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The Honorable Ileana Ros-Lehtinen
Chairman
The Honorable Howard Berman
Ranking Member
Committee on Foreign Affairs
House of Representatives

Subject: *Export Controls: Compliance and Enforcement Activities and Congressional Notification Requirements under Country-Based License Exemptions*

In 2010, the United States announced a reform of its export control systems that proposed, among other things, to reduce the numbers and types of items requiring government review and licensing before export. The U.S. government uses the export control system to limit the risk of sensitive items falling into the wrong hands, while at the same time allow legitimate trade of these items to occur. In particular, the United States controls the export of sensitive defense and dual-use items (items with both commercial and military, proliferation or terrorist applications) to foreign governments and commercial entities and non-governmental organizations. As part of the export control reform effort, the Department of State (State), the Department of Commerce (Commerce), and other agencies are reassessing the level of control warranted for certain defense items they consider to be less sensitive.

The U.S. government generally requires each export of defense articles, services, and dual-use items to undergo a government review and receive a license before export. However, State and Commerce provide certain exemptions¹—commonly referred to as country-based license exemptions—for the export of selected items to particular destinations that present a lower risk of misuse or diversion.² In April 2012, State began implementing a bilateral defense cooperation treaty between the United Kingdom (UK) and the United States to allow certain defense articles and services to be exported without a license.³ A similar treaty with Australia is expected to enter into force in 2013. In addition, State implements a long-established country-based license exemption for

¹In this report, we use the term “exemption” to refer to both State’s license exemptions and Commerce’s license exceptions.

²“Diversion” refers to the transfer or release, directly or indirectly, of a good, service, or technology to an end user or an intermediary that is not an authorized recipient of the good, service, or technology.

³Announcement of Entry Into Force of the Defense Trade Cooperation Treaty Between the United States and the United Kingdom, 77 Fed. Reg. 23,538 (Apr. 19, 2012).

Canada for the export of specific items without a license.⁴ In 2011, Commerce established the Strategic Trade Authorization (STA) license exemption, which allows the export, without a license, of items controlled for multiple reasons, including national security and nuclear nonproliferation, to 36 destinations judged to be of low risk of diversion.⁵ The STA also allows the export of items controlled only for national security reasons to eight additional destinations judged to be of low risk of diversion for such items.⁶

Additionally, as part of the export control reform, the administration is working to establish a framework to transfer control of thousands of defense items from State's U.S. Munitions List to Commerce's Commerce Control List.⁷ In comments on a draft of this report, Commerce stated that the President's Export Control Reform Initiative will enhance national security by (1) allowing greater interoperability with NATO and our other allies while still maintaining and expanding robust controls and, in some cases, prohibitions on exports or reexports to other countries and for proscribed end users and end uses; (2) enhancing the U.S. defense industrial base by reducing the current incentives for foreign companies to design out or avoid U.S.-origin content that is controlled by the International Traffic in Arms Regulations (ITAR) particularly with respect to generic, unspecified parts and components; and (3) permitting the U.S. government to focus its resources on controlling, monitoring, investigating, analyzing, and, if need be, prohibiting exports and reexports of more significant items to destinations, end uses, and end users of greater concern than our NATO allies and other multiregime partners.

Historically, State has controlled defense items, while Commerce controlled dual-use items. According to the Acting Secretary of Commerce, items that will be transferred from State's list to the more flexible Commerce list are those that do not perform an inherently military function and do not provide the United States with a military or intelligence advantage. This would allow the United States to put in place more logical controls on trade with close allies while maintaining strict controls over exports and re-exports to others, according to the Acting Secretary. According to documents obtained from Commerce, most of the defense articles being considered for transfer to Commerce are those determined to no longer warrant stricter controls under State, and include largely

⁴22 C.F.R. § 126.5.

⁵15 C.F.R. § 740.20. The complete list of reasons for control include national security, chemical or biological weapons, nuclear nonproliferation, regional stability, crime control, or significant items. The 36 destinations are Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Turkey, and the United Kingdom.

⁶The eight destinations are Albania, Hong Kong, India, Israel, Malta, Singapore, South Africa, and Taiwan.

⁷The United States Munitions List identifies defense items controlled by State, and the Commerce Control List identifies dual-use and commercial items controlled by Commerce. According to § 730.3 of the Export Administration Regulations (EAR), the convenient term dual use is sometimes used to distinguish the types of items covered by the EAR from those that are covered by the regulations of certain other U.S. government departments and agencies with export licensing responsibilities. In general, the term dual use serves to distinguish EAR-controlled items that can be used for both military and other strategic uses (e.g., nuclear) and commercial applications. Although the short-hand term "dual use" may be employed to refer to the entire scope of the EAR, the EAR also applies to some items that have solely civil uses. For the purposes of this report, we refer to items under Commerce jurisdiction as "dual-use" items.

generic parts and components of military equipment.⁸ As part of the process, Commerce has proposed to establish a new classification category called the “600 series” to control the export of defense articles transferred to Commerce.⁹ Under the proposed rules, certain defense items placed in the 600 series will be subject to additional export restrictions when using an STA license exemption in comparison to those in place for dual-use items. Under the proposed rules, certain defense items placed under Commerce control will be eligible for an STA license exemption.¹⁰

In your request, you raised concerns about compliance and enforcement activities¹¹ for items exported without a license, such as those under the country-based license exemptions. Of particular concern are those defense items proposed to be transferred from State’s to Commerce’s control, which may include items such as certain firearms and satellite technology. You also raised concerns about potentially diminishing congressional notification requirements. U.S. law requires State to notify Congress of certain defense exports and to report to Congress certain statutory violations and has different requirements for Commerce to do so for dual-use items.¹² Finally, you raised concerns about whether notifications to Congress for the export of certain defense articles and services and for statutory violations related to those exports would continue if such articles and services move to Commerce for control.

As such, in response to your request, we analyzed State’s and Commerce’s compliance and enforcement activities for items exported with a license and those that could be exported under four existing or proposed country-based license exemptions: the Defense Trade Cooperation Treaties with the UK and Australia (hereafter referred to as “the treaties”), the Canadian exemption, and the STA.¹³ Specifically, this report describes existing and proposed (1) compliance and enforcement activities for exports under both licenses and country-based license exemptions and (2) requirements for State and Commerce to notify Congress of certain defense exports and of violations of export control laws.

To address these objectives, we reviewed relevant statutory authorities that guide State’s and Commerce’s export controls processes. We identified the existing country-based license exemptions and interviewed State and Commerce officials to determine the compliance and enforcement activities each agency implements with respect to these

⁸We did not assess the level of controls warranted for items being considered for transfer to Commerce for control.

⁹76 Fed. Reg. 41,958 (July 15, 2011).

¹⁰77 Fed. Reg. 37,524 (June 21, 2012).

¹¹Compliance activities, such as vetting parties to a transaction and review of recordkeeping, are intended to encourage compliance with export control laws and regulations, while enforcement activities, such as investigations of potential violations of export control laws and regulations, are intended to apply penalties for violating them.

¹²22 U.S.C. §§ 2776(c)(6) and 2753 and 50 U.S.C. app. §§ 2405, 2413.

¹³Although Commerce implements several license exemptions that take into account destination and item or technology, we limited our review to the STA.

exemptions.¹⁴ We also identified and compared the various congressional notification requirements for the three country-based license exemptions to the requirements for licensed items. We conducted this performance audit from March 2012 to November 2012 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Some compliance activities for the export of controlled items under State and Commerce licenses differ from compliance activities under country-based license exemptions, but enforcement activities are generally the same. Compliance activities provide information for exporters, licensing officials, and enforcement agencies to help assess the validity of export transactions, identify potential violations, or prevent violations before they occur. Of the seven compliance activities we identified, three differ for licensed exports compared with country-based license exemptions. These activities are (1) license application review, (2) vetting parties to transactions, and (3) compliance program reviews (recordkeeping).¹⁵ In contrast to these compliance activities, the other four compliance and three enforcement activities, such as inspection of exports, investigations, and punitive actions for violations, are generally the same for both licensed exports and country-based, license-exempt exports.

The congressional notification requirements for State and Commerce to report proposed exports and statutory violations vary because each agency's authority stems from different legislative statutes.¹⁶ Specifically, each agency's export control regulations derive from different legislative authorities and aim to control articles that have different levels of concern for diversion or unintended use. State is required by law to notify Congress of proposed exports of major defense equipment, articles, and services that meet specific dollar thresholds under a license or treaty.¹⁷ Commerce is required to notify Congress of proposed exports that are destined for a designated state sponsor of terrorism or could make a significant contribution to the military potential of the government of a country that has repeatedly provided support for acts of international terrorism.¹⁸ However, in June 2012, Commerce issued a proposed rule that would add a new requirement to notify Congress of pending exports of major defense equipment, such as articles under the proposed 600 series, including those exported under the STA, that meet the same dollar

¹⁴We did not assess the potential effectiveness of the compliance and enforcement activities conducted by State and Commerce.

¹⁵For the purposes of this report, we characterize the license application review as a compliance activity to be consistent with Commerce's own usage in its annual report and congressional testimony as well as our past reports.

¹⁶State's authority stems from the Arms Export Control Act (AECA). 22 U.S.C. §§ 2751-2799aa-2. Commerce's authority stems from the Export Administration Act (EAA). 50 U.S.C. app. §§ 2401-2420.

¹⁷22 U.S.C. § 2776(c)(6).

¹⁸50 U.S.C. app. § 2405(j).

thresholds as those required of State.¹⁹ As of November 2012, Commerce was considering how to implement its proposal. In terms of enforcement actions, State is required to notify Congress of certain violations of export laws.²⁰ Commerce is required to provide an annual report to Congress that includes statutory violations resulting in administrative and criminal penalties.²¹

Background

The U.S. export control system seeks to prevent defense and dual-use items from falling into the wrong hands and, at the same time, allow legitimate trade to occur. Defense items can include sophisticated technology designed for military use—such as tanks, fighter aircraft, submarines, firearms, satellites, missiles—and training. Dual-use items can include less-sensitive, commonly available items such as computers, radars, and telecommunication equipment. Historically, State regulates defense exports, and Commerce regulates dual-use exports. Defense items controlled by State are identified in the United States Munitions List, which is implemented under the ITAR.²² Dual-use Items controlled by Commerce are identified in the Commerce Control List, which is implemented under the Export Administration Regulations (EAR).²³ Table 1 identifies the U.S. agencies and offices that regulate, enforce, or participate in the defense and dual-use export control systems.

Table 1: Roles and Responsibilities in the U.S. Defense and Dual-Use Export Control Systems

Principal regulatory agency/office	Mission	Statutory authority	Implementing regulations	Control list
State Department's Directorate of Defense Trade Controls	Regulates and enforces controls on the export of defense articles and services	Arms Export Control Act (AECA), as amended	International Traffic in Arms Regulations (ITAR)	United States Munitions List
Commerce Department's Bureau of Industry and Security ^a	Regulates and enforces controls on the export of dual-use items	Export Administration Act (EAA) of 1979, as amended ^b	Export Administration Regulations (EAR)	Commerce Control List

¹⁹77 Fed. Reg. 37,524 (June 21, 2012).

²⁰22 U.S.C. § 2753.

²¹50 U.S.C. app. § 2413.

²²State implements the ITAR and regulates the export of defense items pursuant to the Arms Export Control Act (AECA). 22 U.S.C. § §2751-2799aa-2.

²³Commerce implements the EAR and regulates the export of items subject to the EAR, including dual-use items, pursuant to the Export Administration Act (EAA). 50 U.S.C. app. §§ 2401-2420. The Export Administration Act (EAA) of 1979, as amended lapsed on August 20, 2001. However, the President has, to the extent permitted by law, kept in effect the provisions of the EAA and its implementing regulations through Executive Order 13222 of August 17, 2001 (66 Fed. Reg. 44,025). Executive Order 13222 was issued under the authority provided by the International Emergency Economic Powers Act (50 U.S.C. §§ 1701 et seq.) and most recently was extended by Presidential Notice of August 15, 2012. 77 Fed. Reg. 49,699 (Aug. 16, 2012).

Principal regulatory agency/office	Mission	Statutory authority	Implementing regulations	Control list
Other federal agencies				
Department of Defense	Provides input on which items should be controlled by either State or Commerce and conducts technical and national security reviews of export licenses submitted by exporters to either State or Commerce.			
Department of Homeland Security	Enforces defense and dual-use export control laws and regulations through border inspections and investigations.			
Department of Justice	Investigates suspected criminal violations in certain areas of counterintelligence, including potential export control violations, and prosecutes suspected violators of arms and dual-use export control laws.			
Department of Energy	Participates in the review of export license applications submitted to State and Commerce and provides input on which items should be subject to control under the ITAR and EAR, respectively.			

Source: GAO.

Notes: Data are from GAO, *Export Controls: Observations on Selected Countries' Systems and Proposed Treaties*, [GAO-10-557](#) (Washington, D.C.: May 27, 2010).

^aCommerce's Bureau of the Census implements the Foreign Trade Regulations which require, with some exceptions, that exporters provide shipping data through the Automated Export System (AES). The AES is the central point through which exporters must electronically file the export shipment data required by multiple agencies. 15 C.F.R. part 30.

^b50 U.S.C. app. §§ 2401-2420. The Export Administration Act (EAA) of 1979, as amended, lapsed on August 20, 2001. However, the President has, to the extent permitted by law, kept in effect the provisions of the EAA and its implementing regulations through Executive Order 13222 of August 17, 2001 (66 Fed. Reg. 44,025). Executive Order 13222 was issued under the authority provided by the International Emergency Economic Powers Act (50 U.S.C. §§ 1701 et seq.) and most recently was extended by Presidential Notice of August 15, 2012. See 77 Fed. Reg. 49,699 (Aug. 16, 2012).

Generally, to receive approval to export certain items, exporters must submit a license application to State if their export is a defense item or to Commerce if their export is a controlled dual-use item that requires a license. However, both State and Commerce provide exemptions that allow the export of controlled items without a license if certain conditions are met. State implements three country-based license exemptions: the Defense Trade Cooperation Treaty with the United Kingdom (UK), the Defense Trade Cooperation Treaty with Australia, and a license exemption for Canada. Although Commerce implements several license exemptions, the STA is the only exemption based primarily on the destination of the export.²⁴ According to Commerce, license exemptions reduce uncertainty and delays faced by exporters of items in the licensing process.

State-Implemented Treaties and the Canada Exemption

In 2007, the United States signed separate Defense Trade Cooperation Treaties with the UK and Australia to provide for the license-free export or transfer of selected defense items under certain circumstances. The treaty with the UK entered into force in April 2012, while the treaty with Australia is expected to enter into force in 2013. State's implementation of the UK treaty and future implementation of the Australia treaty fall under the authority of the AECA. The stated goals of the treaties include achieving fully

²⁴Commerce implements other license exemptions. For example, the exemption "Servicing and Replacement of Parts and Equipment" allows for the export and reexport of one-for-one replacement of parts or servicing and replacement of previously exported equipment without a license.

interoperable forces, establishing a closer framework for security and defense cooperation, and leveraging strengths of the security and defense industries. Only authorized governmental and nongovernmental entities, facilities, departments, agencies, and personnel in each country party to the treaties are eligible to export, acquire, or transfer applicable items under the treaties. The treaties establish the process for certain defense articles to be exported into and within these “approved communities” without a license as long as exports are in support of certain (1) combined military and counterterrorism operations; (2) cooperative security and defense research, development, production, and support programs; (3) mutually agreed-upon security and defense projects in which the end user is the UK or Australian government; or (4) U.S. government end-uses. According to State, as of September 2012, there were no reported exports of U.S. Munitions List hardware made pursuant to the UK Treaty exemption in the ITAR.²⁵

Established in 1954, State’s Canadian exemption grew out of the U.S. and Canadian geographic relationship, economic partnership, and mutual interest in the defense of North America. As with the treaties, State implements the Canadian exemption through the ITAR.²⁶ The scope of the Canadian exemption has evolved since its inception. Earlier versions allowed, without a license, the export and import of arms, ammunition, and implements of war, and the export of unclassified technical data. Later revisions expanded the items eligible for the exemption to include defense services and increased the types of items requiring a license.²⁷ According to State, between October 1, 2007, and September 30, 2008—the latest data available from State—exporters conducted roughly 35,000 transactions, worth an estimated \$1.7 billion, using the Canadian exemption.²⁸

Commerce-Implemented Strategic Trade Authorization License Exemption

Under the STA license exemption, the export, reexport, and in-country transfer of dual-use items may be made without a license to destinations that pose a relatively low risk of misuse or diversion. The STA, implemented through the EAR, authorizes the export, reexport, and in-country transfer of items subject to controls for reasons of national security, chemical or biological weapons, nuclear nonproliferation, regional stability, crime

²⁵State can verify only exports of hardware technology transfers for which exporters are required to file export shipment data electronically. This requirement does not apply to technology exports; as such, technology exports may have occurred under the treaty without State’s knowledge.

²⁶22 C.F.R. § 126.5.

²⁷In April 1999, State revised its regulations to clarify when the exemption could be used, and limited the defense items that could be exported under the exemption. State took this action on the basis of its analysis that exports were being reexported from Canada to countries of concern without U.S. government approval and that controls over defense and ammunition transfers needed strengthening. For additional information see GAO, *Defense Trade: Lessons to Be Learned from the Country Export Exemption*, [GAO-02-63](#) (Washington D.C.: Mar. 29, 2002).

²⁸State’s *End-use Monitoring of Defense Articles and Defense Services, Commercial Exports FY 2009*, contains a review of the Canadian exemption and determined the number of transactions and dollar value associated with the Canadian exemption for fiscal years 2007 and 2008. In this report, State erroneously reported to Congress that \$17 billion in exports were conducted under the Canadian exemption during this period; the correct amount is \$1.7 billion; State officials told GAO they plan to report the correct amount to Congress.

control, or significant items to 36 destinations.²⁹ It also enables the export of certain items controlled for national security reasons to another eight destinations. According to Commerce, from July 2011 to July 2012—the 12 months after the STA exemption entered into effect—74 exporters used the STA exemption to conduct 604 transactions worth \$33.9 million.

Under the rules proposed by Commerce in June 2012, certain defense items and services transferred to Commerce control, such as those to be placed in the 600 series, will be eligible for an STA license exemption.³⁰ However, for these eligible defense items, the use of the STA is limited to ultimate government end use by one of the 36 authorized destinations and requires a previously issued State or Commerce license.³¹

Export Processes for Defense and Dual-Use Articles

Generally, exporters are responsible for determining if State or Commerce controls the article they seek to export and if a license is required or an exemption may be used. If the item requires an export license, the exporter must submit a license application to State or Commerce, depending on which agency controls the item, and then follow the designated export control process. Exporters seeking to export items controlled by State must register with the department regardless if the item is exported under a license or a license exemption; however, exporters are not required to register with Commerce.³² If the item is eligible for a license exemption—such as under the treaties, the Canadian exemption, or the STA—the exporter may choose not to submit a license and follow the streamlined export control process under the respective exemption.³³ Figure 1 outlines the U.S. export control processes when items are exported under a license or a country-based license exemption. A full description of these processes is included in enclosure II.

²⁹ 15 C.F.R. § 740.20. See 15 C.F.R. § 742.14 for the regulatory explanation of significant item as a reason for control.

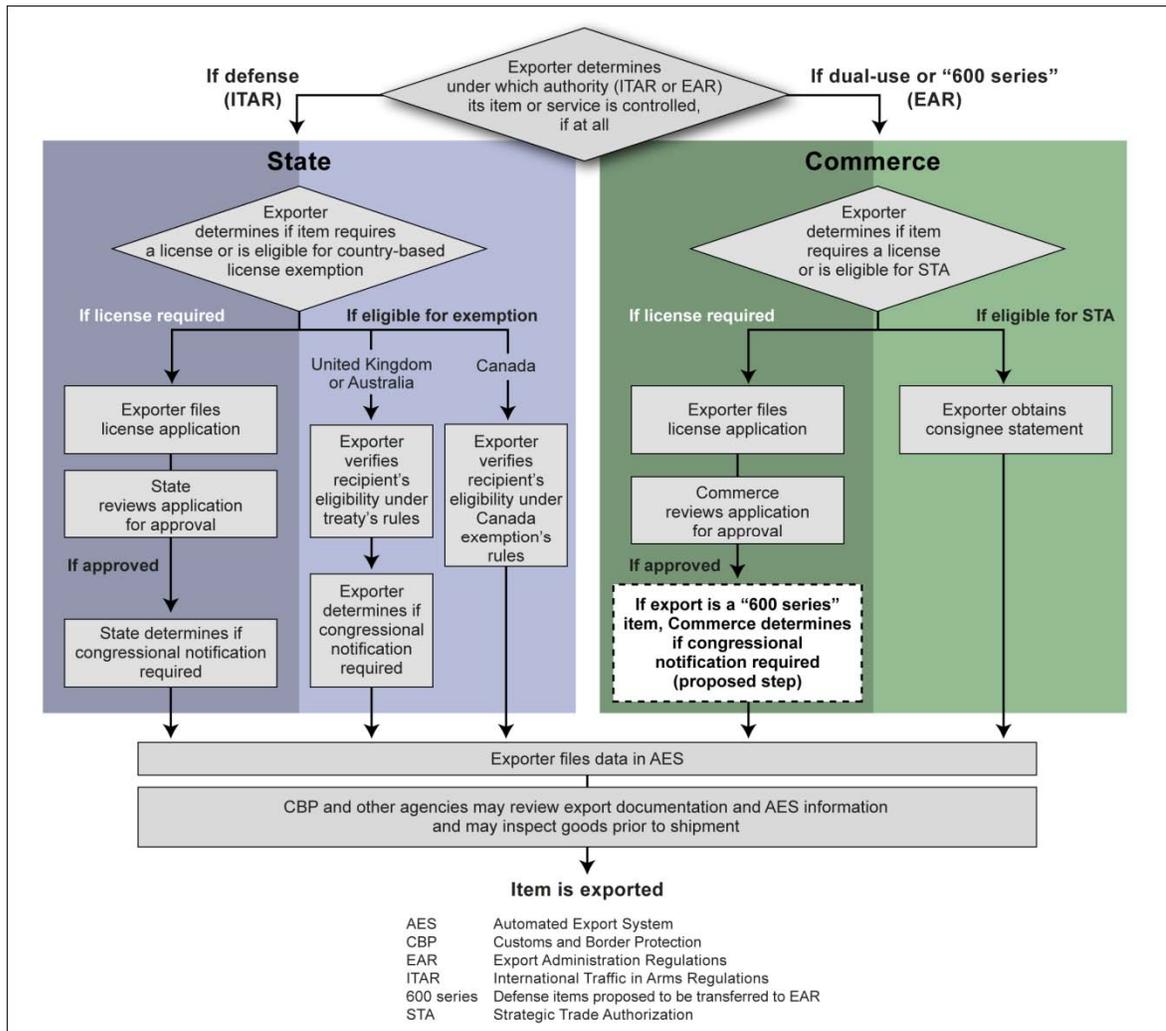
³⁰ 77 Fed. Reg. 37,524 (June 21, 2012).

³¹ The proposed rule states that the purchaser, intermediate consignee, ultimate consignee and end user must have been previously approved on a State or Commerce export license.

³² 22 C.F.R. § 122.1.

³³ The items that Commerce controls may be eligible for other license exemptions.

Figure 1: Export Control Process under a License and Selected Country-Based License Exemption



Source: GAO analysis of State and Commerce information.

Notes: Other agencies may review license applications referred to them by State or Commerce.

Under Commerce's proposed rules, certain defense items to be placed in the proposed 600 series would be eligible for the STA, but 600 series items that would require a congressional notification would not be eligible for the STA.

Congressional Notifications

Items controlled under State's jurisdiction have different controls from those under Commerce's jurisdiction, including different requirements to notify Congress of defense transfers and statutory violations. State implements export controls of defense items, including country-based license exemptions, pursuant to the Arms Export Control Act (AECA), which requires that State notify Congress of certain defense transfers and export statutory violations.³⁴ Commerce implements controls of dual-use exports, including the STA and other license exemptions, under the Export Administration Act (EAA), which

³⁴22 U.S.C. §§ 2776, 2753.

requires Commerce to notify Congress of proposed exports which are destined for designated state sponsors of terrorism or could make a significant contribution to the military potential of a government of a country that has repeatedly provided support for acts of international terrorism.³⁵ However, Commerce is also required to provide an annual report to Congress with information on the number of administrative cases and criminal convictions as a result of export control statutory violations by individuals and companies.³⁶ Since Commerce is expected under export control reform to have jurisdiction over certain defense items, members of Congress have raised concerns about whether notifications to Congress for the exports currently controlled by State will continue after they are transferred to Commerce.

Certain Compliance Activities for Exempted Exports Differ from Activities for Licensed Exports, but Enforcement Activities Are Generally the Same

Certain compliance activities for the export of controlled items under State and Commerce licenses differ from compliance activities under country-based license exemptions, but enforcement activities are generally the same. The three compliance activities that differ are (1) license application review, (2) vetting parties to transactions, and (3) compliance program reviews (recordkeeping). In contrast to these compliance activities, the other four compliance and three enforcement activities, such as inspection of exports, and investigations and punitive actions for violations, are generally the same for both licensed exports and country-based license-exempt exports.

Compliance and Enforcement Activities Aim at Preventing Export Control Violations

Compliance activities provide information for exporters, licensing officials, and enforcement agencies to assess the validity of particular export transactions, identify potential violations, or prevent violations before they occur. Enforcement activities strive to prevent or deter the illegal export or transshipment of defense and dual-use items. We identified seven export control compliance activities and three enforcement activities that the Departments of Commerce, Homeland Security (DHS), Justice, State, and the Treasury conduct to encourage compliance with export control laws and prevent the diversion or misuse of exported items against U.S. allies or interests.³⁷ Within each compliance and enforcement activity, State, Commerce, or other agencies perform specific tasks. Table 2 describes the seven compliance and three enforcement activities, along with selected tasks associated with the export of defense and dual-use items.

³⁵ 50 U.S.C. app. § 2405.

³⁶ 50 U.S.C. app. § 2413.

³⁷ See GAO, *Export Controls: U.S. Agencies Need to Assess Control List Reform's Impact on Compliance Activities*, [GAO-12-613](#) (Washington, D.C.: Apr. 23, 2012); and *Export Controls: Proposed Reforms Create Opportunities to Address Enforcement Challenges*, [GAO-12-246](#) (Washington, D.C.: Mar. 27, 2012).

Table 2: Description of Compliance and Enforcement Activities and Selected Tasks for Export of Defense and Dual-Use Items

Activity	Activity description	Selected tasks associated with activity
Compliance activities		
License application review	When deciding whether to approve or deny an export license application, State and Commerce, among other agencies, evaluate it against several factors, including how the recipient plans to use the item.	<ul style="list-style-type: none"> Agencies review transaction prior to export to identify parties to transaction, proposed export's end use, and destination.
Vet parties to the transaction	Review and assess all parties to the transaction.	<ul style="list-style-type: none"> Reviewing agencies vet license applicant, end-user, and any other parties to the transaction against internal lists, as well as export and licensing histories, intelligence, law enforcement, and public information. State or Commerce vets parties to country-based exemption export prior to the first transaction or after shipment of selected exports.
End-use monitoring	Conduct checks, as needed, including site visits, to verify the bona fides of entities and appropriate receipt and use of controlled items.	<ul style="list-style-type: none"> State and Commerce conduct prelicense checks of applicant, end-user, or other parties to transaction to verify bona fides. State and Commerce conduct postshipment verification checks to determine appropriate receipt and use of export.
Shipping data analysis	Review selected export declarations to identify potential violations and select exports for postshipment verification check.	<ul style="list-style-type: none"> Commerce conducts real-time analysis of information input into the Automated Export System (AES). State and Commerce conduct regular postshipment analysis of AES data.
Compliance program reviews	Review and critique companies' programs to manage export-related decisions and transactions to ensure compliance with regulations and license conditions.	<ul style="list-style-type: none"> State and Commerce review exporter's records to ensure the exporter meets requirements. State and Commerce conduct on-site review of exporters' compliance programs.
List maintenance	Update and maintain lists that inform the licensing process by providing key information on entities of concern to licensing officers and the public.	<ul style="list-style-type: none"> State and Commerce update and maintain internal "watch lists," among other lists. State, Commerce, and Treasury maintain prohibited and sanctioned parties' lists.

Activity	Activity description	Selected tasks associated with activity
Outreach	Provide courses, workshops, and seminars for exporters to inform them of their responsibilities to comply with export control laws and regulations. Provide training to foreign government officials.	<ul style="list-style-type: none"> State and Commerce provide information to exporters to assist in compliance efforts. State, Commerce, DHS, and Justice provide training and seminars to foreign government officials on how to investigate, detect, and interdict unauthorized transfers of items.
Enforcement activities		
Inspection of goods	Inspect items, including review and validation of documentation, scheduled for export at U.S. air, sea, and land ports.	<ul style="list-style-type: none"> DHS's Customs and Border Protection primarily inspects exports at U.S. ports.
Investigation of violations	Investigate potential violations of export control laws for dual-use and defense items.	<ul style="list-style-type: none"> Commerce, DHS's Immigration and Customs Enforcement, and the Justice Department's Federal Bureau of Investigations may investigate potential violations.
Punitive actions for violations	Pursue punitive actions, either criminal or administrative, taken against individuals or companies for violations of export control laws and regulations. Penalties include imprisonment, fines, suspension of an export license, denial, or debarment from exporting, among others.	<ul style="list-style-type: none"> State, Commerce, DHS, and the Departments of Justice and the Treasury may all take punitive actions for violations. Punitive actions taken against violators may be criminal or administrative.

Source: GAO analysis of State, Commerce, DHS, and Departments of Justice and the Treasury information.

Vetting and Compliance Program Reviews for Country-Based License-Exempt Exports Are Different from Those Followed for Licensed Exports

We identified three compliance activities that differ for licensed exports compared with country-based license-exempt exports. The compliance activities that differ are (1) license application reviews (2) vetting parties to transactions and (3) compliance program reviews (recordkeeping). The other four compliance and three enforcement activities are generally the same.

License Application Reviews

Because country-based license exemptions do not require a license, neither State nor Commerce conducts license application reviews for items exported under an exemption. For transactions requiring a license, the exporter submits an application that State or Commerce officials review. As part of the application review process, State and Commerce may consult with other agencies. When deciding whether to approve or deny an export license application, State and Commerce evaluate it against several factors, including how the recipient plans to use the item.

Vetting Parties to a Transaction

The process for compliance activities undertaken to vet parties to a transaction for licensed exports is different from the process for those activities undertaken to vet parties for country-based license-exempt exports. Generally, for items exported under a State or

Commerce license, U.S. agency officials review the license application and screen all entities that are party to each transaction against various agency lists, as well as export and licensing histories, and public, law enforcement, and intelligence information. These lists include State's internal Watch List; Commerce's internal Watch List; Commerce's Denied Persons List, Entity List, and Unverified List; State's Nonproliferation Sanctions List and the AECA Debarred List; and the Department of the Treasury's Specially Designated Nationals List.³⁸ State and Commerce may also conduct a prelicense check to verify the credentials of a party before approving a license.³⁹ Such prelicense checks may include a site visit to the proposed end-user or foreign consignee.⁴⁰ Both State and Commerce may request input or a review of the license application by another agency, such as the Departments of Defense and Energy, as part of the vetting process.⁴¹

The vetting process for State-licensed exports differs from the process for exports under the UK and Australia treaties. Although the treaties do not require a license, they do require prior vetting and membership into an "approved community." Approved communities include exporters and end users that both treaty members (the United States and the UK, or the United States and Australia) have vetted and approved. UK officials vet UK applicants for approved community membership; applicants must have "List-X" approved facilities, an indication that the facility is approved to hold classified information. Once the UK approves applicants, State and other agencies, such as the Departments of Defense and Justice, vet the member applicants. Once applicants become members of the approved community, State does not vet exporters or end-users before each transaction. According to State officials, State can limit the eligibility of or remove members from the approved community. State officials explained that the vetting process will be similar for Australia once the treaty enters into force.

In contrast to the process for State-licensed exports and for the treaties, State does not vet parties to transactions under the Canadian exemption before the transaction. The

³⁸The Denied Persons List includes individuals and entities that have been denied export privileges. Any dealings with a party on this list that would violate the terms of its denial order are prohibited. The Entity List includes parties whose presence in a transaction can trigger a license requirement supplemental to those elsewhere in the EAR. The list specifies the license requirements and policy that apply to each listed party. The Unverified List includes end users whom Commerce's Bureau of Industry and Security has been unable to verify in prior transactions. The presence of a party on this list in a transaction is a "red flag" that should be resolved before proceeding with the transaction. The Nonproliferation Sanctions List includes parties that have been sanctioned under various statutes. The AECA Debarred List includes entities and individuals prohibited from participating directly or indirectly in the export of defense articles, including technical data and defense services. The AECA Debarred List includes persons convicted in court of violating or conspiring to violate the AECA and subject to "statutory debarment" or persons established to have violated the AECA in an administrative proceeding and subject to "administrative debarment." The Specially Designated Nationals List includes parties who may be prohibited from export transactions on the basis of the Department of the Treasury's Office of Foreign Assets Control regulations. The EAR requires a license for exports or reexports to any party in any entry on this list.

³⁹According to Commerce guidance on end-use checks, an on-site visit is a requirement for all prelicense checks except under unusual circumstances that must be reported. State, however, does not require an on-site visit for all prelicense checks.

⁴⁰Consignee refers to a recipient of the exported item during any phase of the export transaction.

⁴¹As provided for under Executive Order 12981, State and the Departments of Defense and Energy have the authority to review any export license application submitted to Commerce, and Commerce may refer export license applications to other departments or agencies as appropriate. Exec. Order No. 12,981, 60 Fed. Reg. 62,981 (Dec. 5, 1995). If there is disagreement among the agencies on the disposition of the application, the application goes through an interagency dispute resolution process.

Canadian Controlled Goods Directorate vets end users and approves them to receive U.S. exports. State officials said that Canadian government officials have briefed them on the vetting and registration process. State officials expressed confidence in the vetting process because, according to them, Canada wants to protect U.S. defense articles and be seen as a reliable trading partner. Table 3 summarizes the differences in the compliance activities for State-licensed exports and State’s country-based license exemptions.

Table 3: Differences among Compliance Activities for State-Licensed Exports, Exports under the UK and Australia Treaties, and Exports under the Canadian Exemption

Activity	State-licensed export	UK and pending Australia treaty exemptions^a	Canadian exemption
License application review	State reviews the license application and proposed transaction before a license is issued.	Members of the approved community may export to other members of the approved community without prior State approval.	State does not review the transaction prior to export.
Vet parties to the transaction	State vets all entities party to the export transaction before a license is issued.	State vets all exporters applying for membership in “approved communities.” Only members of the approved communities are allowed to export items under the treaty.	State does not vet entities party to a transaction under the Canadian exemption. ^b
Compliance program review	State reviews exporter’s compliance program and records; in accordance with ITAR, exporters are required to maintain specific records of their transactions for inspection upon request.	State reviews exporter’s compliance program and records. In addition to the standard ITAR requirements, exporters must apply treaty markings to the items exported.	State reviews exporter’s compliance program and records. In addition to the ITAR requirements, exporters must provide an annual report to State on transactions conducted under the Canadian exemption.

Source: GAO analysis of State and Commerce information.

^aAlthough signed and ratified by the United States, the treaty with Australia had not entered into force as of the date of this report. The information in this column is based on the regulations for the treaty with the UK, which State officials said would be similar.

^bThe Canadian Controlled Goods Directorate vets end users and approves them to receive U.S. exports.

For transactions using the STA for current dual-use items, Commerce does not vet parties to the transaction before export. Commerce officials said that after the shipment has occurred, they identify and vet parties to the transaction and subsequently review new exporters to ensure compliance with STA requirements. However, Commerce has proposed that in order to use the STA for the export of defense items that may be placed under its control, the item must be destined for the end use of a government of one of the 36 authorized destinations. In addition, certain parties to the transaction would be required to have a previously issued State or Commerce license, or have been listed on a previous

license, indicating that those parties had been previously vetted.⁴² Table 4 summarizes the differences among the compliance activities for Commerce-licensed items and Commerce’s STA exemption.

Table 4: Differences among Compliance Activities for Commerce-Licensed Exports and STA License Exemption Exports

Activity	Licensed export	STA license exemption	STA license exemption for defense items (proposed 600 series)^a
License application review	Commerce reviews the license application and proposed transaction before a license is issued.	Commerce does not review the transaction prior to export.	Commerce does not plan to review the transaction prior to export unless certain parties to the transaction were not previously authorized on a State or Commerce license.
Vet parties to the export transaction	Commerce vets entities party to the export transaction before a license is issued.	Commerce identifies and vets parties to the transaction postshipment.	Specified parties will be required to have a previous State or Commerce license to use the STA for defense items.
Compliance program review	Commerce reviews exporter’s records. In accordance with the EAR, exporters are required to maintain specific records of their transactions and produce them for inspection upon request.	Commerce reviews exporter’s records. In addition to the requirements for licensed exports, exporters are required to obtain and maintain consignee statements.	Commerce will review exporter’s records. In addition to the requirements for licensed exports, exporters will be required to obtain and maintain enhanced consignee statements.

Source: GAO analysis of State and Commerce information.

^aOn June 21, 2012, Commerce proposed limitations on the export of items to be placed in the 600 series, including those eligible for export under the STA. The information in this column represents the proposed regulations in the June 21, 2012, *Federal Register* notice. 77 Fed. Reg. 37,524.

Compliance Program Review

If there are compliance concerns, State and Commerce each review and critique companies’ compliance programs and records to manage export-related decisions and transactions to help ensure they conform with regulations and license conditions. Both the ITAR and the EAR require exporters to maintain specific documentation for licensed exports, including a description of the item, transaction date, and destination, which helps facilitate such reviews and ensure compliance with laws and regulations.⁴³ In addition to

⁴²The proposed rule states that the STA may be used for 600 series items only if the purchaser, intermediate consignee, ultimate consignee, and end user have been previously approved on a State or Commerce export license. 77 Fed. Reg. 37,524 (June 21, 2012).

⁴³Specifically, the ITAR requires maintenance of records concerning the manufacture, acquisition, and disposition (to include copies of all documentation on exports using exemptions and applications and licenses and their related documentation) of defense articles; technical data; defense services; brokering activities; and information on political contributions, fees, or commissions furnished or obtained (22 C.F.R. § 122.5). Additionally, requirements specific to the EAR include contracts, financial records, and export control documents such as the license and AES filing (15 C.F.R. § 762.2).

the requirements outlined in the ITAR and EAR, each of the three country-based license exemptions has one additional requirement:

- Under the treaties, exporters are required to apply and maintain appropriate treaty markings or other identification on the items to help ensure that future approved community members understand compliance requirements.
- Exporters using State's Canadian exemption must also submit semiannual reports to State on their use of the defense service provisions of the Canadian exemption.
- Exporters using Commerce's STA exemption must obtain and maintain consignee statements. The statement, which the exporter obtains from the consignee, serves as an acknowledgement of an agreement to the STA requirements. The statement must include, among other things, (1) an indication that the consignee receiving the shipment acknowledges it was shipped pursuant to the STA exemption; (2) an indication that the consignee receiving the shipment agrees not to transfer or reexport the items to any destination, use, or user prohibited by the EAR; and (3) the export control classification numbers of the specific items exported.⁴⁴ If an item exported using the STA is re-exported or retransferred, the re-exporter or transferor must furnish the export control classification number for the item shipped to the subsequent consignee, according to Commerce.

According to Commerce officials, although the STA exemption is the only Commerce license exemption that requires the specific STA consignee statement, other Commerce exemptions require written assurances from foreign parties and also serve as a compliance mechanism.⁴⁵ Commerce officials noted that, in enforcement cases, the STA consignee statements would be useful if a violation of export laws and regulations occurs because the statement would help prove intent to violate the regulation. Commerce recently proposed that the STA consignee statement for the export of the defense items that may be placed under its control would be enhanced to include a specific provision that would permit end-use checks by the U.S. government.⁴⁶

Other Compliance and Enforcement Activities Are Generally the Same

Other compliance activities are generally the same for licensed exports and country-based exempted exports. According to State and Commerce officials, all exports, whether under a license or a license exemption, may be subject to end-use monitoring checks, which helps ensure that parties to the transaction comply with export license terms, licensing conditions, exemption terms, and export regulations. Both State and Commerce analyze shipping data to determine which exports should receive postshipment verification checks (part of end-use monitoring) for licensed exports, for country-based license-exempt exports, and for any other exports subject to the ITAR and EAR. In addition to selecting exports for postshipment verification checks, Commerce also analyzes STA shipping data to verify that the item-country relationship is correct and to identify exporters using the

⁴⁴15 C.F.R. § 740.20.

⁴⁵In previous discussions with Commerce officials, we were told that the STA exemption is the only Commerce license exemption that requires a consignee statement.

⁴⁶77 Fed. Reg. 37,524 (June 21, 2012).

STA exemption for the first time. According to Commerce officials, all first-time users of the STA exemption for current dual-use items are subject to a Commerce Compliance Review to verify compliance with the license exemption regulations (such as obtaining the consignee statement). In addition, Commerce officials conduct real-time analysis of shipping data in order to verify compliance with laws and regulations, and to detect and prevent illegal transactions. According to State and Commerce officials, country-based license exemptions do not influence the process the agencies use for updating and maintaining lists of parties against which applicants or end-users are screened during the vetting process. As part of their ongoing outreach efforts, both State and Commerce officials said they have conducted outreach to exporters and foreign government officials to educate them about the country-based license exemptions.

Enforcement activities are generally the same for licensed exports and country-based exempted exports. According to State and Commerce officials, all exports, regardless of how they are exported, are subject to inspection and possible seizure at the border, investigation for potential violations, and punitive actions for actual violations. Further, State officials said that all exports under ITAR, including exports under a license, the treaties, and the Canadian exemption are subject to retransfer or reexport restrictions in accordance with ITAR regulations. Items exported under the treaties may only be retransferred or reexported to another member of the approved community in accordance with the requirements outlined in the exemption. Items exported under STA cannot be transferred or reexported in violation of the EAR. In addition, items exported under the STA are not eligible to use certain parts of the license exemption “Additional Permissive Re-exports,” which allows for reexport without a license and may be used under certain circumstances with licensed exports.⁴⁷

State and Commerce Have Different Requirements for Notifying Congress of Proposed Controlled Exports and Statutory Violations; Commerce Has Proposed Harmonizing Certain Notification Requirements

State is required by statute to notify Congress of certain proposed defense exports and statutory violations; Commerce is required to notify Congress of exports of dual-use items in specific cases and is not required to provide notification of statutory violations generally.⁴⁸ The congressional notification requirements for exports and statutory violations vary because State and Commerce export control regulations derive from different authorities and aim to control articles that have different levels of concern for diversion or unintended use. State is required to notify Congress of proposed exports of major defense equipment, articles, and services that meet specific dollar thresholds under a license or treaty.⁴⁹ Commerce is required to notify Congress in cases in which proposed exports are destined for a designated state sponsor of terrorism or could make a significant contribution to the military potential of a government of a country that has repeatedly provided support for acts of international terrorism.⁵⁰ However, in June 2012, Commerce issued a proposed rule that would require congressional notification of

⁴⁷ 15 C.F.R. § 740.20. Items exported under the STA are not eligible for paragraphs (a) or (b) of the license exemption Additional Permissive Re-exports.

⁴⁸ 22 U.S.C. §§ 2776, 2753 and 50 U.S.C. app. §§ 2405, 2413.

⁴⁹ 22 U.S.C. §§ 2776 and 2753; see also 22 C.F.R. § 126.17.

⁵⁰ 50 U.S.C. app. § 2405.

pending exports of major defense equipment, such as articles under the 600 series, including those exported under the STA, that meet the same dollar thresholds as those required of State.⁵¹ As of November 2012, Commerce was considering how to implement its proposal. In terms of enforcement actions, State is required to notify Congress of certain violations of export laws that exceed specified statutory dollar thresholds.⁵² Commerce reports statutory violations that result in administrative and criminal cases as part of its annual report to Congress.

State Is Required to Notify Congress of Proposed Exports for Certain Defense Items and of Statutory Violations

The AECA requires State to notify Congress of proposed exports for major defense equipment on the basis of set thresholds that vary among items requiring a license and those under the treaties.⁵³ According to State officials, exporters are responsible for informing State when controlled items exported with a license or under any of the country-based license exemptions will reach the congressional notification threshold. When State obtains this information, it is required to submit a notification to Congress. Since export of major defense equipment, articles, and services are not included under the Canadian exemption and continue to require a license, AECA congressional notification requirements do not apply.⁵⁴

State must notify Congress of planned exports of controlled items that required a license within certain parameters. Specifically:

- State must notify Congress at least 30 days before the export of any major defense equipment requiring an export license in the amount of \$14 million or more, of defense articles or defense services sold under a contract in the amount of \$50 million or more, and firearms in an amount of \$1 million or more to countries outside of the North Atlantic Treaty Organization (NATO), Japan, Australia, New Zealand, South Korea, and Israel.⁵⁵
- State must notify Congress at least 15 days before the export of any major defense equipment requiring an export license in the amount of \$25 million or more, of defense articles or defense services sold under a contract in the amount of \$100 million or more, or of firearms in an amount of \$1 million or more to NATO, Japan, Australia, New Zealand, South Korea, and Israel.⁵⁶

⁵¹77 Fed. Reg. 37,524.

⁵²22 U.S.C. § 2753.

⁵³22 U.S.C. §§ 2753 and 2776.

⁵⁴Specifically, the Canadian exemption does not cover firearms and ammunition, generation III (or more sophisticated) night vision equipment, launch vehicles, most spacecraft, missiles, USML items, and related technical data identified on the Missile Technology Control Regime Annex, as well as other sensitive military technologies, including those that require congressional notification.

⁵⁵22 U.S.C. § 2776. Pursuant to the AECA, major defense equipment means any item of significant military equipment on the USML having a nonrecurring research and development cost of more than \$50 million or a total production cost of more than \$200 million (22 U.S.C. § 2794(6)).

⁵⁶22 U.S.C. § 2776.

State is also required in the notification to identify the foreign country or international organization to which such export will be made, the dollar amount of the items to be exported, and a description of the items to be exported.⁵⁷

Regulations for the implementation of the UK treaty require similar congressional notification for proposed exports.⁵⁸ The specific thresholds for congressional notification for exports of major defense equipment under the UK treaty are the same as those required under licensed exports to NATO countries listed above. Approved community members are required to notify State of a proposed export that meets the above thresholds.⁵⁹ State then has 30 days to respond to the exporter. An exporter may not export the item until an official response from State has been received. In addition, State is required to submit an annual report to Congress on the treaties. This report should include a summary of the amount of exports under the treaty and the defense articles transitioned into the treaty, with an analysis of how the treaty is being used.

In addition, the AECA requires State to notify Congress of certain violations of export laws.⁶⁰ According to State officials, Section 3 of the AECA mandates State to notify Congress of certain violations concerning transfers of defense articles, training, and services under Foreign Military Sales, Excess Defense Articles, and Military Assistance Programs, and in some cases defense articles under Direct Commercial Sales. State officials noted that State provides notifications of violations of Direct Commercial Sales for cases where exports exceed certain statutory thresholds.⁶¹ According to State officials, if there is such a violation, State notifies Congress in writing or through a briefing to the Speaker of the House of Representatives and to the Chairperson of the Senate Foreign Relations Committee. In addition, State issues an annual report to Congress on its Blue Lantern end-use monitoring program,⁶² which includes, among other things, information on the number of unfavorable determinations from end-use checks conducted during the fiscal year.⁶³ According to State officials, all defense exports under State's control, regardless of license requirements, may be subject to Blue Lantern inquiries. In addition to the Blue Lantern annual report, Congress also requires a separate annual report on end-use monitoring and compliance activities specifically related to the treaties.

⁵⁷22 U.S.C. § 2776(c).

⁵⁸Implemented in 22 CFR C.F.R. § 126.17(o). The regulations for the implementation of the Australia treaty have not been developed because the treaty is not yet in effect.

⁵⁹22 C.F.R. § 126.17(o).

⁶⁰22 U.S.C. § 2753.

⁶¹According to State, the set threshold to report Defense Commercial Sales is \$14 million in major defense equipment or \$50 million of other defense articles.

⁶²The Blue Lantern program is operated in accordance with section 40A of the AECA (22 U.S.C. § 2778).

⁶³An unfavorable determination means that the Blue Lantern's findings of fact are not consistent with the information contained in the application or license.

Commerce Is Proposing to Notify Congress Voluntarily of Certain Controlled Exports and Currently Reports on Some Statutory Violations

The Export Administration Act (EAA) requires Commerce to notify Congress of certain proposed dual-use exports, but no general requirement to notify Congress of statutory violations. The EAA requires Commerce to notify Congress of proposed exports which are destined for a designated state sponsor of terrorism or could make a significant contribution to the military potential of a government of a country that has repeatedly provided support for acts of international terrorism.⁶⁴ According to Commerce officials, the absence of a broader congressional notification requirement under the EAA raised concerns that Congress would no longer have oversight of exports of certain defense items that might be transferred from State control to Commerce control. Subsequently, in June 2012, Commerce issued a proposed rule that includes notifying Congress of planned exports of major defense equipment to be placed under Commerce control that meet the same dollar thresholds as those required of State.⁶⁵ Commerce officials also said that the requirement would apply to major defense equipment that might be eligible for the STA exemption. As of September 2012, Commerce was reviewing comments on and considering how to implement the proposed rule.

The EAA also does not contain specific requirements for Commerce to notify Congress of export controls violations. However, it requires Commerce to submit an annual report to Congress that includes information on export control violations.⁶⁶ The report includes information on the number of administrative cases and criminal convictions as a result of export control violations by individuals and companies. For example, in 2011 Commerce reported its investigations resulted in the criminal conviction of 39 individuals and businesses for export violations and that penalties for these convictions came to \$20,214,000 in criminal fines and more than 572 months of imprisonment.⁶⁷ Cases include violations such as attempting to export controlled goods without a license and making false statements in a license to export firearms. The report provides information on the amount collected in fines resulting from convictions and administrative cases each year. According to Commerce officials, any violations related to the STA that result in criminal or administrative penalties will also be included in the report.

Agency Comments and Our Evaluation

We provided a draft of this report to the Departments of Commerce and State for their review and comment. In written comments (which are reproduced in enclosure III), Commerce stated that our report could be improved by describing the rationale for making less-sensitive items moved from the United States Munitions List to the “600 series” in the Commerce Control List eligible for the STA license exemption. We have incorporated the

⁶⁴50 U.S.C. app. § 2405.

⁶⁵77 Fed. Reg. 37,524.

⁶⁶50 U.S.C. app. § 2413(a)(19).

⁶⁷Department of Commerce, Bureau of Industry and Security, *Annual Report to Congress for Fiscal Year 2011* (Washington, DC: Department of Commerce), accessed July 2, 2012, http://www.bis.doc.gov/news/2012/bis_annual_report_2011.pdf.

suggested language as provided. Commerce also provided additional technical comments, which we incorporated as appropriate. State did not provide written comments on the draft of this report but provided technical comments, which we incorporated into the report, as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to interested congressional committees, the Secretary of State, and the Secretary of Commerce. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>. If you or your staffs have any questions about this report, please contact me at (202) 512-9601 or melitot@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who contributed to this report are listed in Enclosure IV.

A handwritten signature in black ink that reads "Thomas M" followed by a long horizontal flourish.

Thomas Melito
Director
International Affairs and Trade

Enclosures (4)

Objectives, Scope, and Methodology

In this review, we analyzed the Departments of State's (State) and Commerce's (Commerce) compliance and enforcement activities and congressional notification requirements for controlled items exported with a license and those exported under four country-based license exemptions: the Defense Trade Cooperation Treaties with the United Kingdom (UK) and Australia (hereafter referred to as "the treaties"), the Canadian exemption, and the Strategic Trade Authorization (STA). Specifically, we compared existing and proposed (1) compliance and enforcement activities for exports under both licenses and country-based license exemptions, and (2) requirements for State and Commerce to notify Congress of certain defense exports and of violations of export control laws or regulations.

To address the first objective, we first identified and reviewed statutory authorities, their implementing regulations, and proposed changes to these regulations that guide State and Commerce's defense and dual-use export control processes. Specifically, we reviewed the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR), as well as the Export Administration Act (EAA) and the Export Administration Regulations (EAR), and selected *Federal Register* notices. To identify and describe the country-based license exemptions, we interviewed officials from State and Commerce and reviewed related regulatory and statutory authorities noted above, as well as the U.S.-U.K Treaty on Defense Trade Cooperation, the U.S.-Australia Treaty on Defense Trade Cooperation, each treaty's Implementing Arrangements, and applicable *Federal Register* notices. To identify the compliance and enforcement activities for State and Commerce's licensed exports and for the agencies' country-based license exemptions, we interviewed State and Commerce officials, and reviewed agency documents and reports, as well as past GAO reports. Specifically, we interviewed officials from State's Directorate of Defense Trade Controls (DDTC), which manages the license and license exemption process for defense exports; and Commerce's Bureau of Industry and Security (BIS), which manages the licensing and license exemption process for dual-use items. We reviewed agency documents related to the compliance and enforcement activities for both the licensing process and country-based license exemption process, including State's standard operating procedures for admitting members to the UK treaty's approved community, State's standard operating procedures for providing annual reports on the UK treaty, Commerce's compliance plan for the STA exemption, State's annual Blue Lantern program reports, BIS's annual reports to Congress, and previous GAO reports. To determine and compare proposed compliance and enforcement activities for items moving from the United States Munitions List to the Commerce Control List, we reviewed selected *Federal Register* notices and interviewed State and Commerce officials.

To compare the existing and proposed congressional notification requirements for transfers and export violations for State's and Commerce's licensed exports and these requirements for State and Commerce's country-based license exemptions, we reviewed statutory regulations and proposed changes to these regulations, including the Arms Export Control Act, International Traffic in Arms Regulations, Export Administration Act, Export Administration Regulations, the U.S.-U.K Treaty on Defense Trade Cooperation, the U.S.-Australia Treaty on Defense Trade Cooperation, the treaties' Implementing Arrangements, and applicable *Federal Register* notices. In addition, we interviewed officials from State and Commerce, including officials from State's DDTC and

Enclosure I

Commerce's BIS, which manage the licensing and license exempt processes for defense and dual-use items, respectively.

We conducted this performance audit from March 2012 to November 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Export Process for Defense and Dual-Use Items and Services under Licenses and Country-Based Exemptions

The Departments of State (State) and Commerce (Commerce) administer the regulatory frameworks for the export of defense and dual-use items. State administers controls for defense items and services, and Commerce does so for dual-use items, which have both military and civilian applications.

Generally, exporters are responsible for determining which agency (State or Commerce) controls the item or service they seek to export and which regulatory requirements apply, if any. Generally, unless an exemption applies, exporters submit a license application to the requisite agency if their item or service is controlled by either State or Commerce to receive approval to export. Once a license application is submitted by the exporter, the agency reviews the application and may approve, approve with conditions, deny, or return the license to the exporter without action.⁶⁸ When deciding whether to approve or deny an application, State or Commerce evaluates it against several factors, including an assessment of all parties to the transaction and how the recipient plans to use the item. As part of the application review process, State and Commerce may consult with other agencies such as the Departments of Defense or Energy.⁶⁹ If the application for export meets certain thresholds, the agencies may provide notification to Congress of the pending export.⁷⁰ If the export license application is approved, the exporter files data into the Automated Export System (AES), the central point through which exporters are required to electronically file shipment data required by multiple agencies.

The initial export process differs for country-based license exempt exports because a license application is not required. For State's Canadian exemption and the United Kingdom and Australia treaties, exporters first must verify the recipient's eligibility to receive the export, either through verifying their registration with the Canadian Controlled Goods Directorate or as a member in the "approved community" for the treaties.⁷¹ For the treaties, the exporter must also determine if the export reaches a threshold that requires notification to Congress of the proposed sale. Once registration or membership has been verified and notification provided to Congress, if needed for the treaties, the exporter files data into the AES.

⁶⁸ An agency may return a license application without action if, for example, the agency needs additional information.

⁶⁹ As provided for under Executive Order 12981, State and the Departments of Defense and Energy have the authority to review any export license application submitted to Commerce, and Commerce may refer export license applications to other departments or agencies as appropriate. Exec. Order No. 12,981, 60 Fed. Reg. 62,981 (Dec. 5, 1995).

⁷⁰ State is required by statute to notify Congress of pending exports that meet specific dollar thresholds. 22 U.S.C. § 2776. Commerce is required to notify Congress of pending exports where the item is destined for a designated state sponsor of terrorism or could make a significant contribution to the military potential of a government of a country that has repeatedly provided support for acts of international terrorism. 50 U.S.C. app. 2405. Commerce recently proposed notifying Congress of pending exports of 600 series items that meet the same dollar thresholds required for State.

⁷¹ Although signed and ratified by the United States, the treaty with Australia had not entered into force as of the date of this report. The information in this enclosure is based on the regulations for the treaty with the UK, which State officials said would be similar.

Enclosure II

For all exporters utilizing the Strategic Trade Authorization (STA) exemption, exporters must obtain a consignee statement prior to export.⁷² As proposed, for 600 series items the exporter must also verify that a previous State or Commerce license has been issued and that the ultimate end-user is the government of one of the 36 destinations, and determine if the proposed export reaches a threshold that requires notification to Congress.⁷³ Once the consignee statement has been obtained, the exporter files data into the Automated Export System.

Once the exporter files data into the Automated Export System for either licensed exports or country-based license exempt exports, the Department of Homeland Security's Customs and Border Protection and other agencies may review and validate the export documentation, inspect outbound cargo and detain questionable shipments. In addition, Commerce and State may conduct end-use monitoring checks to verify the receipt and use of the item or service exported. Exporters are required to maintain STA-related documentation, such as the consignee statement. In addition, Commerce officials said new users of the STA are identified and undergo an export compliance review.

⁷²15 C.F.R. § 740.20.

⁷³On June 21, 2012, Commerce proposed restrictions on the export of 600 series items, including those that would be eligible for export under the STA. As part of this proposed rule, Commerce proposed notifying Congress of planned exports of major defense equipment to be placed under the 600 series of the Commerce Control List that meet the same dollar thresholds as those required of State. However, for exports of 600 series items that meet congressional thresholds, exporters would not be able to use the STA. 77 Fed. Reg. 37,524.

Comments of the Department of Commerce

NOV 07 2012



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

Mr. Thomas Melito
Director, International Affairs and Trade
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Melito,

Thank you for the opportunity to comment on the draft GAO report "Export Controls: Compliance and Enforcement Activities and Congressional Notification Requirements under Country-based License Exemptions" (GAO-12-119R).

The Department of Commerce appreciates the work that went into the report. We believe the report would be improved by describing the rationale for making less sensitive items moved from the United States Munitions List to the "600" series in the Commerce Control List eligible for License Exception Strategic Trade Authorization (STA). The President's Export Control Reform initiative will enhance national security by: (i) allowing for greater interoperability with our NATO and other allies while still maintaining and expanding robust controls and, in some cases, prohibitions on exports or reexports to other countries and for proscribed end users and end uses; (ii) enhancing the U.S. defense industrial base by reducing the current incentives for foreign companies to design out or avoid U.S.-origin ITAR-controlled content, particularly with respect to generic, unspecified parts and components; and (iii) permitting the U.S. Government to focus its resources on controlling, monitoring, investigating, analyzing, and, if need be, prohibiting exports and reexports of more significant items to destinations, end uses, and end users of greater concern than our NATO allies and other multi-regime partners. This is the rationale for making 600 series items eligible for the STA license exception. Please see attached document for additional more specific comments.

If you need further assistance, please contact Mark Crace in the Office of Administration. Mr. Crace may be reached at (202) 482-8093 or via e-mail at mark.crace@bis.doc.gov.

Sincerely,

A handwritten signature in black ink, appearing to read "Eric L. Hirschhorn".

Eric L. Hirschhorn



Enclosure IV

GAO Contact and Staff Acknowledgments

GAO Contact

Thomas Melito, (202) 512-9601 or melitot@gao.gov

Staff Acknowledgments

GAO staff who contributed to this report includes Jeff Phillips, Assistant Director; Jenna Beveridge; Francisco M. Enriquez; and Grace Lui.

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