuance that detail the benchmarks and timeframes for reducing and eliminating unfavorable postlicense end-use checks.

According to PM/DDTC, most commercial defense trade is legitimate. PM/DDTC was taking several actions to improve its export controls, including revising its end-use monitoring manual and developing a training module for Foreign Service personnel that conduct end-use checks at post.

OIG discussed its findings and proposed recommendations with PM/DDTC officials. A senior PM/DDTC official said that unfavorable end-use checks were not a relevant indicator of the program's success or failure, and therefore, the official disagreed with OIG's recommendations. OIG provided a draft copy of this report to the Bureau of Political-Military Affairs. The bureau reviewed the draft and did not provide any comments.

UNCLASSIFIED

BACKGROUND

The Inspectors General of the Departments of Commerce, Defense, Energy, Homeland Security, and State, in consultation with the Director of Central Intelligence and the Director of the Federal Bureau of Investigation, are required by Section 1402 of the National Defense Authorization Act (NDAA) for FY 2000 to conduct an eight-year assessment of the adequacy of current export controls and counterintelligence measures to prevent the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. The NDAA mandates that the Inspectors General report to the Congress no later than March 30 of each year, until 2007, on the status of efforts to maintain and improve export control.

To comply with the NDAA's requirement, the overall objective of the Inspectors General for FY 2006 was to assess the effectiveness of the U.S. government's export control policies and practices with respect to preventing the transfer of sensitive U.S. technologies and technical information to the P.R.C.

In accordance with the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR), PM/DDTC is charged with controlling the export and temporary import of defense articles and defense services covered by the USML. PM/DDTC received about 60,000 export license requests in FY 2004.

PM/DDTC must approve a license application before the export of defense articles or services. In FY 2004, the Department approved 56 license applications for USML commodities to P.R.C., including Hong Kong. There were none to Macau. These commodities included such items as gas masks, anthrax biological threat alert test strips, and CS grenades.

PM/DDTC reviews the license applications against a number of factors, including:

- applicant eligibility,
- foreign policy objectives,
- stated end use and end user,
- commodity,
- quantity,

- national security interests,
- regional stability,
- human rights issues and concerns,
- multilateral agreements and nonproliferation regimes,
- intelligence information, and
- Presidential waiver, as required.

PM/DDTC refers about 30 percent of the applications to other Department offices as well as other agencies (e.g., Defense) for their comments and recommendations.

AECA, as amended in 1996,[4] requires the President to establish a program for end-use monitoring of defense articles and services sold or exported under the provisions of the act and the Foreign Assistance Act.[5] The requirement states that, to the extent practicable, end-use monitoring programs should provide reasonable assurance that recipients comply with the requirements imposed by the U.S. government on the use, transfer, and security of defense articles and services. In addition, monitoring programs, to the extent practicable, are to provide assurances that defense articles and services are used for the purposes for which they are provided.

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

- corroboration of foreign end user,
- reconciliation of quantities shipped under the license to allowable shipments, and
- substantiation of the actual end use of the product.

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[4] 22 U.S.C. 2785.
[5] 22 U.S.C. 2151.

The end-use monitoring program provides numerous benefits according to PM/DDTC, including (1) deterring diversions; (2) aiding the disruption of illicit supply networks by rogue governments and international criminal organizations; and (3) helping the Department make informed licensing decisions and ensuring compliance with AECA and ITAR.

Prior OIG Reports

To comply with NDAA, OIG has issued reports on different aspects of export controls. In 2005, for example, OIG addressed the export licensing process the Department used to help deter the proliferation of chemical and biological weapons of mass destruction.[6] OIG limited its objective to analyzing the files of selected chemical and biological commodities to determine whether the Department executed licensing responsibilities in accordance with established policies and procedures. As such, OIG did not examine any end-use checks in the 2005 report. OIG found that the export licensing process was working as intended and that the Department consistently executed its export licensing responsibilities in regard to chemical and biological commodities in accordance with established policies and procedures.

[6] *Export Licensing of Chemical and Biological Commodities* (AUD/PR-05-29, Apr. 2005).

OBJECTIVE, SCOPE, AND METHODOLOGY

OIG's objective was to conduct a review of the Department's export licensing process to assess the effectiveness of the export control policies and practices with respect to preventing the transfer of sensitive U.S. technologies and technical information to P.R.C. and Macau. In addition, although U.S. export control policy treats Hong Kong as a nonsovereign entity distinct from P.R.C., OIG's review included a review of export licenses to Hong Kong.

To achieve its objective, OIG first focused its efforts on licensing. OIG planned to analyze all 56 licenses that PM/DDTC approved for P.R.C. and Hong Kong during FY 2004.[7] (There were no license applications for Macau during FY 2004.) OIG analyzed these licenses to determine whether the Department executed licensing responsibilities in accordance with established policies and procedures. OIG compared the information contained in the applications against PM/DDTC's standard operating procedures for licensing requirements. OIG's review included determining whether each export request in the files contained the information required to make a licensing decision. This included the following:

- license number and expiration date,
- organization requesting the license,
- export item,
- dollar value of the order,
- shipping company,
- destination of items,
- application review by other bureaus and agencies,
- final disposition (i.e., approved, denied, etc.), and
- Presidential waiver, if required.

[7]PM/DDTC personnel were unable to locate one license application file.

After reviewing the license applications, OIG obtained information on end-use checks. First, to obtain a worldwide perspective on unfavorable determinations, OIG obtained information on the number of end-use checks initiated and the number of unfavorable determinations from FY 2001 through FY 2004. Next, OIG examined all 12 end-use checks that PM/DDTC performed for Hong Kong during FY 2004. OIG reviewed each end-use check to ascertain whether the documentation contained in the files addressed the following:

- end user of the item is the actual user,
- item was used for intended purposes,
- item was transferred without approval to another entity,
- quantities shipped exceeded the approved amount, and
- companies listed in the license application actually existed.

OIG then obtained data on the number and reasons for all unfavorable end-use checks worldwide for FY 2004. Finally, OIG reviewed all 132 postlicense end-use checks that PM/DDTC reported in FY 2004. OIG selected postlicense checks because they demonstrate the effectiveness of export control policies and procedures, as PM/DDTC makes its determinations after the items are exported. OIG examined these cases using the same criteria it used during its review of the 12 Hong Kong cases.

To determine the long-term strategies for export control, and whether there were any performance measures addressing end-use checks, OIG reviewed PM's FY 2006 Bureau Performance Plan and discussed the plan with PM/DDTC officials on January 19, 2006. OIG consulted with PM/DDTC officials and with OIG officials from the Departments of Commerce, Defense, Energy, Homeland Security, and the Central Intelligence Agency.

OIG's Office of Audits, International Programs Division conducted this review from July 2005 through January 2006 in the Washington, DC, area. OIG limited its examination to Department records and did not independently verify the accuracy of the information at overseas locations. OIG performed this work in accordance with government auditing standards and included such tests and auditing procedures as were considered necessary under the circumstances. OIG discussed its findings and proposed recommendations with PM/DDTC officials. On March 15, 2006, a senior official said that unfavorable end-use checks were not a relevant indicator of the program's success or failure, and therefore, the official disagreed with OIG's recommendations. OIG provided a draft copy of this report to the Bureau of Political-Military Affairs. The bureau reviewed the draft and did not provide any comments.

REVIEW RESULTS

OIG found that although PM/DDTC adhered to its export licensing policies and procedures before issuing a license, the unfavorable postlicense end use checks, particularly cases where the authorized recipient of the items denied placing the order, demonstrate that PM/DDTC needs to reassess its licensing policies and procedures to prevent the unauthorized transfer of militarily sensitive items. Also, OIG recommended that PM/DDTC establish performance measures for the export control program within 60 days that would detail the benchmarks and timeframes for reducing and eliminating unfavorable postlicense end-use checks.

Licensing Policies and Procedures

OIG reviewed 55 of the 56 license applications that PM/DDTC approved for Hong Kong and P.R.C. during FY 2004.[8] OIG found that PM/DDTC adhered to its export licensing process, consistently executing its export licensing responsibilities in accordance with established policies and procedures.

OIG verified that PM/DDTC had initially screened all license applications to establish that the company submitting the application, commodity involved, intended user, and importing country were eligible to receive an export license. OIG also substantiated that PM/DDTC had established the eligibility of each shipping company for export control purposes.

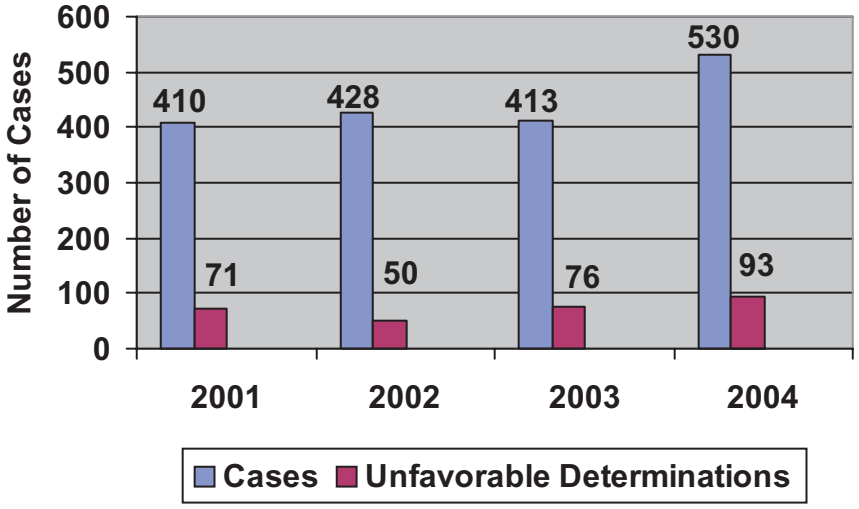
OIG confirmed that PM/DDTC tracked interagency and intra-agency referrals to ensure it received their responses in a timely manner. PM/DDTC considered information provided in the referrals when making its licensing decisions and in all cases accepted the respondents' recommendations. In addition, PM/DDTC did not make any licensing decisions before it received the requested information. Finally, the conclusions reached by PM/DDTC personnel were fully supported by file documentation.

[8]PM/DDTC personnel were unable to locate one license application file.

End-Use Monitoring

OIG considers the effectiveness of export control policies and procedures to be measured in part by the number of unfavorable determinations PM/DDTC made in the end-use monitoring program. "Unfavorable" means that the application contained incomplete, derogatory, or inaccurate information or there was a violation of export procedures or laws. Chart 1 details the number of end-use reviews initiated by PM/DDTC and the number of unfavorable determinations from FYs 2001 through 2004.[9]

Chart 1: Worldwide End-Use Checks and Unfavorable Determinations by Fiscal Year



Source: Congressional Budget Justification, Foreign Operations (FYs 2001-04).

The unfavorable determinations involve a wide range of commodities, including firearms and ammunition; aircraft spare parts; electronics and communications equipment; missile spare parts; military training equipment; and night-vision equipment. Depending on the reason for the unfavorable determination, PM/DDTC can take several actions, including placing the license applicant on a watch list for future scrutiny or referring the matter for civil or criminal action. According to PM/DDTC, although most commercial defense trade is legitimate, a small percentage of cases can fall into wrongful hands.

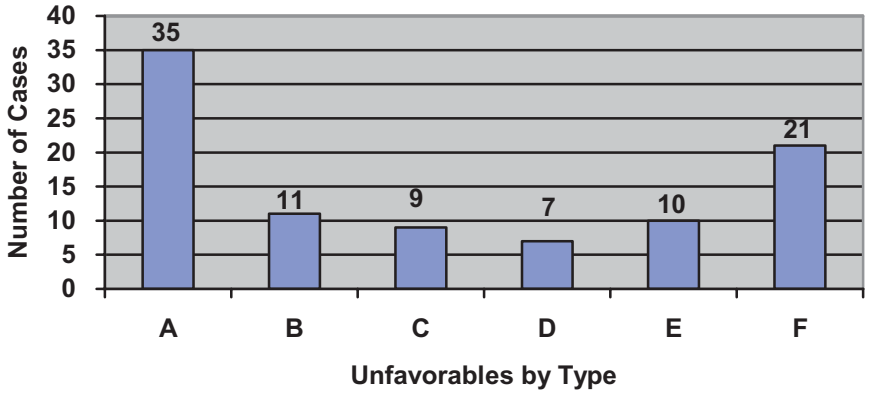
[9]PM/DDTC officials used a targeted approach to selecting cases for review, and as a result, analysts must use caution when using these data for statistical purposes.

After obtaining this multiyear worldwide perspective on end-use checks, OIG reviewed all of the FY 2004 end-use cases for China, which includes Macau and Hong Kong. PM/DDTC conducted a total of 12 end-use checks for Hong Kong. PM/DDTC did not conduct any end-use checks for exports to P.R.C. or Macau during FY 2004.

The 12 Hong Kong cases consisted of nine prelicense and three postlicense checks. PM/DDTC concluded that three were "unfavorable." All the unfavorable determinations were from prelicense checks. In one case, the recipient may have actually received the item before PM/DDTC approved the license application. In the second case, a company located in Hong Kong received technical data without the required PM/DDTC registration. In the third case, the Licensing Division denied a license because the purported end user was not, in fact, to be the end user.

Considering the results of its review of the Hong Kong cases, OIG obtained information on the number and reasons for all worldwide unfavorable end-use checks reported by PM/DDTC in FY 2004. As shown in Chart 2, 35 out of a total of 93 unfavorable end-use checks, or 37.6%, concerned a purported end user that did not order the commodity.

Chart 2: Worldwide Unfavorable End-Use Checks in FY 2004



Legend:

A. Purported recipient of the shipment did not order the commodity.

B. Derogatory information on parties involved.

C. Misuse or unauthorized transfers.

D. Inadequate justification for quantities ordered.

E. Foreign companies were not found or did not cooperate with the inquiry.

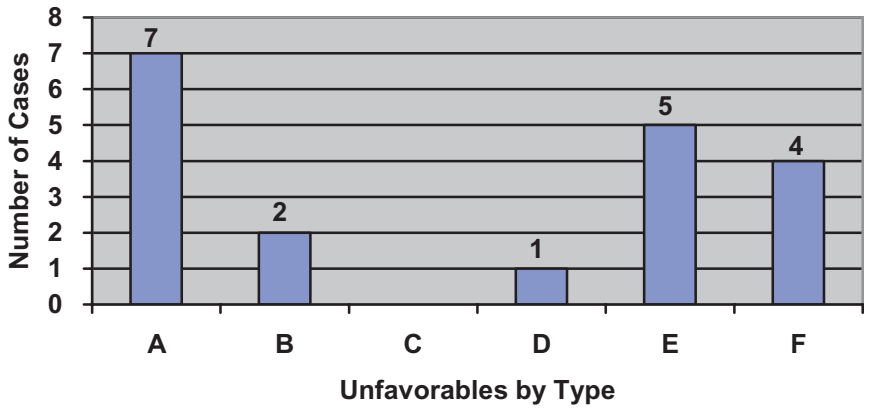
F. Miscellaneous all other.

Source: OIG analysis of unfavorable cases as shown in PM/DDTC's Report to Congress on *End-Use Monitoring of Defense Articles and Defense Services Commercial Exports, FY 2004*.

PM/DDTC provided examples to illustrate its FY 2004 end-use checks. In one case, PM/DDTC made an unfavorable determination on a prelicense end-use check for gyroscopes to a Southeast Asian country for use in CASA 212 aircraft. The end user as well as the foreign consignee denied ever placing the order. As a result, PM/DDTC did not approve the license. In another case, PM/DDTC made an unfavorable determination on a postlicense end-use check. The export was for C-130 aircraft parts to a government in the Middle East via Southeast Asian foreign intermediate consignees. PM/DDTC found that the government did not have either a contract or a firm order with the company. PM/DDTC placed the company on its watch list requiring special scrutiny.

Recognizing that once militarily sensitive items are exported, they can be diverted to countries of concern, including China, OIG then expanded its review to all of the 132 postlicense checks conducted worldwide by PM/DDTC in FY 2004. PM/DDTC reported unfavorable determinations on 19 of these postlicense checks. Reasons for the unfavorable checks are shown in Chart 3.

Chart 3: Worldwide Unfavorable Postlicense End-Use Checks in FY 2004



Legend:

A. Purported recipient of the shipment did not order the commodity.

B. Derogatory information on parties involved.

C. Misuse or unauthorized transfers.

D. Inadequate justification for quantities ordered.

E. Foreign companies were not found or did not cooperate with the inquiry.

F. Miscellaneous all other.

Source: OIG computation.

The charts and examples provided by PM/DDTC demonstrate that, worldwide, some entities seek to obtain militarily sensitive items by providing false or incomplete information on their license application. Regularly, PM/DDTC's prelicense end-use checks resulted in unfavorable determinations, thus preventing items from being exported in violation of export laws and the Department's policies. In other cases, PM/DDTC approved the licenses and made unfavorable determinations after the items were exported. As a result, PM/DDTC could not prevent unauthorized transfers of militarily sensitive items in those cases.

Factors Contributing to Unfavorable Determinations

A senior PM/DDTC official said that no system is foolproof and that there are ways to fool or evade the licensing process. For example, applicants could photocopy purchase orders and use them for multiple requests. They could counterfeit documentation. They could slightly conceal the identity of a commodity sought. However, fixing the system to eliminate these few examples would likely result in a much more elaborate export control program that would impede good defense trade, according to the official.

Further, according to this official, the number and complexity of license requests are increasing each year, as is the number of countries where trade is authorized. In 1990, PM/DDTC reviewed and took action on approximately 50,000 license requests, while in FY 2004, it received about 60,000 license requests. More requests are in the form of technical assistance and manufacturing license agreements (150% increase during those years), whose technology transfer is much more complex than a hardware transaction.

Finally, there are limited human resources. PM/DDTC has five compliance specialists (three civil servants and two contractors) in the Research and Analysis Division and one division chief. Only four of the five specialists are devoted to the Blue Lantern Program.

Actions To Strengthen Export Control Program

PM/DDTC is taking several actions to strengthen its export control program. During 2006, PM/DDTC plans to issue a revised Blue Lantern Policy document, which will establish new guidelines, criteria, and timelines for conducting end-use checks. PM/DDTC is working with officials from the Foreign Service Institute to develop a training module for Foreign Service personnel serving overseas who are responsible for end-use checks. Finally, PM/DDTC intends to continue its Outreach Program, visiting posts and host governments overseas to educate and encourage host government support for and participation in the Blue Lantern Program. PM/DDTC expects that these domestic and international efforts will, in the medium- to long-term, yield overall improvements in the quality and timeliness of the end-use monitoring program. Although OIG believes that these efforts can enhance PM/DDTC's reporting of unfavorable determinations, they do not include changes to the licensing policies and procedures, which could reduce and eliminate unfavorable postlicense end-use checks.

Performance Measures

In its FY 2006 Bureau Performance Plan, PM recognizes that sound export controls and licensing operations are essential to preventing the spread of dangerous weapons of mass destruction technologies and providing conventional technologies only to those entities that will use them responsibly. PM's long-term strategies include expanding compliance reviews, registration requirements, and onsite visits to defense industry exporters to increase compliance with AECA and ITAR.

Performance measures for end-use checks could demonstrate progress toward reducing and eliminating unfavorable determinations. However, PM/DDTC has not developed performance measures. Additionally, PM/DDTC could use the measures to track performance and identify areas for improvement and make decisions about resource allocation.

Conclusions

PM/DDTC adhered to its export licensing policies and procedures before issuing licenses. However, the unfavorable postlicense end-use checks, particularly cases where the authorized recipient of the items denied placing the order, demonstrate that PM/DDTC needs to reassess its licensing policies and procedures to prevent the unauthorized transfer of militarily sensitive items. PM/DDTC should report to OIG within 60 days of report issuance the changes it plans to make to reduce and eliminate unfavorable postlicense end-use checks. Also within 60 days, PM/DDTC should establish performance measures for its export control program that detail its progress toward reducing and eliminating the number of unfavorable postlicense end-use checks.

Recommendation 1: OIG recommends that the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls reassess its licensing policies and procedures and report to OIG within 60 days of report issuance the changes it will make to reduce and eliminate unfavorable postlicense end-use checks.

Recommendation 2: OIG recommends that within 60 days of report issuance the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls establish performance measures that detail the benchmarks and timeframes for reducing and eliminating the number of unfavorable postlicense end-use checks.