



***U.S. DEPARTMENT OF COMMERCE
Office of Inspector General***



***BUREAU OF INDUSTRY
AND SECURITY***

***U.S. Dual-Use Export Controls for India
Should Continue to Be Closely Monitored***

Final Report No. IPE-18144/March 2007

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Office of Inspections and Program Evaluations





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

March 30, 2007

MEMORANDUM FOR: Mark Foulon
Acting Unc'

FROM:

Johnnie E.

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SUBJECT:

Final Report: *U.S. Dual-Use Export Controls for India
Should Continue to Be Closely Monitored (IPE-18144)*

As a follow-up to our February 23, 2007, draft report, attached is our final report on dual-use export controls for India, the eighth 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.

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 India, we identified several areas of concern related to U.S.-India export control activities. We offer a number of specific recommendations beginning on page 27 that we believe will help strengthen these activities, if implemented. This report contains three classified appendixes that have been provided under separate cover. Appendix D discusses implementation of the Next Steps in Strategic Partnership and is classified **SECRET**. Appendix E is classified **CONFIDENTIAL** and highlights concerns related to BIS' end-use check program in India. Appendix F contains a summary of the classified recommendations and is classified **SECRET**.

We are pleased to note that BIS, in its written response to our draft report, indicated that it plans to take action on many of 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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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 8-year assessment of whether export controls and counterintelligence measures are adequate for preventing the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. The NDAA mandates that the Inspectors General report their findings to Congress no later than March 30 of each year, until 2007.

To satisfy the NDAA's FY 2007 reporting requirement, the Commerce Office of Inspector General assessed the effectiveness of BIS' export control program for India in conjunction with a separate review to determine the status of prior-year recommendations involving dual-use licensing and enforcement activities. We examined (1) whether BIS' export control policies, practices, and procedures for India are clear, documented, and designed to achieve the desired goals; (2) whether BIS personnel are following the prescribed policies, practices, and procedures relating to India; and (3) how effective BIS is in detecting and preventing the diversion of sensitive commodities to weapons of mass destruction-related programs (either within or outside India).

Following the nuclear tests conducted by both India and Pakistan in May 1998, the United States imposed economic sanctions on both countries. However, in 2001, the President eliminated the sanctions and committed the United States to a "strategic partnership" with India—representing a major change in India-U.S. relations. At that time, both countries agreed to greatly expand cooperation on a wide range of issues, including counterterrorism, regional security, space and scientific collaboration, civilian nuclear safety, and broadened economic ties. Toward that end, BIS has played an active and key role in improving relations with India. Its most direct involvement began in 2002 with the establishment of the U.S.-India High Technology Cooperation Group (HTCG), designed to provide a forum for discussing high-technology issues of mutual interest and to broaden dialogue and cooperation in the area of export controls.¹

As the world's fastest growing free-market democracy, India presents lucrative and diverse opportunities for U.S. exporters along with unique challenges to U.S. export control policy. In 2005 the value of U.S. merchandise exports to India totaled almost \$8 billion—up 30 percent from 2004² and nearly double the 2002 figure.³ BIS reports that only about 1 percent of total U.S. exports to India require an export license, and the agency approves most exports that do require a license provided such items do not contribute to India's nuclear, missile, or chemical and biological weapons programs. Although India is recognized as a democratic partner in the fight against terrorism and as a counterbalance to China, concerns have been raised by nonproliferation specialists about its nuclear capabilities and intentions. As current U.S. policy moves toward "full civil nuclear cooperation" with India, a critical question needs to be

¹Matthew Borman, Deputy Assistant Secretary for Export Administration, *Overview of U.S.-India Dual-Use Export Policies and Procedures* (presentation given to Indian industry in New Delhi on November 21, 2003).

²U.S. Trade Representative, 2006, *National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C., page 300.

³Department of Commerce, U.S. Commercial Service, November 29-December 5, 2006, *Official Mission Statement*.

answered: Does the U.S. government have the capability to implement effective export controls to help ensure U.S. exports to India do not contribute—either directly or indirectly—to Indian nuclear weapons or missile programs?

The number of India export license applications received by BIS increased 30 percent from FY 2002 to FY 2005, but decreased 19 percent from FY 2005 to FY 2006. This decline is attributable to a reduction in licensing requirements for exports to India. The most significant changes occurred in 2005, namely (1) elimination of export and reexport license requirements for most end users in India for items controlled unilaterally by the United States for nuclear nonproliferation reasons, (2) removal of the Indian Space Research Organization (ISRO) headquarters from BIS' Entity List,⁴ and (3) elimination of licensing requirements for exports of EAR99 items⁵ to several ISRO subordinate entities.

Our review of India export license applications that were escalated to the interagency dispute resolution process in fiscal years 2005 and 2006 found that coordination between the various federal export licensing agencies was adequate. However, our overall review of U.S.-India export control activities identified the following concerns that warrant management's attention:

⁴The Entity List, established in February 1997 by BIS, identifies individuals, groups, organizations, and other entities whose activities offer the potential for diverting exported and reexported items into programs related to weapons of mass destruction. The EAR imposes additional export license requirements for transactions involving listed entities.

⁵EAR99 essentially serves as a "basket" designation for items that are subject to the Export Administration Regulations (EAR) but not listed on the Commerce Control List. 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.

⁶George W. Bush, January 12, 2004. *President's Statement on Strategic Partnership with India*, <http://www.whitehouse.gov/news/releases/2004/01/20040112-1.html> (accessed January 31, 2007). Alan K. Kronstadt, April 6, 2006. *India-U.S. Relations*, CRS Issue Brief for Congress, IB93097.

⁷*Joint Statement Between President George W. Bush and Prime Minister Manmohan Singh*, July 18, 2005 (<http://www.whitehouse.gov/news/releases/2005/07/20050718-6.html> (accessed January 31, 2007)).

steps outlined under the NSSP. We discuss this issue and our concerns in Appendix D,

We also found a problem with BIS' Entity List—a list of entities worldwide for which the U.S. government requires a license for virtually all items subject to the EAR. Some Indian entities on the list are not clearly identified, which raises the risk that U.S. exporters could inadvertently export controlled dual-use items to these entities without the required license. The Entity List contains 12 Indian entities identified by name along with 3 “types” of Indian end users (e.g., nuclear reactors not operating under International Atomic Energy Agency safeguards. At least 2 of 29 license applications were escalated to the interagency dispute resolution process in FY 2005 because of questions about whether the Indian entity on the application was covered under one of these broad designations of end users (see page 13).

BIS' End-Use Check Program in India Needs to Be Improved. End-use checks seek to 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 suitable for a transaction involving controlled U.S.-origin goods or technical data. Post-shipment verifications (PSVs) strengthen assurances that exporters, shippers, consignees, and end users are complying with the terms of export licenses, by determining whether goods exported from the United States were actually received by the party named on the license and are being used in accordance with license provisions. BIS has an export control officer (ECO) stationed in India to conduct end-use checks.

Our review of BIS' India end-use check program identified several weaknesses. First, the September 2004 End-Use Visit Arrangement between the U.S. Department of Commerce and the Indian Ministry of External Affairs—designed to strengthen existing commitments on export controls—actually limits the effectiveness and utility of end-use checks in India. In addition, while end-use checks involving Indian private sector entities are generally conducted in a timely manner, those involving Indian government or government-affiliated entities have not always been conducted within prescribed time frames. We also found that BIS has not set clear and consistent time frames for two parts of its internal end-use check process: (1) initiating PSVs upon receipt of required shipping documents and (2) notifying the Ministry of External Affairs about end-use check requests.

Furthermore, we determined that BIS failed to follow its end-use check criteria for two PLCs that were cancelled but should have been rated as “unfavorable” because the government entity involved failed to cooperate in the checks. Finally, although the U.S. government is concerned about diversions of sensitive exports to programs involving weapons of mass destruction (either within or outside India), BIS did not adequately target PSVs to help determine whether diversions were occurring. We detail our concerns about these issues in Appendix E, End-Use Checks in India, classified CONFIDENTIAL.

BIS Needs to Enhance Its Efforts to Ensure Compliance with License Conditions. Placing conditions on a license is the U.S. government's way of better controlling and monitoring certain shipments. However, license conditions only have the desired effect when exporters and/or end users fully comply with them. In general, BIS has put adequate procedures in place over the last

few years, in response to OIG recommendations, to help ensure compliance with license reporting conditions.⁸ However, we found that Export Administration and Export Enforcement, both of which have responsibility for monitoring compliance with certain license conditions, need to improve their implementation of these procedures.

Within Export Administration, we determined that some licensing officers did not fully adhere to BIS procedures for requiring exporters or end users to fulfill the license reporting conditions, that is, to submit documentation related to the shipment. For 5 of the 13 India licenses we identified as having reporting conditions, the licensing officer did not mark the licenses for follow-up. In addition, Export Administration issued a memorandum on May 9, 2006, requiring licensing officers to review technical documentation submitted pursuant to a license condition if the documentation was requested because of BIS national security concerns with the transaction. However, the memorandum specifically excludes those licenses involving reporting conditions placed on a license by the Defense Department unless BIS licensing officers also have a concern with the transaction. As a result, 10 of the 13 India licenses were not marked for licensing officer review because the technical reporting condition was placed by Defense. However, BIS has the authority to administer and enforce the EAR and, as such, is ultimately responsible for monitoring *all* conditions placed on a dual-use license. Furthermore, we determined that staff from the Office of Exporter Services (OExS) were not fully aware of the reporting conditions they were required to monitor, and they were not properly referring noncompliant exporters to Export Enforcement. This breakdown in Export Administration's monitoring process might diminish the deterrent effect that license conditions can have on potential violators (see page 18).

Within Export Enforcement, we found that the Office of Enforcement Analysis (OEA) is not fully adhering to its guidance for monitoring or enforcing compliance with licenses that contain condition 14, which requires exporters to notify OEA within 30 days that a shipment pertaining to a license has taken place. It is one of the most critical conditions placed on a license, because the interagency licensing agencies decided that a PSV was needed to determine whether the goods or technology were being used in accordance with the license provisions. But the PSV cannot be initiated until the shipment has actually taken place. Our review of 24 India licenses containing condition 14 determined that 11 exporters submitted their shipping documents to BIS between 12 to 1,158 days after the 30-day deadline. In fact, of the cases where a PSV was requested, 8 out of 24 PSVs were initiated more than 100 days after shipment. This delay diminishes the possibility of detecting diversions or other violations of license terms and conditions. We also found that OEA (1) recommended approval for additional licenses to exporters that had previously not fully complied with the condition 14 reporting requirement, and (2) did not refer noncompliant exporters to the Office of Export Enforcement for appropriate action (see page 22).

On page 27, we summarize the unclassified recommendations we are making to address our concerns. A summary of classified recommendations can be found in Appendix F, which is SECRET.

⁸U.S. Department of Commerce Office of Inspector General, 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; Commerce OIG, March 2006. *U.S. Dual-Use Export Controls for China Need to be Strengthened*, IPE-17500.



BIS Response to OIG Draft Report and OIG Comments

In its March 23, 2007, written response to our draft report, BIS indicated that it was still in the process of reviewing some of the recommendations while taking steps to address others. The response also highlighted BIS' belief that India has fulfilled its commitment under the Next Steps in Strategic Partnership. Where appropriate, we have made changes to the report in response to both formal and informal comments from BIS. We also discuss pertinent aspects of BIS' response in appropriate sections of the report. The complete responses from BIS are included as appendixes to the unclassified and classified reports.

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 commodities, software, and technologies that have predominantly civilian uses, but also can have military, proliferation, and terrorism-related applications. The primary legislative authority for controlling the export of dual-use commodities is the Export Administration Act of 1979, as amended, which is implemented through the Export Administration Regulations (EAR).¹

The Department of Commerce's Bureau of Industry and Security (BIS) administers the EAR by developing export control policies and regulations, issuing export licenses, and enforcing the laws and regulations for dual-use exports. In FY 2006, BIS had 353 full-time equivalent staff members and an appropriation of approximately \$75 million. Its two operating units principally responsible for export controls are Export Administration and Export Enforcement.

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



The U.S.-India relationship has undergone a significant transformation since the end of the Cold War. Both countries, “politically and economically distant” for almost half of the late 20th century, are now finding a common ground with respect to their national interests.² As the world's fastest growing free-market democracy, India presents lucrative and diverse opportunities for U.S. exporters.³ In 2005, U.S. merchandise exports to India were almost \$8 billion, 30 percent higher than in 2004 and nearly double the 2002 figure. Corresponding U.S. imports from India were \$18.8 billion in 2005, up 20.8 percent from the previous year.⁴ India is the 22nd largest export market for U.S. goods,⁵ and its requirements for equipment and services in the infrastructure, transportation, energy, environmental, health care, high-tech, and defense sectors are expected to exceed tens of billions of dollars in the coming years.⁶

U.S. Export Control Policies and Practices Toward India

India presents unique challenges to U.S. export control policy. Although India is recognized as a democratic partner in the fight against terrorism and as a counterbalance to China, nonproliferation experts have raised concerns about India's nuclear capabilities and intentions. Following the nuclear tests conducted by India and Pakistan in May 1998, the United States

¹50 U.S.C app. sec. 2402(2). Although the act expired on August 20, 2001, Congress agreed to the President's request to extend existing export regulations under Executive Order 13222, dated August 17, 2001, as extended by the Notice of August 3, 2006, 71 FR 44551 (August 7, 2006), thereby invoking emergency authority under the International Emergency Economic Powers Act.

²U.S. Department of Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement: Under Secretarial Business Development Mission to India*. Washington, DC.

³With more than one billion residents, India is the second most populous country and the largest democratic republic in the world.

⁴U.S. Trade Representative, 2006. *National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C., p. 300. Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement*.

⁵U.S. Trade Representative, 2006. *National Trade Estimate Report on Foreign Trade Barriers*, p. 300.

⁶Commerce, U.S. Commercial Service, November 29-December 5, 2006. *Official Mission Statement*.

imposed economic sanctions on both countries.⁷ At that time, the U.S. government implemented a licensing policy of denial for exports and reexports of items controlled for nuclear nonproliferation and missile technology reasons to India (and Pakistan), with limited exceptions.

In September 2001, President George W. Bush waived the sanctions against India (and Pakistan) and, subsequently, the policy of denial for exports and reexports of items controlled for nuclear nonproliferation and missile technology reasons changed to a case-by-case review. Then, in November 2001, President Bush and then-Indian Prime Minister Atal Bihari Vajpayee committed the United States and India to a strategic partnership, that among other things envisioned full civil nuclear cooperation between the United States and India and reversed almost 30 years of U.S. nonproliferation policy toward that country. Both countries also agreed to greatly expand cooperation on counterterrorism, regional security, space and scientific collaboration, and broadened economic ties. Since that time, two initiatives regarding relations between the United States and India have received wide public attention. The first was what has become known as the Next Steps in Strategic Partnership (NSSP), announced in January 2004. Under the NSSP, the United States and India agreed to increase cooperation in civilian nuclear activities, civilian space programs, and high-technology trade, and expand their dialogue on missile defense. The initiative was to proceed through a series of reciprocal steps that built on each other. They included nuclear safety issues and regulatory changes that would enhance trade in high-technology dual-use goods.⁸

The second major announcement—coinciding with the reported completion of the NSSP—came on July 18, 2005, when President Bush and Prime Minister Manmohan Singh jointly declared that they were committed to transforming the relationship between the United States and India and establishing a “global partnership.” Their statement highlighted five broad areas of agreement and cooperation: economic development; energy and the environment; democracy and development; nonproliferation and security; and high-technology and space. In his speech, the President recognized India’s “strong commitment” to preventing the proliferation of weapons of mass destruction and noted that “as a responsible state with advanced nuclear technology, India should acquire the same benefits and advantages as other such states.” The President added that he would “...work to achieve full civil nuclear energy cooperation with India as it realizes its goals of promoting nuclear power and achieving energy security.” However, the President also acknowledged that this would require adjustment to U.S. law (e.g., the Atomic Energy Act of 1954, as amended),⁹ and policy as well as international export control regimes (e.g., Nuclear Suppliers Group, which controls items or technologies that could be used in nuclear weapons).¹⁰

⁷The sanctions were imposed pursuant to Section 102 (b)(2) of the Arms Export Control Act, also known as the Glenn Amendment of 1994. The Act requires that the President impose sanctions against a “non-nuclear-weapon” state if it “detonates a nuclear explosive device.”

⁸George W. Bush. *President’s Statement on Strategic Partnership with India*, January 12, 2004, <http://www.whitehouse.gov/news/releases/2004/01/20040112-1.html> (accessed January 31, 2007); Kronstadt, Alan K. *India-U.S. Relations*, CRS Issue Brief for Congress, April 6, 2006, IB93097.

⁹42 U.S.C. 2153. The Atomic Energy Act prohibits the transfer of nuclear materials and technology to countries that are not signatories to the Treaty on the Non-Proliferation of Nuclear Weapons.

¹⁰*Joint Statement Between President George W. Bush and Prime Minister Manmohan Singh*, July 18, 2005 (<http://www.whitehouse.gov/news/releases/2005/07/20050718-6.html>) (accessed January 31, 2007).

Toward this end, the U.S. Congress passed and the President signed the United States-India Peaceful Atomic Energy Cooperation Act of 2006 on December 18, 2006. The act enables the United States to enter into an agreement for nuclear cooperation with India if the President makes a determination that various actions have occurred.¹¹ For instance, the President must find that India has provided the United States and the International Atomic Energy Agency with a credible plan to separate civil and military nuclear facilities, materials, and programs, and has filed a declaration regarding its civil facilities and materials with the International Atomic Energy Agency. The President must also find that India is taking the necessary steps to secure nuclear and other sensitive materials and technology, including:

- Enactment and effective enforcement of comprehensive export control legislation and regulations;
- Harmonization of its export control laws, regulations, policies, and practices with the guidelines and practices of the Missile Technology Control Regime and the Nuclear Suppliers Group; and
- Adherence to the Missile Technology Control Regime and the Nuclear Suppliers Group (NSG) in accordance with the procedures of those regimes for unilateral adherence.

According to BIS, as a result of the HTCG work and in conjunction with the NSSP, the U.S. government eliminated approximately 25 percent of the licensing requirements for exports to India by removing some Indian entities from the Entity List¹³ and dropping most unilateral export controls. As a result, U.S. firms can export many formerly controlled items to India

¹¹These actions were specified in Section 104 (b) of the Henry J. Hyde United States-India Peaceful Atomic Energy Act of 2006, December 18, 2006.

¹²BIS, November 21, 2003. *Overview of U.S.-India Dual-Use Export Policies and Procedures*, Presentation by Matthew Borman, Deputy Assistant Secretary for Export Administration.

¹³The EAR contains an Entity List that imposes increased export license requirements for transactions involving certain "listed" entities (e.g. companies, organizations, persons). The Entity List was established in February 1997 to inform the public of entities whose certain activities impose a risk of diverting exported and reexported items into programs related to weapons of mass destruction. The list may also include entities sanctioned by the State Department for which United States foreign policy goals are served by imposing additional license requirements on exports and reexports to those entities. The list contains entities from a variety of countries including China, India, Israel, and Pakistan. See chapter I for a discussion about Indian entities on the list.

without a license or under a license exception.¹⁴ BIS reports that approximately 1 percent of total U.S. exports to India require an export license and that it approves most of the exports of controlled items provided that such items would not be used in unsafeguarded nuclear activities, ballistic missiles, or space launch vehicle programs or otherwise be diverted to uses contrary to U.S. policy.

The United States currently controls dual-use exports to India that have potential applications for chemical and biological, nuclear weapons, or missile technology, or that can impact regional stability, national security, and crime control. These controls are primarily derived from multilateral export control regimes, and the list of items controlled is mutually agreed upon by participating countries. There are no U.S. sanctions currently in place against the Indian government, although several Indian entities have U.S. sanctions placed on them for proliferation reasons.

Dual-Use License Application Process for Exports to India

License applications received by BIS are entered into the Export Control Automated Support System (ECASS),¹⁵ where they are screened to determine whether the listed parties have registration numbers or need numbers assigned. ECASS flags applications that require referral to the Office of Export Enforcement (OEE), and sends them simultaneously to OEE and licensing officers in Export Administration. All other applications are referred only to the licensing officers for processing.

According to Executive Order 12981,¹⁶ BIS has 9 days to conduct its initial review of a license application, during which the licensing officer first verifies the export control classification number (ECCN) the applicant obtained from the Commerce Control List (CCL)—a listing of commodities, software, and technology subject to BIS' export licensing authority. Items subject to the EAR but not listed on the CCL are designated as "EAR99."¹⁷

After verifying the ECCN, the licensing officer reviews the related license requirements and exceptions, determines the reasonableness of the end use specified by the exporter, and documents the (1) licensing history of the exporter and ultimate consignee or end users, and (2) reasons for not referring an application to the other licensing agencies (if applicable). The licensing officer provides a written recommendation on whether to approve or deny the application, and refers it to the Departments of Defense, Energy, and State unless those licensing referral agencies have delegated their decision-making authority to Commerce.¹⁸

¹⁴According to the BIS, a license exception is an authorization granted by BIS that allows exports or reexports of items subject to the EAR that would otherwise require a license.

¹⁵ECASS is an unclassified system that BIS uses to process and store its dual-use export licensing information.

¹⁶*Administration of Export Controls*, December 5, 1995.

¹⁷EAR99 essentially serves as a "basket" designation for items that are subject to the EAR but not specifically listed on the CCL by an ECCN. 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.

¹⁸BIS refers licenses to the Department of Justice only when the item is controlled for reasons relating to the protection of encryption technologies. As such, per Executive Order 13026, the Department of Justice is a voting representative at all levels of the dispute resolution process for encryption cases (including the Operating Committee, the Advisory Committee on Export Policy, and the Export Administration Review Board).

In addition, BIS requires that its licensing officers forward all India export license applications (with the exception of deemed export license applications and EAR99 items without red flags)¹⁹ to the CIA's Weapons Intelligence, Nonproliferation, and Arms Control Center for an end-user review.

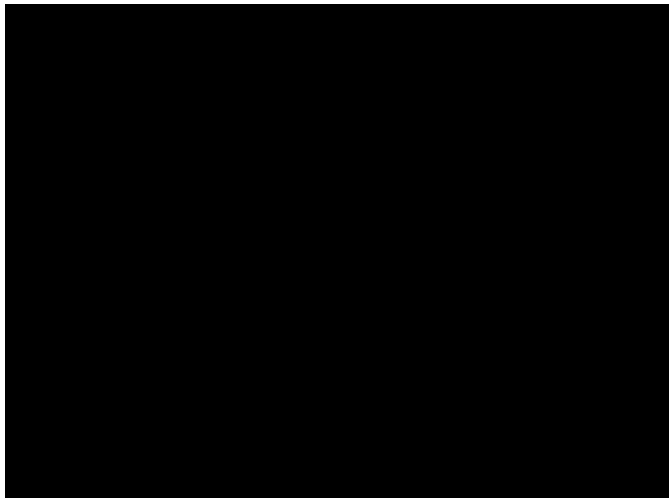
Under Executive Order 12981, each licensing referral agency must provide a recommendation to approve or deny the license application and all related required information to the Secretary of Commerce within 30 days of receiving the referral. To deny an application, a referral agency or BIS is required 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).

In FY 2006, all export licenses for India were issued with conditions that subjected the exporter to 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 India Export License Applications

If there is disagreement on whether to approve a pending license application after the 30-day review period or if there is disagreement on the conditions of approval, the application is referred to a higher-level interagency working group called the Operating Committee (OC), which meets

Figure 1: Determinations for India Export License Applications Escalated to the Operating Committee (FY2005 and 2006)



Source: BIS

weekly (see figure 1 for the number of India export license applications escalated to the OC in FYs 2005 and 2006). Under Executive Order 12981, the OC has voting representatives from the Departments of Commerce, Defense, Energy, and State. Nonvoting 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. With one exception, the chairman's decision does not have to follow the recommendations of the majority of the participating agencies, though we found that the chair's decisions for India cases generally

¹⁹Red flags indicate possible violators or violations of the EAR.

did reflect interagency consensus.²⁰ If any of the voting agencies disagree with the OC decision, they have 5 days to appeal.

Appeals at the OC level 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 consists of Assistant Secretary-level voting representatives from the Departments of Defense, Energy, and State. Nonvoting representatives are drawn from the CIA and the Joint Chiefs of Staff. The ACEP's decision is based on a majority vote. In FY 2005, one India export license was escalated to the ACEP; it was ultimately approved with conditions. Two India export license applications were escalated to the ACEP in FY 2006, and both were approved with conditions.

An agency that disagrees with an ACEP decision has 5 days to appeal to the Export Administration Review Board (EARB). The Secretary of Commerce chairs the EARB, whose voting members also include the Secretaries of Defense, Energy, and State. The chairman of the Joint Chiefs of Staff and the director of Central Intelligence are nonvoting members. The EARB's decision is based on a majority vote and a dissenting agency has 5 days to make a final appeal to the President. No export license application for India was escalated to the review board in either FY 2005 or FY 2006.

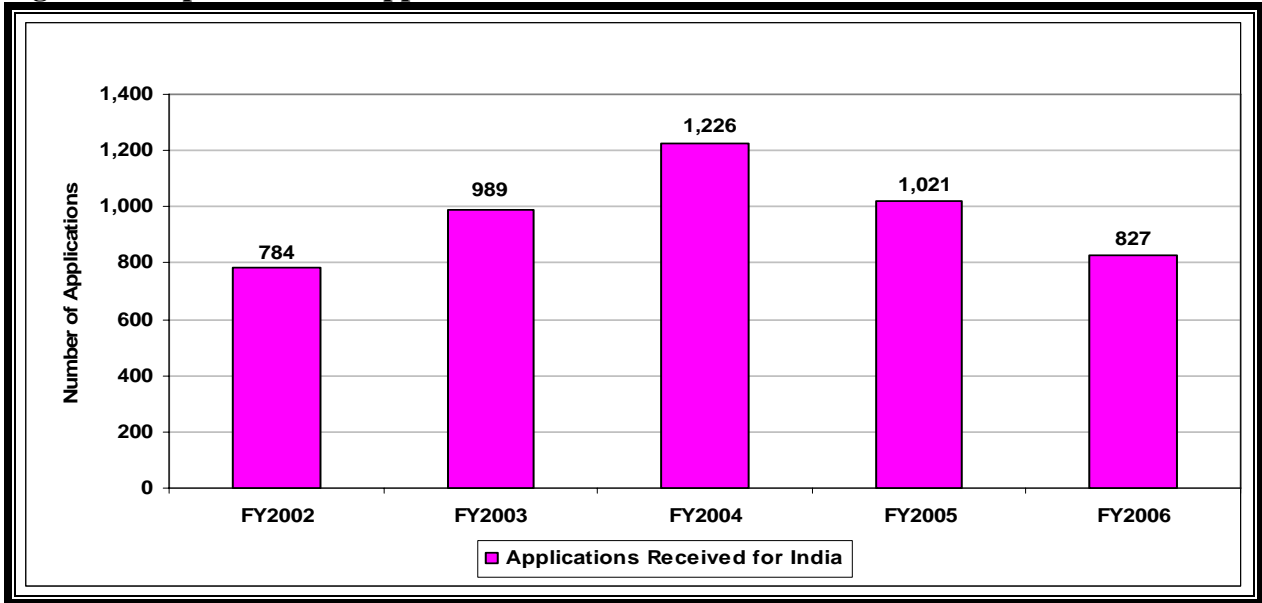
Overall, we found that the interagency escalation process for disputed India export license applications allows dissenting agencies a meaningful opportunity to seek additional review of such cases.

India Export License Application Trends

During FYs 2002 through 2004, the number of dual-use export license applications received for India increased approximately 56 percent from 784 to 1,226. However by FY 2006, this number dropped by approximately 30 percent (see figure 2). Of the 18,698 export license applications BIS received during FY 2006, 827 (approximately 4.4 percent) were for exports to India. A reduction in the number of dual-use export license applications for India is attributable to fewer license requirements, as a result of the NSSP and the ongoing work of the HTCG.

²⁰Executive 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 OC chair is to report the “majority vote decision of the OC” rather than his/her decision.

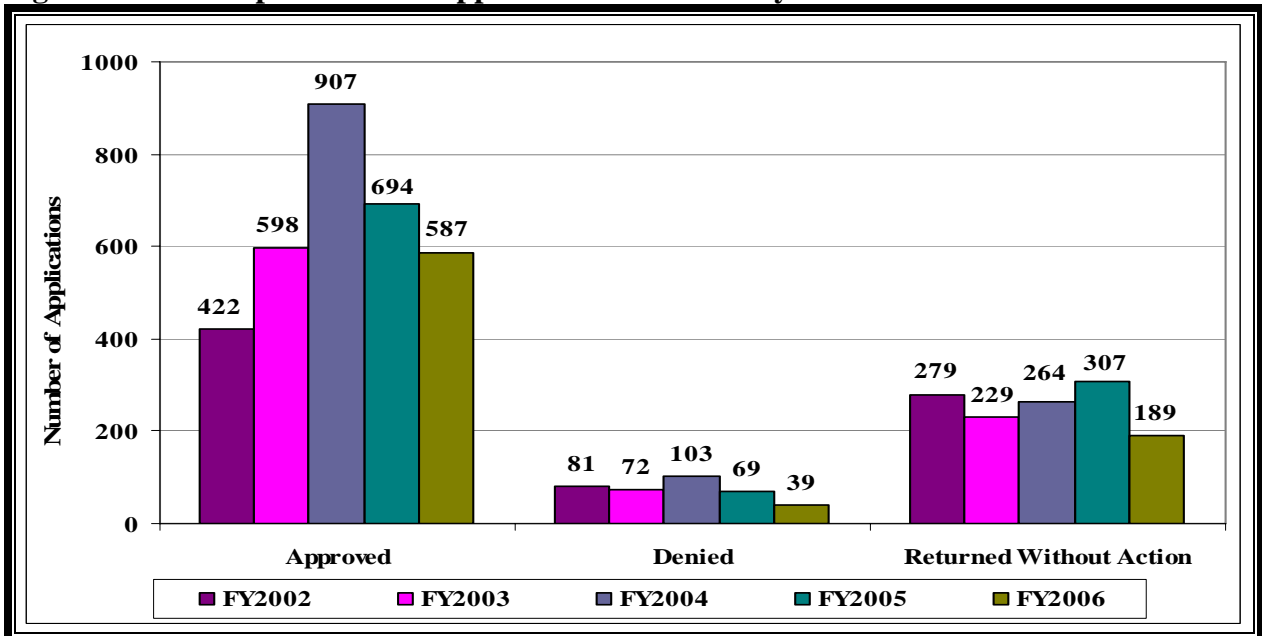
Figure 2: Export License Applications BIS Received for India



Source: BIS

Based on the number of export license applications BIS processed for India during FY 2006, 587 were approved, 39 were denied, and 189 were returned without action (see figure 3 for a breakdown of BIS' determinations for these licenses).

Figure 3: India Export License Applications Processed by BIS



Source: BIS

Trends in Technologies Sought by India Through the Export Licensing Process

Most of the export license applications for India in FY 2006 involved technologies categorized under materials, chemicals, “microorganisms,” and toxins; materials processing; telecommunications and information security; and computers (see table 1 for a full listing of the number of export license applications BIS received for each CCL category).

Table 1: BIS License Applications for India by CCL Category (in FY 2006)

Cat ry	tegrory	Applications* Received in FY 06
0	Nuclear Materials, Facilities, and Equipment	8
1	Materials, Chemicals, “Microorganisms,” and Toxins	225
2	Materials Processing	208
3	Electronics	95
4	Computers	130
5	Telecommunications and Information Security	206
6	Lasers and Sensors	22
7	Navigation and Avionics	56
8	Marine	2
9	Propulsion Systems, Space Vehicles, and Related Equipment	55
EAR99	Classification used for items subject to the EAR but not listed on the CCL	147

*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 India export applications BIS received during FY 2006.

ource: BIS

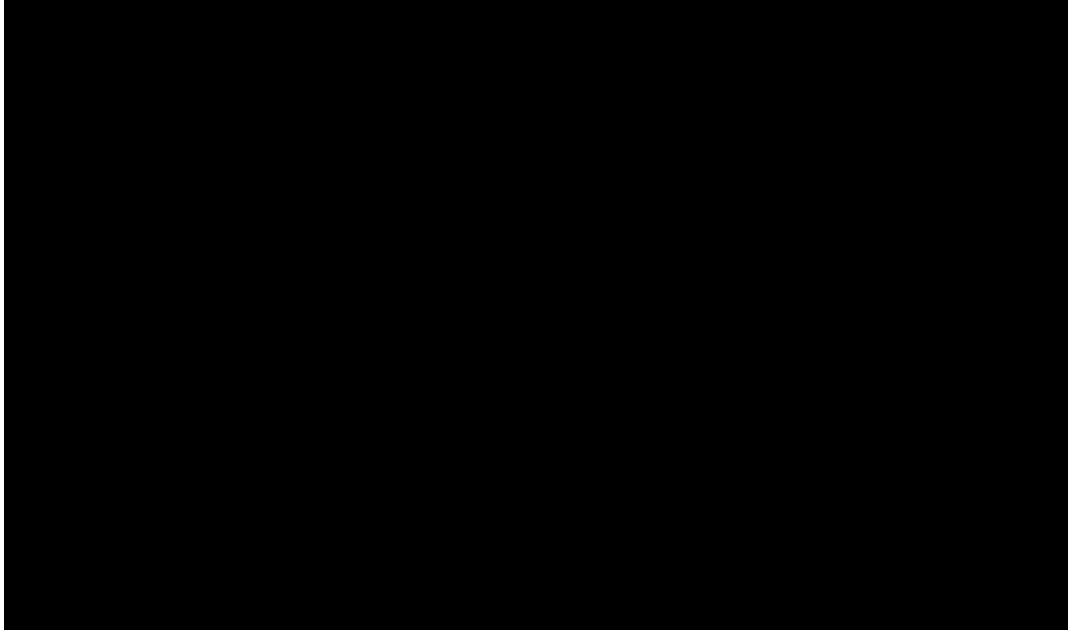
End-Use Checks in India

End-use checks play an important part in the export licensing process by helping BIS 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 include either pre-license checks (PLCs) or post-shipment verifications (PSVs) and may be requested by any of the executive agencies involved in the interagency licensing process. A PLC is conducted to establish the *bona fides*—or evidence of the qualifications—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 shipped to help determine whether the licensed item is being used in accordance with license conditions.

The U.S. Department of Commerce and the Indian Ministry of External Affairs entered into an End-Use Visit Arrangement in September 2004. Since November 2004, end-use checks in India have been conducted by an export control officer (ECO) based in New Delhi. ECOs are BIS export enforcement agents who hold the rank of commercial officer in the commercial section of U.S. embassies and consulates.²¹ In addition to conducting end-use checks, they handle various other in-country export control activities.

²¹BIS has additional ECOs stationed in Abu Dhabi, United Arab Emirates; Moscow, Russia; Beijing, China; and Hong Kong.

[REDACTED] (see Chapter II for more discussion on the targeting of end-use checks).



[REDACTED] A Sentinel trip is performed by domestic BIS export enforcement agents, largely to conduct PSVs. Often, Sentinel teams target some checks that are not requested by licensing officers or other U.S. government officials. Usually, the Sentinel checks involve conducting multiple PSVs at the same entity (so the team—and in this case the ECO in New Delhi—can group multiple checks at the same location), whereas headquarters-initiated checks usually involve conducting only one check at one entity. Therefore, in addition to conducting the end-use checks that were requested by BIS headquarters in FY 2005, the ECO conducted [REDACTED].

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 through FY 2007 of the adequacy of current export controls and counterintelligence measures in protecting against the acquisition of sensitive U.S. technology and technical information by countries and entities of concern. This is the eighth and final review under the NDAA requirement.

To satisfy the NDAA's FY 2007 reporting requirement, the Commerce Office of Inspector General assessed the effectiveness of BIS' export control program for India in conjunction with a review to determine the status of prior-year recommendations involving dual-use licensing and enforcement activities.²³ We examined (1) whether BIS' export control policies, practices, and procedures for India are clear, documented, and designed to achieve the desired goals; (2) whether BIS personnel are following the prescribed policies, practices, and procedures relating to India; and (3) how effective BIS is in detecting and preventing the diversion of sensitive commodities to weapons of mass destruction-related programs (either within or outside India).

We conducted our evaluation from June through November 2006 under the authority of the Inspector General Act of 1978, as amended, and 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 the Acting Under Secretary for Industry and Security and other senior BIS officials.

Our methodology included the following activities:

U.S. Interviews. Within BIS, we spoke with the Acting Under Secretary, Deputy Assistant Secretary for Export Administration, and the Assistant Secretary and 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 National Security and Technology Transfer Controls, as well as with staff from each office. Within Export Enforcement, we met with the director and staff of the Office of Export Enforcement (OEE) and the Office of Enforcement Analysis (OEA). We also spoke with staff from OEE's Boston field office regarding closed investigations involving Indian entities. In addition, we met with the chairperson of the Operating Committee, the policy advisor to the Assistant Secretary for Export Administration, the Export Administration Intelligence Liaison, and staff from BIS' Office of Chief Counsel.

We spoke with officials from federal agencies directly involved with or knowledgeable about U.S. dual-use export control policies and procedures related to India. Within the CIA, we spoke with analysts from the Center for Weapons Intelligence, Nonproliferation, and Arms Control. Within the Department of Defense, we spoke with officials from the Defense Technology Security Administration. Within the State Department, we interviewed staff from the Bureaus of South and Central Asia; International Security and Nonproliferation; and Political-Military Affairs, and

²³A separate report on the status of all open recommendations resulting from Commerce OIG's NDAA reporting will be issued in March 2007.

attended meetings of the Missile Technology Export Control Group and Subgroup on Nuclear Export Coordination. Within the Department of Energy, we met with officials from the Office of International Regimes and Agreements.

Overseas Visit. We also traveled to India to assess U.S. dual-use export control operations. At the post, we interviewed officials at the U.S. embassy in New Delhi. We met with BIS' ECO and accompanied him on two end-use visits to Indian entities located in Chennai and Bangalore (a representative from India's Ministry of External Affairs was also present at the end-use visit in Chennai).

We also spoke with the Commercial Service's (CS) deputy senior commercial officer in India and the two commercial specialists who currently assist the ECO. In addition, we spoke with the



embassy's deputy chief of mission and the heads of the consular; defense; economic; environment, science, technology, and health; and political sections; and other relevant U.S. government officials.²⁴ Finally, we met with Government of India officials from the Defence Research and Development Organization and the Indian Space Research Organization to discuss the progress of end-use visits in India and obtain the Indian government's views on some aspects of U.S. dual-use export controls.

While in India, we also met with representatives from two leading Indian industry associations—the Confederation of Indian Industry and the Federation of Indian Chambers of Commerce—to discuss U.S. export controls and their efforts to promote U.S. and India export control compliance among Indian companies.

Source: <https://www.cia.gov/cia/publications/factbook/geos/in.html>

Review of export control laws and regulations, relevant BIS guidance, and other documents. We examined current and prior legislation, executive orders, policy papers, and related regulations (including the EAR) that pertained to India. In addition, we reviewed the following documents, covering the period of FYs 2005 and 2006 (unless otherwise indicated):

- Complete licensing histories for 43 India cases escalated to the OC and ACEP
- Records for 106 India end-use checks (including applicable licensing histories) that were initiated or completed (for FY 2005 we only reviewed those checks that received ratings other than favorable)
- Sentinel trip reports from July 2000 to December 2003
- Program material related to the roles and responsibilities of the ECO in India

²⁴During our visit we were unable to meet with Homeland Security's Immigration and Customs Enforcement attaché because the position was vacant.

- ECO's subject matter files at post relating to export controls
- Summaries of 124 India technology licenses for FYs 2005-2006 (through April 30, 2006)
- BIS directives and procedures related to license monitoring
- Relevant cable traffic and intelligence reports pertaining to India

OBSERVATIONS AND CONCLUSIONS

I. Dual-use Export Control Policies and Practices for India Are Not Fully Transparent

We also found a problem with the listing of Indian entities found on BIS' Entity List. Specifically, some Indian entities meant to be captured on the list are not clearly identified. As a result, U.S. exporters could inadvertently export dual-use controlled items to these entities without the required license.²⁵

A. *Questions remain over whether the Government of India has fully implemented two of the export control-related steps under the "Next Steps In Strategic Partnership"*

Due to the classified nature of the material discussed in this section, we offer our specific findings and recommendations in Appendix D, which is classified at the SECRET level.



BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it believes that India has fulfilled its commitments under the NSSP. BIS' specific comments and our response are provided in the classified section of this report.

B. *BIS' Entity List does not clearly identify some Indian entities*

BIS established the Entity List, a supplement to the EAR's export license requirements, in February 1997 to inform the public of entities whose activities impose a risk of diversion of exported and reexported items into programs related to weapons of mass destruction (WMD). In conjunction with the 1998 economic sanctions against India for its nuclear tests, BIS increased

²⁵A license is required for the export or re-export of all items subject to the EAR for most of the Indian entities on the *Entity List*. In addition, the nuclear end-use/end-user control in Section 744.2 of the EAR imposes a license requirement on all exports to three activities, one of which is "unsafeguarded" nuclear activities. This license requirement exists independent of the license requirements imposed by the Entity List.

the number of Indian entities on the list from 4 to more than 200. According to BIS, these additional entities were “determined to be involved in nuclear or missile activities.”

In March 2000, BIS removed 51 Indian entities from the list after conducting a congressionally-mandated review intended to focus the list on entities that made direct and material contributions to WMD and missile programs. After removing the 51 entities, BIS restructured the list, moving many subordinate organizations affiliated with the listed Indian entities and of interest to the United States to a special appendix to the Entity List. The appendix included over 100 Indian subordinate entities associated with 6 different Government of India agencies.

After the President waived the economic sanctions against India in 2001, BIS removed some Indian entities from the list and deleted the special appendix, reducing the number of named Indian entities on the Entity List at that time to 15.²⁶ As part of this action, BIS grouped subordinate entities of the Indian Department of Atomic Energy into three types or categories without listing the specific entities by name. The types are as follows:

- Nuclear reactors (including power plants) not under the International Atomic Energy Agency safeguards (excluding Kundankulam 1 and 2),²⁷
- Fuel reprocessing and enrichment facilities, and
- Heavy water production facilities and their collocated ammonia plants.

According to representatives of the agencies involved in the interagency licensing process, consolidating these subordinate entities into the three categories without naming them has made it more difficult to determine whether a specific entity is covered by the list. As a result, U.S. exporters could inadvertently export certain sensitive or EAR99 items to these entities without the required license.

We identified two export license applications that were escalated to the Operating Committee, in part, because of disputes among interagency licensing officials as to whether the Indian entities on the applications were covered by the Entity List. Both cases involved subordinates of the Indian Department of Atomic Energy, but the licensing officials could not agree as to whether the entities were “safeguarded” or “unsafeguarded” nuclear facilities—a key factor in determining whether the entities are subject to the list.

It should be noted that in one of the two cases, part of the confusion was based on erroneous information provided by the applicant, who reported on the license application that the ultimate consignee was a subordinate of a listed entity. When the applicant realized that the ultimate consignee was not a subordinate of that entity, he asked BIS to modify the license application accordingly. At this point, according to the OC records, the then-acting OC Chair “suggested that the application be returned without action because the items listed were EAR99 and were destined to a non-listed entity.” However, while the ultimate consignee was not a subordinate of

²⁶Since that time, an additional 3 Indian entities were removed from the list, making the total now 12.

²⁷According to the International Atomic Energy Agency, safeguards are applied to verify a state’s compliance with its agreement to accept safeguards on all nuclear material in all its peaceful nuclear activities and to verify that such material is not diverted to nuclear weapons or other nuclear explosive devices.

a listed entity, the Energy representative at the OC reported that it was a subordinate of the Indian Department of Atomic Energy and as such, was still covered by the Entity List. State concurred with this assessment.

Ultimately, it was determined that the ultimate consignees in both cases were “unsafeguarded” facilities and, as a result, were included on the list. Both license applications were subsequently rejected. However, these cases call into question how clear the Entity List actually is with regard to the Indian Department of Atomic Energy subordinates since it led to some confusion during the interagency licensing review process.

The OC chair acknowledged that consolidating the list has created some confusion both for exporters and interagency licensing officials, resulting in an occasional dispute about whether a particular entity was listed. As a result, he prepared a handbook for OC members in early 2006 that includes a section on Indian entries on the Entity List. The section compiles all the *Federal Register* notices relating to the addition and deletion of Indian entities on the list, as well as any licensing policy changes for specific entities since 1998. The chair believes this guidance has eliminated much of the confusion over which subordinate entities are covered by the list.

The OC chair also provided this guidance to BIS licensing officers who attended an OC training session in June 2006. The positive feedback he received on the guidance prompted him to put it on BIS’ shared network in October 2006 so that all BIS’ licensing officers could have access to it. This document is not available to the public. Thus, while BIS and other U.S. licensing officials now have clearer information on the specific Indian entities on the Entity List, U.S. exporters do not. BIS needs to ensure that U.S. exporters clearly understand which Indian entities are meant to be captured on the Entity List to help ensure export controlled dual-use items are not inadvertently shipped to these entities without the required license.

Recommendation:

We recommend that BIS specifically list all of the Indian entities that should be captured on the Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements.



BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it will review the listing of the Indian entities on the Entity List to determine how additional information can be provided to exporters. The planned completion date for this review is April 30, 2007. We acknowledge BIS’ planned efforts in this area and look forward to receiving a copy of the review results upon completion.

II. BIS' End-Use Check Program in India Needs to Be Improved

Given India's importance in U.S. export control matters, BIS assigned one of its export enforcement agents to New Delhi in November 2004 to conduct end-use checks. This move has provided BIS with new opportunities to work more closely with the Government of India on export control matters. However, we identified several weaknesses in BIS' end-use check program for India that should be addressed:

- The End-Use Visit Arrangement²⁸ between the U.S. Department of Commerce and India's Ministry of External Affairs limits the effectiveness of end-use checks.
- While end-use checks involving Indian private sector entities are generally conducted in a timely manner, the majority of those involving government or government-affiliated entities are not.
- BIS has not set clear and consistent time frames for completing two steps of the end-use check process, namely (1) initiation of PSVs upon receipt of required shipping documents and (2) notification to the Ministry of External Affairs of end-use check requests.
- Two of the India PLCs BIS cancelled in FY 2006 should have been rated "unfavorable" per the bureau's end-use check criteria.
- Although the U.S. government is concerned about diversions of sensitive exports to programs involving weapons of mass destruction, BIS did not adequately target PSVs to determine whether diversions were occurring.

Because of the sensitive nature of these findings, we discuss them in Appendix E, classified at the CONFIDENTIAL level.



BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it disagreed with some of the report findings listed above. However, it agreed to take action to implement a number of the recommendations we proposed. BIS' specific comments and our response are provided in the classified Appendix E to this report.

²⁸Commerce and India's Ministry of External Affairs entered into this agreement in September 2004 to establish procedures for full and timely end-use checks.

III. BIS Needs to Enhance Its Efforts to Ensure Compliance with License Conditions

The EAR allows BIS or licensing referral agencies to place conditions on an export license when there are specific concerns about the exporter, end use, or end user. Frequently, the conditions are the result of lengthy negotiations among the licensing referral agencies. They are an important part of the interagency export licensing process and offer BIS an additional means for monitoring certain shipments. BIS monitors export licenses to ensure the holders comply with all license conditions. This endeavor requires the combined efforts of Export Administration and Export Enforcement.

There are 55 standard license conditions. Six of these place reporting conditions on exporters or end users which require them to submit documentation to BIS regarding the shipment (see table 2).²⁹ A seventh condition—referred to as “Write Your Own”—allows licensing officers to formulate unique requirements, which may include reporting requirements for either the exporter or the end user. Licenses with reporting conditions are tracked in the Follow-up Subsystem within ECASS.

Table 2: License Conditions with Reporting Requirements*

10–Temporary Demonstration	Export Administration	Notify BIS once the licensed item is returned to the United States after its temporary demonstration in another country.
12–Delivery Verification Standard	Export Administration	Provide BIS delivery verification documents.
13–Delivery Verification Triangular	Export Administration	
14–Post-Shipment Verification (PSV)	Export Enforcement	Submit a shipper’s export declaration to BIS following the shipment of the item (so that a PSV can be initiated).
17–Aircraft on Temporary Sojourn	Export Administration	Notify BIS after the return of an aircraft on temporary sojourn to a foreign country.
*The table excludes the “Write Your Own” condition (since there is no standard requirement to be followed) as well as the “NDAA PSV” condition (see footnote 30 below).		

Source: BIS and OIG

²⁹The NDAA for FY 1998 requires BIS to perform PSVs on all high-performance computers with a computing capability beyond a certain threshold that are exported or reexported to “Tier 3” countries, including China, India, United Arab Emirates, and Israel. BIS implements this provision through condition 34 which requires exporters to submit a post-shipment report to BIS on exports of high-performance computers to “tier 3” countries. The act also requires BIS to submit annual reports to the Congress listing these high-performance computer exports and the results of the PSVs. License condition 34 is tracked separately from the ECASS Follow-up Subsystem.

The OIG previously reported that Export Administration and Export Enforcement did not consistently monitor licenses with reporting conditions and, therefore, did not ensure exporter or end user compliance with license conditions.³⁰ In response to our recommendations, both units instituted procedures to (1) regularly monitor licenses with reporting conditions that are marked for follow-up by licensing officers, (2) follow up with exporters to request any necessary reporting documentation, and (3) provide for the review of technical documentation submitted by exporters and end users. However, our review found that both Export Administration and Export Enforcement need to improve implementation of the procedures.

A. *Export Administration is not adequately monitoring India licenses with reporting conditions*

Within Export Administration, the Office of Exporter Services (OExS) is responsible for monitoring exporter compliance with five of the seven reporting conditions, including Write Your Own conditions that have reporting requirements. Of these five conditions, four involve the submission of routine documentation, such as delivery verification, that does not require a level of technical expertise to verify. If a licensing officer marks a license with any of these four conditions, the license is automatically entered into the Follow-Up Subsystem, enabling OExS to follow up with the applicable exporters to ensure that the required documentation is submitted in accordance with the condition.

By contrast, Write Your Own conditions are unique and for each one, the licensing officer must determine whether the condition needs to be entered into the Follow-Up Subsystem. Write Your Own conditions may sometimes require the exporter or end user to provide BIS substantive reports related to the export, such as maintenance reports or technology control plans (TCPs),³¹ which require some level of technical review. For these conditions, the licensing officer must choose “yes” or “no” in the Write Your Own screen indicating first whether the condition requires follow-up. If the licensing officer marks “yes” for follow-up, he then must indicate whether the documentation requires a licensing officer’s technical review. The license is only entered into the Follow-up Subsystem if the officer marks “yes” for “follow-up” required.

Of the 273 India export license applications included in our sample, only 13 contained reporting conditions that fell under the responsibility of OExS to monitor. Twelve of the 13 licenses contained a Write Your Own condition, whereas the 13th license contained a standard reporting condition requiring the submission of a report summarizing specific details related to demonstrations of the item. Based on our review of these 13 licenses, licensing officers failed to mark 5 of them for follow-up to verify that the reporting conditions were met. We also found that staff from OExS were not fully aware of the reporting conditions they were required to monitor and were not properly referring noncompliant exporters to Export Enforcement. This breakdown in Export Administration’s monitoring process might diminish the deterrent effect that license conditions can have on potential violators.

³⁰U.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; Commerce OIG, March 2006. *U.S. Dual-Use Export Controls for China Need to be Strengthened*, IPE-17500.

³¹According to BIS, a TCP is a reporting requirement put in place by BIS or Defense in cases when foreign nationals are employed at or assigned to security-cleared facilities that handle export-controlled items or information.

Licensing Officers are not properly marking the “follow-up” box in ECASS for India licenses with Write Your Own conditions

We found that 5 of the 13 licenses that contained a reporting requirement as part of the Write Your Own condition, were not marked for “follow-up” by the licensing officers. These errors occurred despite the fact that each export license application was reviewed and signed off by a countersigner.³² Because these licenses were not entered into the Follow-up Subsystem, OExS staff did not know to follow up with the exporters to determine whether they had complied with the conditions.

Regardless, two exporters provided the required documentation to OExS. However, OExS did not have any information pertaining to the remaining three licenses. Export Enforcement’s Office of Enforcement Analysis (OEA) later informed us that two of the remaining three licenses had been shipped against. However, OEA did not have any records relating to the third license.³³

In response to similar monitoring weaknesses identified in our March 2006 report on dual-use export controls for China, the director of OExS issued a memorandum on May 9, 2006, reminding licensing officers of the importance of marking a license for follow-up.³⁴ We do not know whether the May 2006 memo has improved officer compliance with this requirement since the five licenses not marked for follow-up were processed before this memorandum was issued. Under the circumstances, we suggest that OExS review a sample of license applications to see whether licensing officers and countersigners are consistently marking the appropriate licenses for follow-up. Additionally, OExS should contact exporters for the three licenses that were not properly marked for follow-up to determine whether they complied with their reporting requirement.

Licensing officers are not required to review all technical documentation submitted by exporters or end users pursuant to license conditions

Of the 13 India licenses that had reporting conditions, we found that 10 required submission of technical documentation but were not marked for and did not receive the licensing officers’ review. Reporting requirements are 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 these 10 cases, the licensing officers informed us that because Defense had requested the technical reporting conditions, they did not believe that they were responsible for reviewing the documentation. While Defense may have requested these conditions, BIS ultimately agreed to issue the licenses with the conditions.

Two of the 10 licenses had conditions that required the end user or consignee to develop and implement a technology control plan prior to shipment. Seven licenses required the exporter to submit a service report on the condition and use of the commodity covered under the license,

³²A countersigner is typically a division director. The countersigning process was established by BIS to help ensure that export license applications are processed appropriately.

³³Licenses are generally issued for a period of 2 years and the exporter can ship anytime during that period. This license expires in May 2007.

³⁴Memorandum from the Director of OExS to BIS Licensing Officers, *Review of Technical Reports Submitted Pursuant to a License Condition*, May 9, 2006.

following any maintenance performed on the equipment. In the last case, the condition required submission of a biannual report to BIS summarizing specific details related to the demonstrations of the item. Aside from licensing officer review, there are no BIS processes in place for reviewing the technical documentation to ensure that exporters or end users comply with such license conditions.

Prior to May 2006, BIS did not require any form of technical review of the documentation submitted to ensure that it meets the requirements of the condition. In response to similar concerns in our March 2006 report on export controls for China, the May 9, 2006, OExS memorandum additionally required licensing officers to review technical documentation submitted pursuant to a license condition if the documentation was requested because of concerns with the transaction. However, the memorandum excludes those licenses involving reporting conditions placed on a license by the Defense Department unless BIS licensing officers also have a concern with the transaction.

With regard to reporting requirements placed on a license as a condition of approval by Defense, BIS reported that Defense has the ability to identify technical reports it wishes to review and BIS provides those reports to them accordingly. BIS further reported that if Defense identifies a problem during its review of the reports, DOD will notify BIS of a compliance issue and raise this in future reviews of license applications involving the applicable exporter. The Acting Under Secretary for Industry and Security stated that he did not know whether Defense actually requests copies of technical reports required as part of license conditions. Based on our discussions with two of the licensing officers who were responsible for several of the licenses referenced above that had technical reporting conditions, it appears that these reports are not routinely provided to Defense.

BIS has the authority to administer and enforce the EAR and, as such, is ultimately responsible for monitoring and enforcing all conditions placed on a dual-use license. Without knowing whether an exporter or end user is fully compliant with license conditions, BIS cannot make informed decisions on future license applications involving the same parties or take appropriate enforcement action on the current license. BIS should revise its procedures with respect to the review of technical documentation by licensing officers to require that *all* technical documentation requested by any licensing agency, and included in an approved license, be examined by the appropriate licensing officer upon submission by the exporter to ensure compliance with the reporting conditions.

OExS staff are not always aware of the reporting conditions they are required to monitor

Our review of the 13 licenses with reporting conditions also revealed that OExS staff (1) prematurely closed out two India licenses that required reporting documents from the exporter or end user, and (2) failed to forward shipping documentation received for one license to OEA.

- **Licenses prematurely closed out.** In the first case,³⁵ OExS staff did not have any information documenting whether the license was shipped against and could not explain why it was prematurely closed out of the Follow-up Subsystem. However, OEA officials

³⁵This license required the submission of a delivery verification report, which is provided to BIS after delivery of goods, and a maintenance report, provided when maintenance is performed on equipment.

apparently had information indicating that the goods had been exported. In the second case,³⁶ OExS staff had information relating to the date the goods were shipped, but they could not explain why they closed the license out in the Follow-Up Subsystem before receiving the required documentation. According to BIS procedures instituted in early 2005 in response to a recommendation from our March 2003 export enforcement report,³⁷ OExS staff must obtain all required documentation from the exporter or end user before closing out a license.

- **Failure to forward shipping documentation to OEA.** OExS staff failed to forward shipping documentation they received for one license to OEA so that a PSV could be initiated. This case involved a shipper's export declaration and a post-shipment report, both of which should have been submitted directly to OEA by the exporter, but were mistakenly submitted to OExS after the May 2006 shipment. According to a memorandum issued by the director of OExS in March 2006, OExS staff must forward misrouted shipper's export declarations and all relevant documentation to OEA within 48 hours of receipt of those documents. An OExS employee said that she did not forward the shipping documentation to OEA because she believed monitoring the license conditions in this case was the responsibility of OExS. But if OEA does not receive shipping documents, it has no way of knowing whether exporters have complied with the license condition and cannot initiate a PSV.

BIS should ensure that OExS staff understand which license conditions they are responsible for monitoring and when they should forward documentation to OEA. In addition, OExS should reopen the two licenses that were prematurely closed out of its system and contact the exporters to obtain the documentation needed to fulfill the reporting requirements.

OExS staff are not referring non-compliant exporters to OEE

According to BIS' guidance, OExS staff are required to follow up with exporters that are noncompliant with reporting conditions prior to closing out the license in the Follow-Up Subsystem. The procedures further state that if exporters are non-responsive to requests for information, OExS staff should refer them to the Office of Export Enforcement (OEE). However, in the two cases of noncompliance, both exporters had shipped against their licenses, but neither one had provided BIS all of the required documentation as of October 2006. We brought these cases to the attention of OExS staff members during the course of our review, but they were not referred to OEE. OExS should immediately refer any noncompliant exporters to OEE.

Recommendation:

BIS should, at a minimum, take the following actions to improve its monitoring of license conditions:

³⁶This license required the submission of a demonstration report to BIS every 6 months for a period of 2 years.

³⁷Commerce OIG, March 2003. *Improvements Are Needed to Better Enforce Dual-Use Export Control Laws*, IPE-15155.

- Determine why there are persistent breakdowns in BIS' process for monitoring license conditions.
- Review a sample of license applications to ensure licensing officers and countersigners are properly marking licenses for follow-up.
- Contact exporters for the three licenses we identified as not marked for follow-up to determine whether the exporters complied with reporting requirements.
- Amend procedures to require licensing officers to review *all* technical documentation submitted by exporters or end users to ensure their compliance with the conditions.
- Ensure that relevant OExS staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to OEE, as appropriate.
- Reopen the two licenses that were closed by OExS and contact the exporters regarding reporting requirements.
- Refer all noncompliant exporters to the Office of Export Enforcement.



BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report, BIS stated that it is still reviewing our recommendations pertaining to Export Administration's monitoring of license conditions. The planned completion date for this review is April 30, 2007. We look forward to reviewing BIS' response when completed.

B. Export Enforcement needs to improve its monitoring and enforcement of India licenses with condition 14

Within Export Enforcement, OEA is responsible for monitoring licenses marked with the remaining two reporting conditions—the submission of shipper's export declarations, which is referred to as condition 14, and post shipment reports on high-performance computer exports to certain countries, referred to as condition 34.³⁸ Licenses with condition 14 require a PSV on a specific foreign entity following the first shipment made against the license. Within 30 days of shipment, exporters are required to submit a copy of the shipper's export declaration directly to OEA, which then initiates the PSV to confirm a commodity's stated end-use

Our review of the 24 India licenses from our sample that contained condition 14 revealed that OEA is not fully adhering to its guidance for monitoring licenses with condition 14. Condition 14 is one of the most critical conditions placed on a license because either the interagency

³⁸Since licenses with condition 34 are tracked separately from Export Enforcement's Conditions Follow-up Subsystem, we focused our review on licenses with condition 14. However, some of the licenses with condition 14 in our sample also contained condition 34.

licensing agencies or export enforcement officials decided that a PSV was needed to determine whether the goods or technology were actually being used in accordance with that license. However, it should be noted that even when condition 14 is imposed on a license, the PSV might not occur in all cases. For example, if there is no export against the license or if the agency requesting this condition changes its mind (e.g., the item subsequently becomes decontrolled), the PSV may be cancelled. One of the 24 PSVs in our sample was cancelled because the item was decontrolled after the license was issued.

Of the reviewed India licenses that contained condition 14, several exporters submitted their shipping documents to BIS well after the established time frame, which in some cases hinders BIS' ability to detect possible diversions or violations of license conditions. In addition, OEA recommended approval of additional licenses to exporters that had not fully complied with condition 14 reporting requirements on previous licenses and did not refer noncompliant exporters to OEE for appropriate action.

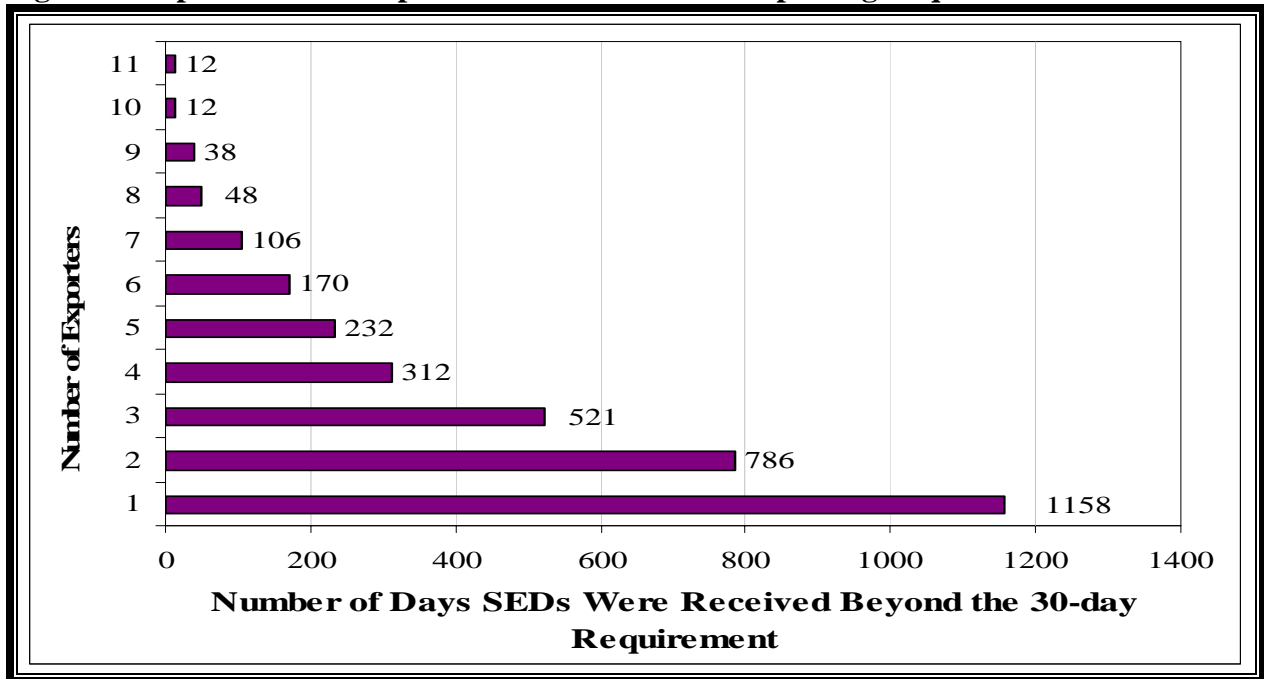
Export Enforcement management is unable to determine whether OEA analysts and supervisors are fully adhering to OEA's follow-up procedures

We determined that exporters submitted their shipper's export declarations after the established 30-day deadline in 11 of the 24 cases—between 12 and 1,158 days beyond the deadlines (see figure 6). In response to our March 2003 export enforcement report, BIS issued procedures requiring its staff to follow up at least twice with the exporter on all licenses with condition 14: first, 1 year after the license's date of issue and then within 30 days of the date of license expiration to see whether shipments have occurred. However, we were unable to determine if OEA followed these procedures in these cases. Specifically, records in OEA's electronic follow-up tickler system for 8 of the 11 licenses³⁹ in which exporters submitted their shipper's export declarations late did not clearly show what actions were taken to monitor compliance. Seven of the 8 records only showed the date when the follow-up tasks were assigned to an analyst and not what actions the analyst took. The remaining record did not provide any information about OEA follow-up.

Given that the acting director for OEA's South Asia and Europe Division was new to this position at the time of our review and the fact that OEA's follow-up tickler system did not clearly indicate what follow-up action, if any, was taken in these cases, she could not confirm if analysts followed the prescribed procedures for these eight cases. Since only OEA supervisors have access to the Follow-up Subsystem, it was their responsibility to record what actions were taken by the analysts in these cases. However, the acting director for OEA's South Asia and Europe Division suggested that supervisors would be better able to hold analysts accountable if the analysts had access to the Follow-up Subsystem so that they could record the actions they took to monitor these cases.

³⁹One exporter was under investigation by OEE at the time of our review, so we did not pursue our inquiry related to this license. While the remaining two licenses had been shipped against, they were granted in March 2006 and, as such, had not reached the one-year mark requirement for follow-up as called for in OEA's guidance.

Figure 6: Exporters Noncompliant with Condition 14 Reporting Requirement



Source: BIS

OEA is not denying noncompliant exporters future licenses or referring them to OEE per its guidance

OEA’s procedures require its analysts to (1) refer noncompliant condition 14 exporters to OEE for possible investigation, and (2) recommend denial of any subsequent license applications involving a party who has not complied with a previous license condition. We found also that at least 6 of the 11 noncompliant exporters in our sample received additional licenses after the 1-year deadline established by OEA for its analysts to follow up with exporters to determine compliance with condition 14.

In addition, only 2 of the 11 exporters that submitted their shipping documents to OEA after the established deadline were referred to OEE. The director of OEA informed us that while he was aware of the other 9 noncompliant exporters, he made the decision not to make the referrals. He and the acting director for the South Asia and Europe Division stated that despite BIS’ guidance, they generally do not refer these types of cases to OEE because they believe these cases would not be a priority.

We discussed this matter with the director of OEE, and he stated that OEA should refer these types of cases. He stressed that these violations should be examined so that they can consider appropriate enforcement action (e.g., a warning letter or fine).

BIS needs to ensure that its analysts and supervisors closely monitor licenses at the 1-year mark and within 30 days of license expiration to prevent additional licenses from being issued to exporters that do not comply with condition 14, and it should hold those exporters accountable.

Recommendation:

BIS needs to review Export Enforcement's process of monitoring and enforcing license condition 14 and take the following actions:

- Require OEA analysts and supervisors to closely monitor licenses at the specified follow-up time frames, record their monitoring activities in the Conditions Follow-up Subsystem, and recommend that exporters who do not comply with condition 14 be denied additional licenses.
- Refer all noncompliant exporters to the Office of Export Enforcement.
- Hold exporters accountable for noncompliance with condition 14 through appropriate enforcement action.



BIS Response to OIG Draft Report and OIG Comments

In its written response to our draft report and our recommendation addressing Export Enforcement's license monitoring and enforcement efforts, BIS stated that it is still reviewing the first part of this recommendation to determine whether it can be implemented using the current license processing system (ECASS), or if some alternative approach is necessary. We look forward to learning of BIS' decision upon completion of its review.

As for the second part of our recommendation related to BIS' adherence to its own guidance on denying licenses to those exporters who do not comply with condition 14 and/or referring noncompliant exporters to OEE, BIS stated that this requirement needs modification. Specifically, BIS reported that it put this requirement into place in October 2003 in response to a previous OIG recommendation, but found that there were many factors involved that needed to be considered before determining whether subsequent licenses should be denied or referrals made to OEE based on a late filing. As such, BIS stated that in cases where OEA believes it is appropriate to refer an investigative lead to OEE, it does so while also screening the party involved and recommending against issuance of any license until the OEE investigation has been concluded.

While we agree that some flexibility might be warranted (e.g., if the exporter is just a few days late in providing the required shipping documentation) in determining whether future licenses should be denied or referrals made to OEE based on a late filing, we found no evidence in the case files to indicate any type of analysis was conducted to determine whether or not the late filer should be held accountable for not fully complying with the license condition. In fact, as discussed in our report, the director for OEA and the acting director for the South Asia and Europe Division stated that they generally do not refer these types of cases to OEE because they believe these cases would simply not be a priority. Nonetheless, the director of OEE informed us during our review that these types of cases should be referred to OEE so that they can consider

appropriate enforcement action, such as a warning letter. Therefore, we reaffirm our recommendations on these matters and ask that BIS address them in its action plan.

With regard to the part of our recommendation about holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action, BIS' response stated that its Office of Chief Counsel and OEE, as well as the Department of Justice, determine the appropriate investigation and prosecution for filing documentation late, based on all the facts present. While we agree that these three entities, as appropriate, should make the decision as to what type of investigation and/or prosecution is appropriate on any given case, as stated above, none of the nine cases highlighted in our report were referred to these offices so that an appropriate decision could be made. As such, we reaffirm this part of our recommendation on this matter and ask that BIS address it in its action plan.

Finally, BIS' response noted that the 24 licenses from our sample did not all contain condition 14. We disagree. Our review of these licenses indicated that all 24 contained the standard condition 14 language:

After the first shipment is made against this license, send one copy of your shipper's export declaration, or automated export system (AES) record, bill of lading or airway bill to the Department of Commerce within 30 days of the date of export. Indicate the license number on each document. Send these documents to the Bureau of Industry and Security, Office of Enforcement Analysis, Room 4065, 14th Street and Constitution Avenue, N.W., Washington, D.C. 20230. These documents must be received by certified mail or via a private courier. They may not be faxed.

While the licensing officers for 2 of the 24 licenses had improperly coded this condition in ECASS as a "Write Your Own" condition instead of condition 14, the intent of the condition was clearly for a PSV to be conducted. In addition, the exporters in these cases were still required to submit the appropriate shipping documents in accordance with the license terms.

SUMMARY OF UNCLASSIFIED RECOMMENDATIONS

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

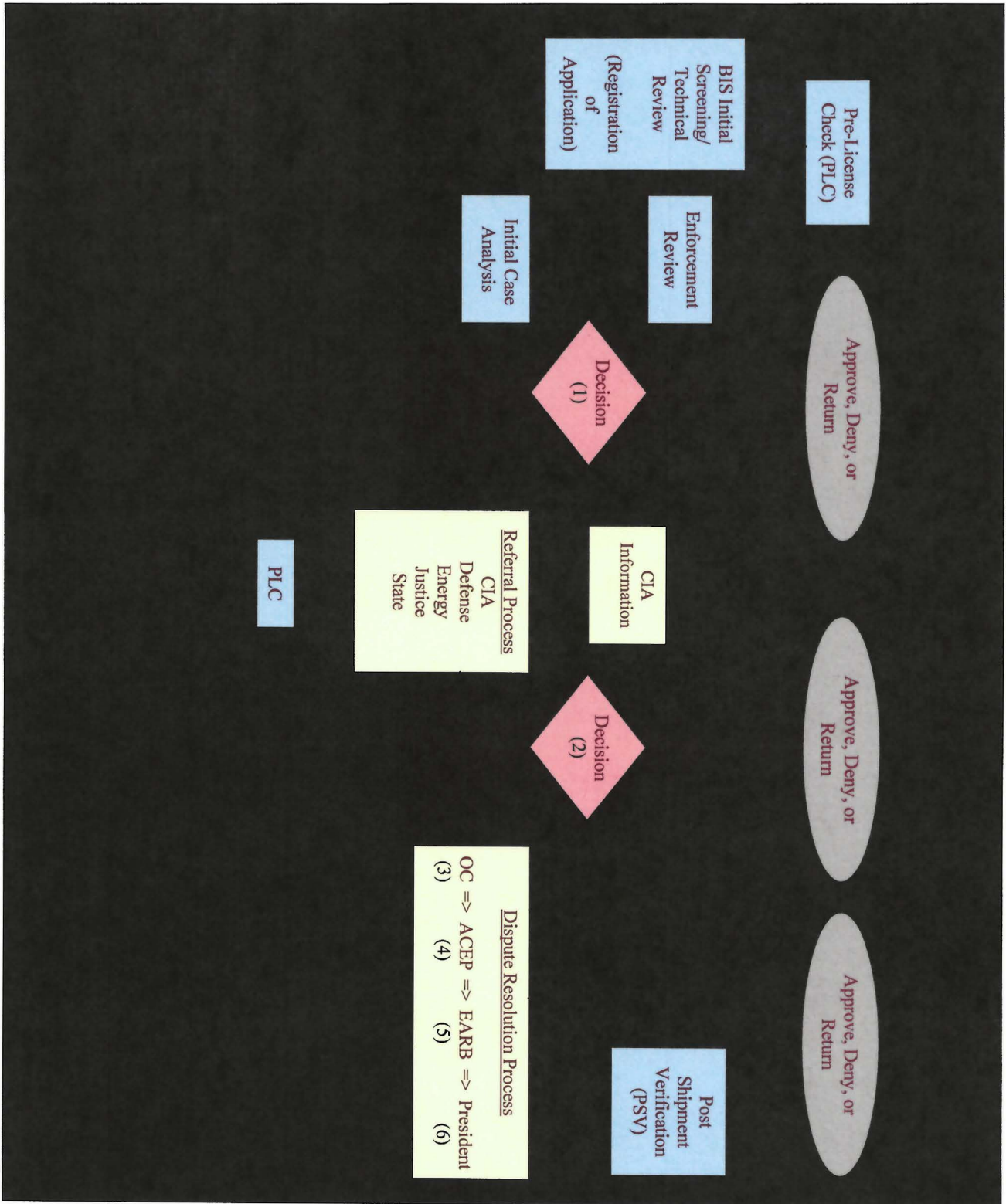
1. Specifically list all of the Indian entities that should be captured on BIS' Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements (see page 13).
2. Improve Export Administration's license monitoring efforts by:
 - a. Determining why there are persistent breakdowns in BIS' process for monitoring license conditions (see page 18).
 - b. Reviewing a sample of license applications to ensure licensing officers and counter-signers are properly marking licenses for follow-up (see page 18).
 - c. Contacting exporters for the three licenses cited in this report that licensing officers did not mark for follow-up to determine exporters' compliance with reporting requirements (see page 18).
 - d. Amending BIS procedures to require licensing officers to review *all* technical documentation submitted by exporters or end users to better ensure their compliance with the conditions (see page 18).
 - e. Ensuring that relevant Office of Exporter Services staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to the Office of Export Enforcement, as appropriate (see page 18).
 - f. Reopening the two licenses that were closed by Office of Exporter Services staff and contacting the exporters regarding reporting requirements (see page 18).
 - g. Referring any noncompliant exporters to the Office of Export Enforcement (see page 18).
3. Improve Export Enforcement's license monitoring and enforcement efforts by:
 - a. Requiring Office of Enforcement Analysis analysts and supervisors to closely monitor licenses at the specified follow-up time frames, recording their monitoring activities in the Conditions Follow-up Subsystem, and recommending that exporters who do not comply with condition 14 be denied additional licenses (see page 22).
 - b. Referring all noncompliant exporters to the Office of Export Enforcement (see page 22).
 - c. Holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action (see page 22).

APPENDIXES

Appendix A: Acronyms

ACEP	Advisory Committee on Export Policy
BIS	Bureau of Industry and Security
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
HTCG	High Technology Cooperation Group
IPE	Inspections and Program Evaluations
NDAA	National Defense Authorization Act
NLR	No License Required
NSSP	Next Steps in Strategic Partnership
OC	Operating Committee
OEA	Office of Enforcement Analysis
OEE	Office of Export Enforcement
OExS	Office of Exporter Services
OIG	Office of Inspector General
PLC	Pre-License Check
PSV	Post-Shipment Verification
TCP	Technology Control Plan
WINPAC	Center for Weapons Intelligence, Nonproliferation, and Arms Control
WMD	Weapons of Mass Destruction

Appendix B: Interagency Dual-Use Export Licensing Process



Source: Office of Inspector General

Appendix C: BIS Management Response to OIG Draft Report — Unclassified Version



UNITED STATES DEPARTMENT OF COMMERCE
Under Secretary for Industry and Security
Washington, D.C. 202320

March 23, 2007

MEMORANDUM FOR
Inspector General

FROM: *MF* Mark Foulon, Acting

SUBJECT: Audit Report No. IPE-18144
Draft Report Date: February 23, 2007
Audited Entity: Bureau of Industry and Security

Attached are the Bureau of Industry and Security's comments addressing the Office of the Inspector General's draft report entitled: U.S. Dual Use Export Controls for India Should Continue to Be Closely Monitored. Draft Inspection Report No. IPE-18144, February 2007.

The response consists of two parts. First are comments on the unclassified report's text and recommendations, followed by BIS's response to the report's classified text and recommendations.

Attachment



COMMENTS:

U.S. Dual Use Export Controls for India Should Continue to Be Closely Monitored,
Draft No. IPE-18144, February 2007

Comments on the Report's Unclassified Text:

- p. ii For reasons discussed in the classified section, BIS believes that India has fulfilled its commitments under the NSSP.
- p. iii In the classified section of the report, BIS explains the reasons for its disagreements with certain of the report's findings as stated on this page.
- p. iv For reasons discussed in the classified section of the report, BIS believes that performing 8 of 24 PSVs within 100 days of shipment is not a disadvantage.
- p. 14 For reasons discussed in the classified section, BIS believes that India has fulfilled its commitments under the NSSP.
- p. 15 There were two cases in the Operating Committee (OC) in which there was confusion about whether, or how, a proposed ultimate consignee was on the Entity List. In one of the two cases, the confusion was based on erroneous information provided by the applicant.
- p. 17 In the classified section of the report, BIS explains the reasons for its disagreements with certain of the report's findings as stated on this page.
- pp. 20-21 On a monthly basis, Defense identifies reports it wishes to review and Commerce provides those reports. If Defense requested copies of technical reports it required as license conditions, _____ would be provided to Defense for its review. Thus, there is a process for Defense to request reports it required in license conditions. If its review of those reports were to identify an issue, it would notify Commerce as a compliance issue and raise this in any future license application involving the exporter.
- p. 23 The characterization of condition 14 as "one of the most critical conditions" because it means that the interagency has decided that a post-shipment verification check (PSV) was needed, reflects a misunderstanding of the PSV process, as well as the purpose of condition 14. License condition 14, which specifically requests the licensee to submit shipping documents to BIS within 30 days of the first shipment, is used in instances where Export Enforcement personnel review documentation and initiate a PSV at a later point in time. It can also be imposed on the licensee by the licensing officer when another agency requires that a PSV be conducted as a condition of approval. However, even when condition 14 is imposed, the PSV might not occur, for example, if there is no export against the license or if the agency

requesting this condition cancels the request. Commerce has the authority to initiate a PSV at any time, regardless of whether it is included as a condition of the license or whether the license contains condition 14, and independent of the interagency process. Indeed, not all PSVs require condition 14, and not all licenses with condition 14 result in PSVs. Of the 24 India licenses containing PSVs noted in the report, 10 either did not contain condition 14 or the condition was not placed on the license by the interagency, but by an OEA analyst.

Response to the Report's Recommendations:

Recommendation 1: Specifically list all Indian entities that should be captured on BIS' Entity List, or determine an alternative means to better ensure exporter compliance with export license requirements(see page 14).

BIS Response:

BIS will review the listing of the Indian entities on the Entity List to determine how additional information can be provided to exporters. The planned completion date for this review is April 30,2007.

Recommendation 2: Improve Export Administration's license monitoring efforts by:

- a Determine why there are persistent breakdowns in **BIS'** process for monitoring license conditions (see page 19).
- b Reviewing a sample of license applications to ensure licensing officers and counter-signers are properly marking licenses for follow-up (see page 19).
- c Contacting exporters for the three licenses cited in this report that licensing officers did not mark for follow-up to determine exporters' compliance with reporting requirements (see page 19).
- d Amending BIS procedures to require licensing officers to review all technical documentation submitted by exporters or end users to better ensure **their** compliance with the conditions (see page 19).
- e Ensuring that relevant **Officer** of Exporter Services staff know which license conditions they are responsible for monitoring and the steps they should be taking to follow up on license conditions, including referral to the Office of Export Enforcement, as appropriate (see page 19).
- f Reopening the two licenses that were closed by Office of Export Services staff and contacting the exporters regarding reporting requirements (see page 19).
- g Referring any noncompliant exporters to the Office of Export Enforcement (see page 19).

BIS Response:

BIS is reviewing these seven recommendations. The **planned** completion date for this review is April 30,2007.

Recommendation 3: Improve Export Enforcement's license monitoring and enforcement efforts by:

- a. Requiring Office of Enforcement Analysis analysts and supervisors to closely monitor licenses at the specified follow-up time frames, recording their monitoring activities in the Conditions Follow-up Subsystem, and recommending that exporters who do not comply with condition 14 be denied **additional** licenses (see page **23**).
- b. Referring all noncompliant exporters to the Office of Export Enforcement (see page **23**).
- c. Holding exporters accountable for noncompliance with condition 14 through appropriate enforcement action (see page **23**).

BIS Response:

- a. BIS is reviewing the first part of this recommendation to determine if it can be implemented using the current license processing system (ECASS), or if some alternative approach is necessary.

The second part of the recommendation, to deny licenses to those exporters who do not comply with condition 14, requires modification. BIS put this requirement into place in October **2003** in response to a previous OIG recommendation, but found that there were many factors involved that needed to be considered before BIS should determine to deny subsequent licenses. Thus, BIS believes it is more appropriate to consider **all** of the factors related to a late filing prior to **referral** to a criminal investigator. In cases where the Export Compliance Analyst believes it is appropriate to refer an investigative lead to OEE, OEA does so and also screens the party involved and recommends against issuance of any license until the **OEE** investigation has been concluded.

- b. As explained above, **BIS/OEA** considers all of the factors related to a late filing and, if circumstances warrant, refers the matter to OEE for investigation.
- c. **The** Office of Chief Counsel, Office of Export Enforcement, and the Department of Justice determine the investigation and prosecution that is appropriate for filing documentation late, based on all facts present.