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February 2019

(U) Audit of Department of State Directorate of Defense Trade Controls Export Licensing Processes

SECURITY AND INTELLIGENCE DIVISION

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HIGHLIGHTS

Office of Inspector General
United States Department of State

AUD-SI-19-07

(U) What OIG Audited

(U) The U.S. Government regulates the sale, export, and re-transfer of defense articles and services to safeguard national security and advance U.S. foreign policy objectives. Within the Department of State (Department), the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (DDTC), is charged with controlling the export of defense articles and services.

(U) At the request of the Bureau of Political-Military Affairs, the Office of Inspector General (OIG) conducted this audit to determine whether DDTC implemented sufficient internal controls to ensure that export license applicants provide complete and accurate information, Department bureaus and offices involved with the application review process are effectually engaged, and the end-use and end-user of exports are appropriately vetted.

~~(SBU)~~ (U) OIG reviewed 21 permanent export license applications and performed tests of DDTC's internal controls. OIG also conducted fieldwork in (b) (7)(F) and (b) (7)(F).

(U) What OIG Recommends

(U) OIG made 11 recommendations that are intended to improve DDTC's internal controls. On the basis of the Bureau of Political-Military Affairs response to a draft of this report, OIG considers all recommendations resolved pending further action. A synopsis of the Bureau of Political-Military Affairs comments to the recommendations and OIG's reply follow each recommendation in the Audit Results section of this report. The Bureau of Political-Military Affairs response to the draft report is reprinted in Appendix C.

UNCLASSIFIED

(U) February 2019

(U) OFFICE OF AUDITS

(U) Security and Intelligence Division

(U) Audit of Department of State Directorate of Defense Trade Controls Export Licensing Processes

(U) What OIG Found

(U) OIG found that DDTC did not implement sufficient internal controls to ensure that permanent export license applications included all required information as set forth in its standard operating procedures (SOP). Specifically, Licensing Officers approved 20 of 21 applications (95 percent) reviewed despite the absence of required information, including 5 applications that should have been returned to the applicant without action. OIG also found that DDTC did not always provide Congress with certifications to ensure that proposed licenses met U.S. national security and foreign policy objectives. In addition, OIG found one instance in which the Licensing Officer did not have the authority to issue the license. These deficiencies occurred because DDTC (a) permitted deviations from its SOPs and (b) has not trained Licensing Officers on updated procedures. If these deficiencies are not corrected, DDTC will have limited assurance that licenses issued meet U.S. national security and foreign policy objectives.

(U) In addition, of the 21 applications reviewed, OIG found a single instance in which DDTC did not seek the input of other Department bureaus and offices, as required. The single exception was due to human error. However, during the audit, OIG learned of other instances in which Licensing Officers deviated from Department guidance and did not engage other Department bureaus in licensing decisions. When Licensing Officers fail to engage Department bureaus and offices, Department officials who are most familiar with foreign policy issues specific to the countries or commodities to be exported cannot provide input in the licensing decision.

(U) OIG also found that DDTC appropriately vetted the end-use and end-user of exports associated with applications reviewed for this audit. However, during audit fieldwork, OIG observed an end-use/end-user check that was not conducted in accordance with guidance. This exception occurred, in part, because the Department does not have a standard training program for the overseas Foreign Service Officers who conduct the checks. Furthermore, staff rotations at posts can impact the timeliness of vetting. Without proper vetting, DDTC could fail to safeguard the integrity and security of defense articles.

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(U) OBJECTIVE

(U) The Office of Inspector General (OIG) conducted this audit to determine whether the Directorate of Defense Trade Controls (DDTC) has implemented sufficient internal controls to ensure export license applicants have provided complete and accurate information, other Department of State (Department) bureaus and offices involved with the license application review process are effectually engaged, and the end-use and end-user of exports are appropriately vetted.

(U) BACKGROUND

(U) Directorate of Defense Trade Controls

(U) The U.S. Government regulates the sale, export, and re-transfer of defense articles and services¹ to safeguard U.S. national security and advance U.S. foreign policy objectives. Within the Department's Bureau of Political-Military Affairs, DDTC is charged² with controlling the export and temporary import of defense articles and services covered by the United States Munitions List (USML). The USML is divided into 21 categories, including:

- (U) Category I – firearms, close assault weapons, and combat shotguns.
- (U) Category IV – launch vehicles, guided missiles, ballistic missiles, rockets, torpedoes, bombs, and mines.
- (U) Category VII – ground vehicles.³

(U) DDTC issues several types of licenses:⁴

- (U) Permanent export.⁵
- (U) Temporary export⁶ (for articles that will be exported for less than 4 years and will be returned to the United States).⁷

¹ (U) Defense service means: (1) the furnishing of assistance to foreign persons in the design, development, engineering, manufacture, production, assembly, testing, repair, maintenance, modification, operation, demilitarization, destruction, processing, or use of defense articles; (2) the furnishing to foreign persons of any controlled technical data; or (3) military training of foreign units and forces.

² (U) Arms Export Control Act, 22 United States Code 2778-2780; *see also* International Traffic in Arms Regulations, 22 Code of Federal Regulations (C.F.R.) 120-130 (implementing the Arms Export Control Act).

³ (U) See 22 C.F.R. Part 121.1 for the complete USML.

⁴ (U) 22 C.F.R. Part 120.28(a)(1)(3)(4)(6).

⁵ (U) 22 C.F.R. Part 120.28(a)(1).

⁶ (U) 22 C.F.R. Part 120.28(a)(4).

⁷ (U) 22 C.F.R. Part 123.5(a).

- (U) Temporary import⁸ (for articles that are in transit to another foreign destination or that will be brought into the United States from a foreign country and then returned to the country from which they were shipped or taken).⁹
- (U) Classified defense articles and related classified technical data.¹⁰
- (U) Amendments to a license for permanent export, temporary export, and temporary import of unclassified defense articles.¹¹
- (U) Approvals for reselling, transferring, reexporting, retransferring, transshipping, or disposing of a defense article to any end-user, end-use, or destination other than as stated on the export license.¹²
- (U) Brokering, which is any action on behalf of another to facilitate the manufacture, export, permanent import, transfer, reexport, or retransfer of a U.S. or foreign defense article or defense service, regardless of its origin.¹³

(U) In addition, DDTTC issues advisory opinions as to whether it would likely grant a license or other approval for a particular defense article or defense service to a particular country.¹⁴

(U) DDTTC is composed of three offices: the Office of Defense Trade Controls Licensing (DTCL), which reviews and adjudicates license applications; the Office of Defense Trade Controls Policy (DTCP), which manages the various checks required by the Blue Lantern Program¹⁵; and the Office of Defense Trade Controls Compliance (DTCC), which manages the applicant registration process and International Traffic in Arms Regulations compliance efforts. Figure 1 shows the organization of the three offices.¹⁶

⁸ (U) 22 C.F.R. Part 120.28(a)(3).

⁹ (U) 22 C.F.R. Part 120.18.

¹⁰ (U) 22 C.F.R. Part 120.28(a)(6).

¹¹ (U) 22 C.F.R. Part 123.25(a).

¹² (U) 22 C.F.R. Part 123.9(a).

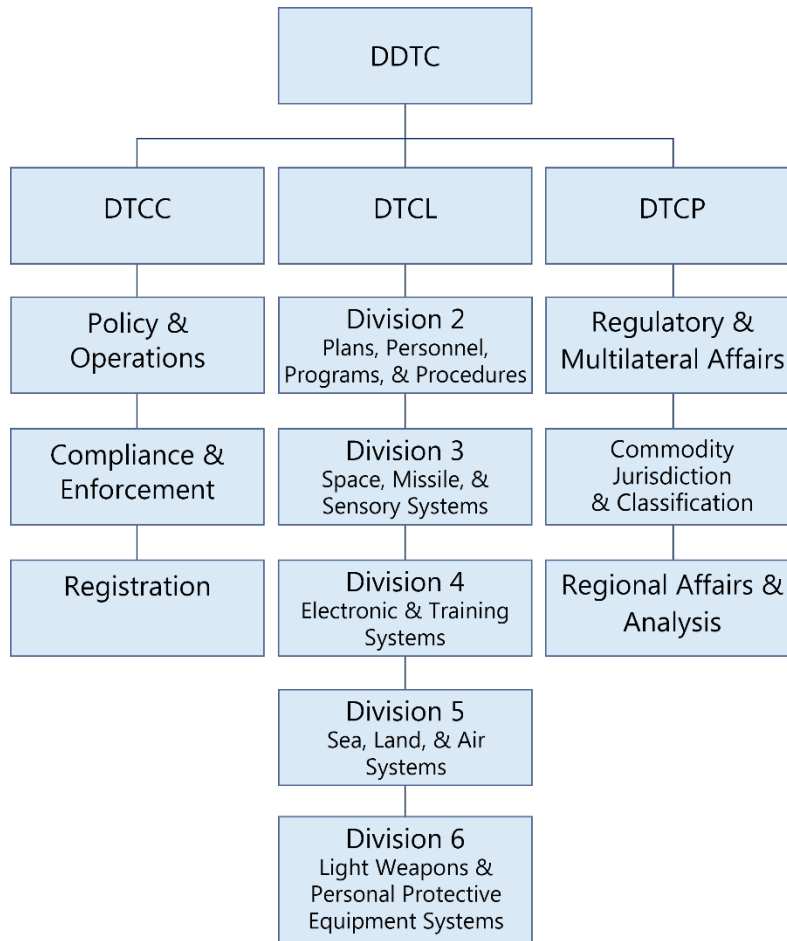
¹³ (U) 22 C.F.R. Part 129.1 and 129.2(b).

¹⁴ (U) 22 C.F.R. Part 126.9(a).

¹⁵ (U) The Blue Lantern Program includes pre-license, post-license (pre-shipment), and post-shipment checks to verify the legitimacy of transactions and provide reasonable assurance that (1) the recipient is complying with the requirements imposed by the U.S. Government with respect to use, transfers, and security of defense articles and services and (2) articles and services are being used for the purposes for which they are provided. Generally, checks are conducted by Foreign Service personnel at embassies or consulates.

¹⁶ (U) DDTTC also has management staff that includes the Information Technology team.

(U) Figure 1: DDTC Offices



(U) Source: OIG-generated.

(U) License Application Process

(U) To export¹⁷ defense articles or furnish defense services, a U.S. manufacturer or exporter must first be registered¹⁸ with DDTC. Once registered, the manufacturer or exporter can submit an application via the DTrade2¹⁹ system. DTrade2 determines which DTCL Division will receive the application on the basis of the commodities listed in the application. The application is then

¹⁷ (U) This audit focused on permanent export license applications.

¹⁸ (U) Registration entails paying a fee and submitting a DS-2032 Statement of Registration and supporting documentation, such as documents issued or endorsed by a Government authority enabling the registrant to engage in business in the United States or in a foreign country.

¹⁹ (U) DTrade2 is the intake and exit point for most applications. When an applicant submits an application through DTrade2, the system verifies that the applicant's registration is current.

transferred to USXPORTS,²⁰ a Defense Technology Security Administration system, in which a DTCL Division Chief assigns the application to a Licensing Officer for adjudication.

(U) According to DTCL's standard operating procedures (SOP), the license application review process generally entails a review of supporting documentation, including the purchase order or letter of intent, and of the end-use and end-user of the export. In some cases, DTCL will refer an application to other Department bureaus and offices for comment and recommendations to ensure all equities (e.g., foreign policy, regional security, and human rights) are addressed. Within the Department, DTCL refers applications to the Bureau of Political-Military Affairs, Office of Regional Security and Arms Transfers (RSAT); the Bureau of Democracy, Human Rights, and Labor (DRL); and the regional bureaus. Some applications must also be "certified" to Congress. The Arms Export Control Act requires such certifications²¹ before granting an export license involving: (a) major defense equipment²² sold under a contract in the amount of \$14 million or more, or for defense articles and services sold under a contract in the amount of \$50 million or more to Australia, Japan, New Zealand, South Korea, or any country that is not a member country of the North Atlantic Treaty Organization; (b) major defense equipment sold under a contract in the amount of \$25 million or more, or for defense articles and services sold under a contract in the amount of \$100 million or more to a North Atlantic Treaty Organization member country, Australia, Japan, New Zealand, or South Korea and provided the transfer does not include any other countries; or (c) firearms controlled under Category I of the USML in the amount of \$1 million or more. If Congress does not respond after a certain number of days (the length varies depending on the country in question), DTCL can continue adjudicating the license.

(U) Ultimately, DTCL adjudicates the application and provides the final U.S. Government position, which is essentially a foreign policy decision, for each license. A license can be approved, approved with provisos (i.e., subject to specific conditions), returned without action²³ (i.e., a denial without prejudice), or denied. Figure 2 details the license application review process.

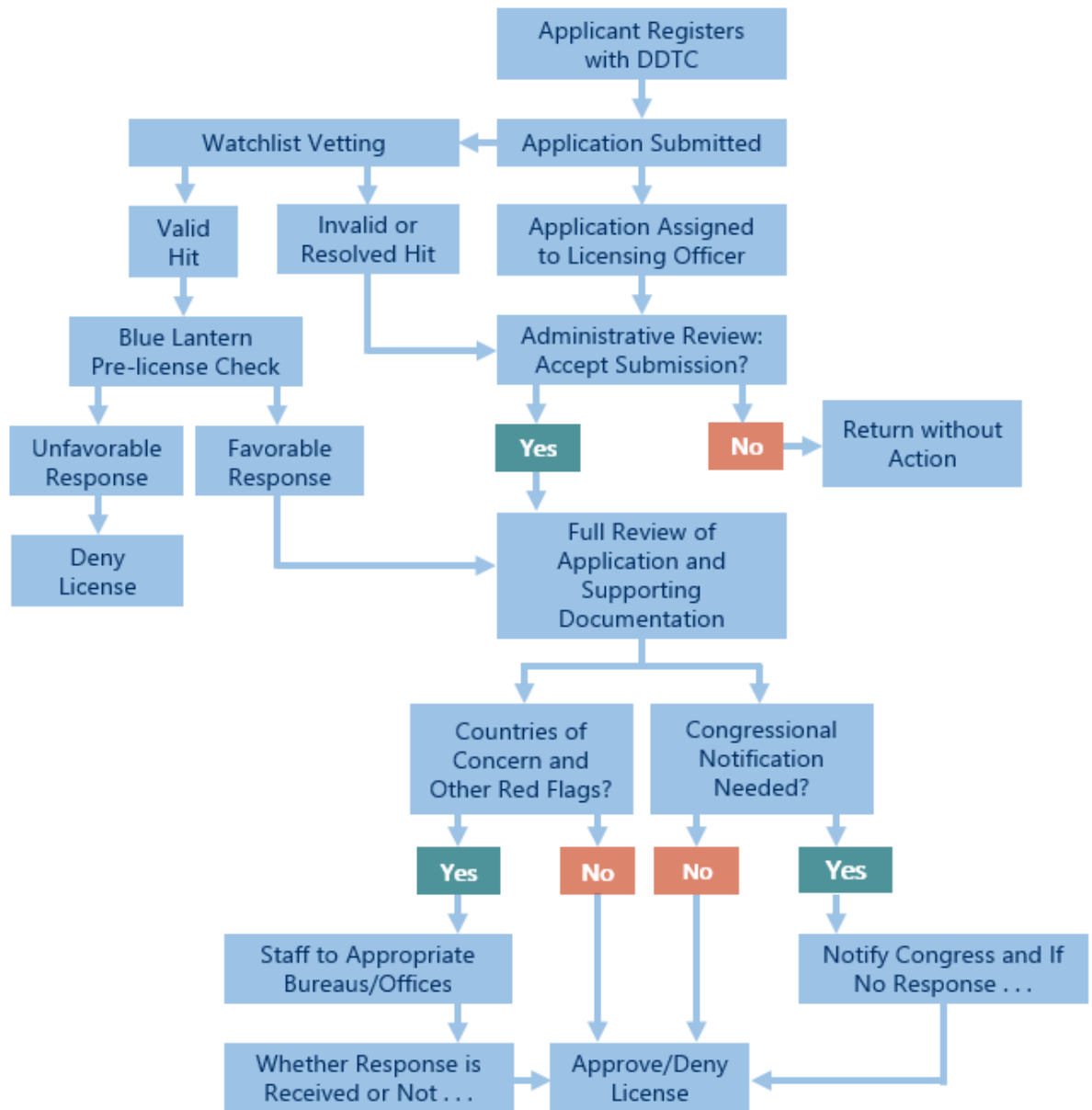
²⁰ (U) USXPORTS is a congressionally mandated IT system, which automates the license application process. Its users consist of the Departments of State, Commerce, and Defense.

²¹ (U) The certification letter includes all U.S. and foreign licensees, non-signatory end-user countries, total value, scope, and end-user of the proposed export.

²² (U) Major defense equipment is any item of significant military equipment (e.g., defense articles for which special export controls are warranted because of the capacity of such articles for substantial military utility or capability) on the USML. These items have nonrecurring research and development cost greater than \$50 million or a total production cost of more than \$200 million.

²³ (U) Applications are usually returned without action because required information or documentation is missing.

(U) Figure 2: DDTC License Application Review Process



(U) Source: OIG-generated from DDTC's policies and procedures.

(U) Internal Controls

(U) The U.S. Government Accountability Office (GAO) publication *Standards for Internal Control in the Federal Government* (the Green Book)²⁴ defines internal control as a process used by management that provides reasonable assurance that the objectives of an entity will be achieved. According to the Green Book, "an effective internal control system increases the likelihood that an entity will achieve its objectives. However, no matter how well designed, implemented, or operated, an internal control system cannot provide absolute assurance that all

²⁴ (U) GAO, *Standards for Internal Control in the Federal Government* (GAO-14-704G, September 2014).

of an organization's objectives will be met Therefore, once in place, effective internal control provides reasonable, not absolute, assurance that an organization will achieve its objectives."

(U) Federal law requires Executive Branch entities to establish internal controls in accordance with the Green Book.²⁵ The five components of internal control contain required principles that are necessary to establish an effective internal control system:

- (U) The control environment component includes, among others, the principle that management should evaluate performance and hold individuals accountable for their internal control responsibilities.
- (U) The risk assessment component includes, among others, the principle that management should identify, analyze, and respond to risks related to achieving objectives.
- (U) The control activities component includes, among others, the principle that management should implement control activities, such as segregation of duties, through policies.
- (U) The information and communication component includes, among others, the principle that management should use quality information to achieve the entity's objectives.
- (U) The monitoring component includes, among others, the principle that management should monitor the internal control system and evaluate the results.

(U) The scope of this audit included internal control components and principles that fit within the context of the permanent export license application review process and the end-use vetting of exports.

~~(SBU)~~ (b) (7)(F) Export License

(SBU) OIG conducted this audit in response to a request from DDTC. DDTC asked OIG to review its license application review process after a Licensing Officer improperly issued a license to (b) (7)(F) an American manufacturer of semi-automatic weapon systems. (b) (7)(F) applied for a permanent export license on July 25, 2017. The stated purpose of the (b) (7)(F) license was to supply the Philippines Bureau of Customs with rifles, ammunition, and cleaning and maintenance kits for "military use." OIG included the (b) (7)(F) application in its review of 21 permanent export license applications. See Appendix A for details related to OIG's findings regarding this particular application.

²⁵ (U) Section 3512 (c) and (d) of Title 31 of the United States Code (commonly known as the Federal Managers' Financial Integrity Act).

(U) AUDIT RESULTS

(U) Finding A: DDTC Did Not Always Ensure Permanent Export License Applications Included All Required Information

(U) OIG found that DDTC did not implement sufficient internal controls to ensure that permanent export license applications included all required information as set forth in its SOPs. Specifically, Licensing Officers approved 20 of the 21 applications (95 percent) reviewed despite lacking required information, including 5 applications that should have been returned to the applicant without action. OIG also found that DDTC did not always provide Congress with certifications when required. In addition, OIG found one instance in which the Licensing Officer did not have the authority to issue the license. These deficiencies occurred for two primary reasons: (1) DDTC permitted deviations from its SOPs and (2) DDTC has not trained Licensing Officers on updated procedures. Until these deficiencies are corrected, DDTC will have limited assurance that licenses issued meet U.S. national security and foreign policy objectives.

(U) Licensing Officers Approved Applications That Lacked Required Information

(U) DTCL management established control activities through SOPs to help ensure license applicants provide complete and accurate information.²⁶ According to DTCL's SOPs, Licensing Officers must verify, among other requirements, that applications contain the following information:

- (U) Physical street addresses (post office boxes, without an explanation, are not acceptable).
- (U) Only one permissible country²⁷ as the ultimate destination of the permanent export.²⁸
- (U) The seller of the permanent export is a U.S. entity.
- (U) The specific purpose of the permanent export.
- (U) Supporting documentation, such as a purchase order or import authorization.
- (U) Commodities, quantity, and values that are consistent with supporting documentation.

(U) OIG reviewed 21 permanent export license applications that were approved by DTCL. OIG found that Licensing Officers approved 20 of the 21 applications (95 percent) reviewed even though they lacked all required information as set forth in DTCL's SOPs. Specifically, OIG found that, of the 21 applications reviewed:

²⁶ (U) As noted, the Green Book explains that internal control principles require management to implement control activities through policies.

²⁷ (U) This only applies to licenses for hardware, not technical data.

²⁸ (U) The prohibited countries are Afghanistan, Belarus, Burma, Central African Republic, China, Cuba, Cyprus, Democratic Republic of Congo, Eritrea, Haiti, Iran, Iraq, Lebanon, Libya, North Korea, Somalia, Sudan, Syria, Venezuela, and Zimbabwe, 22 C.F.R. 126.1.

- (U) 7 (33 percent) included a post office box or an imprecise address rather than a physical street address. Moreover, four of seven (19 percent) included a post office box without explanation. Lack of an explanation should have prompted the applications to be returned to the applicant without action.
- (U) 2 (10 percent) had a total value that exceeded one of the supporting documents. This should have prompted the applications to be returned to the applicant without action.
- (U) 2 (10 percent) did not include a specific purpose for the permanent export.
- (U) 13 (62 percent) did not include elements,²⁹ such as end-use, that are required in the purchase order.
- (U) 8 (38 percent) had quantities, articles, or values listed on the DSP-83 Form³⁰ that were not consistent with the items listed in the application and purchase order.
- (U) 3 (14 percent) did not include the make or model of significant military equipment parts.
- (U) 2 (10 percent) had supporting documentation that was not addressed to the U.S. applicant.³¹

(U) DTCL management explained that some of the exceptions noted by OIG reflected the fact that various considerations require Licensing Officers to analyze and review applications on a case-by-case basis rather than use a standard approach. For example, according to DTCL management, in previous years, purchase orders had to be addressed to the export license applicant but, in practice, companies now use different methods to generate electronic purchase orders. Additionally, DTCL management explained that a purchase order no longer needs to include all the information required in its SOP; for example, the applicant is now permitted to provide the end-user and end-use on other supporting documents. As these two examples illustrate, the current SOPs do not reflect current needs and practices of DTCL. DTCL management also stated that, in some instances in which inconsistencies were present, such as when the DSP-83 Form was inconsistent with the application and the purchase order, the Licensing Officer should obtain clarification from the applicant and add notations to the application record. OIG found no clarifications or notations for the eight applications that had quantities, articles, and values listed on the DSP-83 Form that were inconsistent with the items listed in the application and purchase order.

(U) OIG concludes that the underlying cause of the control deficiencies identified are twofold: (1) DTCL permitted deviations from its SOPs but did not update the SOPs to reflect those practices and (2) DTCL has not trained Licensing Officers on updated procedures. For example, Licensing Officers told OIG that Division Chiefs often provide procedural updates verbally or via email.

²⁹ (U) Purchase orders for firearms applications should be from the foreign party identified as the ultimate foreign end-user on the application; addressed to the applicant; signed by that foreign party; and specify the type of firearm, caliber, quantity, dollar value, make/model, end-use, and end-user.

³⁰ (U) A DSP-83 Form is required for all applications requesting the export of significant military equipment.

³¹ (U) The 21 applications reviewed complied with the requirements for (a) having only 1 country as ultimate destination, (b) the seller being a U.S. entity, (c) supporting documentation being included with the application, and (d) applications not including countries listed in 22 C.F.R. 126.1.

However, DTCL management, in turn, did not update its SOPs. As a result, some Licensing Officers have created their own SOPs and checklists, leading to differences in the processing by Licensing Officers.

(U) In addition, Licensing Officers stated that DTCL previously had a Training Division led by a Chief. DTCL management explained that, because of staffing reductions, the training staff and Chief were reassigned to review applications.³² Accordingly, a staffed Training Division no longer exists. In addition, DTCL management stated that, as of July 2018, DTCL had a 28-percent reduction in staffing, and Licensing Officers told OIG that it was difficult to keep up with their workload. The acting Assistant Secretary for the Bureau of Political-Military Affairs also stated that she believes the vacancy rate has affected both the quantity and quality of the application review by Licensing Officers.

(U) To improve DTCL's capacity to review permanent export license applications and ensure all required information is included, DTCL must implement internal controls and obtain appropriate resources for its operations. Until such actions are completed, DDTC will have limited assurance that licenses issued meet U.S. national security and foreign policy objectives.

Recommendation 1: (U) OIG recommends that the Office of Defense Trade Controls Licensing update its license application review standard operating procedures to provide uniform guidance to Licensing Officers for their review of export license applications.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will update SOPs to provide uniform guidance to Licensing Officers for their review of export license applications.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has updated its license application review SOPs to provide uniform guidance to Licensing Officers.

Recommendation 2: (U) OIG recommends that, once its license application review standard operating procedures have been updated (Recommendation 1), the Office of Defense Trade Controls Licensing (a) train all Licensing Officers in the new procedures and (b) develop and implement an annual refresher training program for its Licensing Officers on the procedures.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will train all Licensing Officers on the new procedures as the SOPs are updated and as policies change.

³² (U) According to the Green Book, one of the principles of internal control is that management should demonstrate a commitment to develop "competent individuals." Management should enable individuals to develop competencies appropriate for key roles and tailor training based on the needs of the roles.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has (a) trained all Licensing Officers in the new procedures and (b) developed and implemented an annual refresher training program for its Licensing Officers.

Recommendation 3: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to annually review and update its license application review standard operating procedures.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will develop and implement a process to review and update its license application review SOPs on an annual basis.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented a process to annually review and update its license application review SOPs.

Recommendation 4: (U) OIG recommends that the Office of Defense Trade Controls Licensing (a) determine the capacity of its Licensing Officers to meet the license application workload, (b) establish the appropriate Licensing Officer staffing level needed to meet that workload, and (c) develop and implement an action plan to attain the established Licensing Officer staffing level and related resources needed to be successful.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will continue to examine the capacity of its Licensing Officers to ensure they are able to meet the license application workload and work with Human Resources and the Office of the Director General to establish requirements and obtain appropriate resources for its operations.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has (a) determined the capacity of its Licensing Officers to meet the license application workload, (b) established the appropriate Licensing Officer staffing level needed to meet that workload, and (c) developed and implemented an action plan to attain the established Licensing Officer staffing level and related resources needed to be successful.

(U) DDTC Did Not Always Provide Congress With Certifications

~~(SBU)~~ As described in the Background section, license applications that meet certain thresholds must be certified to Congress. These certifications are intended to ensure that proposed licenses meet the national security interests and foreign policy objectives of the United States. Licensing Officers told OIG that they have not complied with this requirement in the past for a variety of reasons. For example, Licensing Officers stated that they did not know that a particular commodity was considered major defense equipment. In addition, the Licensing Officer who adjudicated the (b) (7)(F) application stated that he did not fulfill the congressional certification requirement because his computer screen “dropped” the last zero in (b) (7)(F). According to the officer, this meant that the total license value appeared as (b) (7)(F) and he read the total value of the firearms in the application as less than (b) (7)(F) rather than (b) (7)(F).³³ Because the threshold for congressional certification is (b) (7)(F) or more for the type of firearms in the application, this error meant that he did not prepare the necessary certification.

~~(SBU)~~ After DTCL management realized that the (b) (7)(F) application had not been congressionally certified, DTCL management provided greater oversight for any application for firearms more than \$1 million. First, it implemented a “second signature” process for all applications assigned to the division in question (Division 6 – Light Weapons and Personal Protective Equipment Systems).³⁴ DTCL management stated that congressional certifications, especially for firearms, are complicated, particularly when applications include multiple USML categories and subcategories. DTCL management also assigned a Licensing Officer to identify³⁵ other licenses that were issued that might have met the congressional certification threshold but were nonetheless not certified. As part of this review, DTCL identified 17 licenses that should have been certified to Congress but were not. As of July 2018, only two of the licenses had not expired or had remaining shipments. DTCL suspended these licenses and planned to notify Congress. OIG believes that the second signature approach is beneficial and should be applied more generally throughout DTCL.

Recommendation 5: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a “second signature” process for licenses in all Divisions to segregate duties and reduce the risk of errors.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it has implemented a second level review process for license applications.

³³ (U) Neither the OIG nor the Licensing Officer could replicate the “dropped zero.”

³⁴ (U) According to the Green Book, internal control principles dictate that management should implement control activities, such as continuous supervision and segregation of duties, to reduce the risk of error.

³⁵ (U) DDTC searched for license applications that had been approved or approved with provisos from November 2013 through November 2017. The search targeted applications for USML Category I firearms totaling more than \$1 million, major defense equipment totaling more than \$14 million, and all defense articles totaling more than \$50 million.

(U) **OIG Reply:** On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and actions taken, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented a second level review process for license applications.

(U) Licensing Officers Did Not Have the Authority To Issue Licenses

(U) DTCL management grants Licensing Officers specific “signature authorities” on the basis of their experience; as they become more experienced, this authority is increased.³⁶ Some Licensing Officers can issue licenses of unlimited value, and others have specific dollar limits.³⁷

~~(SBU)~~ OIG found that 1 of the 21 (5 percent) applications reviewed was approved by a Licensing Officer who did not have the authority to issue the license. In this instance, the value of the (b) (7)(F) application was greater than \$1 billion. Nonetheless, a Licensing Officer assigned the application to another Licensing Officer with a signature authority limit of \$50 million. The Licensing Officer who made the assignment stated that he did so because the Division Chief had instructed him verbally that all applications for the Philippines—as was the case here—should be assigned to one particular Licensing Officer. The assigning officer stated that he did not know the limitations of the other Licensing Officer’s signature authority.

(U) Furthermore, for 6 of the 21 applications (29 percent) reviewed, OIG could not determine whether the Licensing Officer was authorized to issue the licenses because that person had retired and no one could provide the respective Letter of Authority to OIG. Another Licensing Officer who was still employed was unable to provide a Letter of Authority to OIG. These deficiencies occurred because DTCL does not maintain a central repository of Letters of Authority. If license applications are not assigned to Licensing Officers who are authorized to issue that type of license, license applications may be assigned to personnel without the appropriate experience to fully evaluate the merits of the export license application.

Recommendation 6: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to assign Licensing Officers license applications that correspond with their levels of authority.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will develop and implement a process to assign Licensing Officers license applications that correspond with their levels of authority.

³⁶ (U) According to the Green Book, a common control activity is ensuring that “transactions are authorized and executed only by persons acting within the scope of their authority”; furthermore, management should clearly communicate authorizations to personnel.

³⁷ (U) Other variations include the authority to approve applications for classified transactions, technical assistance agreements, manufacturing license agreements, and warehouse distribution agreements without a Division Chief reviewing their adjudication, although others are not authorized to issue these licenses or agreements until a Division Chief reviews them.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented a process to assign Licensing Officers license applications that correspond with their levels of authority.

Recommendation 7: (U) OIG recommends that the Office of Defense Trade Controls Licensing establish a central repository to document Licensing Officers' signature authority.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will establish a central repository to document Licensing Officers' signature authority.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has established a central repository to document Licensing Officers' signature authority.

(U) Finding B: DDTC Did Not Always Engage Department Bureaus and Offices as Required

(U) OIG found that DDTC did not implement sufficient internal controls to ensure that other bureaus and offices involved in the license application review process were effectually engaged. Specifically, OIG found 1 of the 21 (5 percent) applications reviewed did not engage other Department bureaus and offices to obtain their positions on the proposed transaction, as required. However, during audit fieldwork, OIG learned of other instances in which Licensing Officers deviated from Department guidance in this way. These deficiencies occurred, in part, because the referral guidance provided by other bureaus and offices is often outdated. Furthermore, updates to the guidance are generally conveyed informally, either verbally or via email. When Licensing Officers fail to engage Department bureaus and offices, Department officials who are most familiar with foreign policy issues specific to the countries or commodities to be exported cannot provide information relevant to the licensing decision.

(U) Licensing Officers Did Not Refer Applications, as Required

~~(SBU)~~ During the license application review process, the Licensing Officer determines whether an application should be referred to other Department bureaus and offices on the basis of guidance provided by the bureaus and offices. (b) (5)

(b) (5)

(b) (5)

Licensing Officers are to use this guidance to determine whether an application should be referred; when this occurs, the

bureaus or offices review the application (specifically, the commodity value, purpose, quantity, and whether application affects bilateral relationships) and provide a position (i.e., approve, approve with provisos, or deny) on the basis of current foreign policy objectives.

~~(SBU)~~ OIG found 1 of the 21 (5 percent) applications reviewed³⁸ was not referred to another Department bureau, as required. The single exception occurred because the Licensing Officer mistook the country on the application for another country that did not require referral. However, during audit fieldwork OIG learned of other instances in which Licensing Officers did not refer applications. For example, OIG was present³⁹ at regional working group meetings³⁹ in which Department representatives discovered that two applications⁴⁰ should have been referred but were not. In one instance, the Licensing Officer did not refer an application, as required, to both the Bureau of European and Eurasian Affairs and DRL because of human error. (b) (5)

(b) (5)

(b) (5)

■ OIG also
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that the end-use and end-users involved did not present a risk. Even acknowledging that these officers may have extensive experience, without engaging the Department bureaus, offices, and officials who are most familiar with foreign policy issues specific to the countries or commodities to be exported, valuable input may be lost.

(U) In addition, Licensing Officers stated that the referral guidance provided by bureaus and RSAT is outdated. Even when they provide updates, it is done verbally or via email. For example, two applications were referred although it was not required. In one instance, the Licensing Officer stated that he referred the application because he received written instructions from the Division Chief to make the referral. In the other instance, the Licensing Officer referred an application to RSAT on the basis of written draft guidance that had not been finalized by RSAT. A lack of standardized guidance that is provided to all DTCL Divisions results in inconsistencies because not all Licensing Officers have access to the same updates. If this internal control issue is not evaluated⁴¹ and addressed, DTCL may continue to exclude positions from other Department bureaus and offices and risk that DTCL will approve applications that do not support U.S. national security and foreign policy objectives.

Recommendation 8: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement controls for license applications that are referred to other Department bureaus and offices, as required.

³⁸ (U) Of the 21 applications reviewed for this audit, 20 required a referral.

³⁹ (U) DTCL leads six regional working groups (one per regional bureau) that meet on a biweekly basis. These meetings are designed to target applications with an open status due to non-response or non-consensus.

⁴⁰ (U) These were applications outside the 21 applications reviewed by OIG.

⁴¹ (U) Per the Green Book, internal control principles dictate that management evaluate internal control issues and determine appropriate corrective actions for internal control deficiencies on a timely basis.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will develop and implement controls for license applications that are referred to other Department bureaus and offices.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented controls for license applications that are referred to other Department bureaus and offices.

Recommendation 9: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to document, keep current, and communicate referral guidance to all Licensing Officers.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it will develop and implement a process to document, keep current, and communicate referral guidance to all Licensing Officers.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented a process to document, keep current, and communicate referral guidance to all Licensing Officers.

(U) Finding C: DDTC Did Not Always Ensure End-Use and End-Users of Exports Were Appropriately Vetted

(U) OIG found that DDTC did not implement sufficient internal controls to ensure that the end-use and end-user of exports were appropriately vetted. Although the end-use and end-user of exports associated with the applicable applications in OIG's audit sample were appropriately vetted during audit fieldwork, OIG observed that one Blue Lantern check was not conducted in accordance with guidance. Furthermore, delays in completing the vetting were lengthy. This occurred, in part, because the Department does not have a standard training program for the overseas Foreign Service Officers who conduct the checks or track staff rotations at posts. Without proper vetting, DDTC could fail to safeguard the integrity and security of defense articles.

(U) Six Applications in OIG's Audit Sample Were Appropriately Vetted

(U) According to DDTC's Blue Lantern Guidebook, pre-license checks can entail visiting end-users and asking questions. Checks are intended to verify the legitimacy of transactions and to provide reasonable assurance that recipients comply with requirements imposed by the U.S. Government with respect to use, transfers, and security of defense articles. Pre-license checks are time-sensitive, and results are requested within 30 days. Of the 21 applications reviewed for this audit, 6 were required to undergo a Blue Lantern pre-license check. OIG found that all six

applications (100 percent) were appropriately vetted through the Blue Lantern Program. In addition, OIG found that three of the six checks (50 percent) were conducted within 30 days and one was completed within 33 days. For the remaining two checks, which were in the same country, one was completed in 151 days and the other was completed in 206 days. The extended delays for these two checks were due to lack of responsiveness from the host government. OIG does not consider these exceptions because, during these delays, DTCP maintained communication with post officials. Furthermore, all six pre-license checks resulted in favorable findings related to the end-use and end-users of the proposed exports.

(U) One Application Was Not Appropriately Vetted

~~(SBU)~~ In addition to the 21 applications reviewed for this audit, OIG observed Blue Lantern checks in (b) (7)(F) and (b) (7)(F). Through inquiries with foreign companies and governments, and by conducting site visits, Blue Lantern checks allow U.S. embassy personnel to verify that end-users are responsible recipients of controlled technologies and services. Specifically, in (b) (7)(F) OIG observed a Blue Lantern check related to one application for rifle parts and approved export licenses for the end-use of rifles and assorted parts. In (b) (7)(F) OIG observed a Blue Lantern check for one application for firearms and ammunition parts, three approved licenses for the end-use of pistols and assorted parts, and one warehouse distribution agreement for firearms and assorted parts.⁴²

~~(SBU)~~ OIG found that the Mission (b) (7)(F) Blue Lantern Officer conducted the check in accordance with DDTC guidance. However, the Mission (b) (7)(F) Blue Lantern Officer did not inform the firearms dealer that (a) Blue Lantern checks are mandated by the Arms Export Control Act and are designed to protect the security and integrity of the defense trade relationship in the mutual interest of the United States and its defense trade partners, (b) unauthorized re-export or retransfer of U.S.-origin defense articles is prohibited by the Department pursuant to Section 123.9 of the International Traffic in Arms Regulations, and (c) U.S. origin defense articles may be subject to future end-use inquiries by the Department. When asked why she did not include these elements, the Blue Lantern Officer stated that she was not aware of these requirements. DTCP management stated that they will work directly with the Blue Lantern Officer to correct the deficiencies identified and provide necessary education to ensure Blue Lantern checks are conducted in accordance with published procedures. It is important for Blue Lantern officers to understand requirements to ensure the checks they conduct provide reasonable assurance that the recipient of the U.S.-origin defense articles and services will comply with U.S. Government requirements with respect to use, transfer, and security of such articles and services and that such articles and services are being used for their intended purpose.

⁴² (U) A warehouse distribution agreement is an agreement to establish a warehouse or distribution point abroad for defense articles exported from the United States for subsequent distribution to entities in an approved sales territory.

(U) Delays in Completing Blue Lantern Checks Have Been Lengthy

~~(SBU)~~ Although pre-license checks are requested within 30 days and post-shipment checks are within 45 days, both locations that OIG visited experienced lengthy delays. In (b) (7)(F) because of staff transitions at post, Blue Lantern duties were not passed down from the departing to the arriving Foreign Service Officer and two Blue Lantern checks were more than 300 and 600 days past due, respectively. For the check that was more than 300 days overdue, DTCP sent a reminder cable 6 months after the original request.⁴³ For the check that was more than 600 days overdue, DTCP did not send a reminder cable until almost a year after the original request. At the time of OIG's audit fieldwork in June 2018, the Blue Lantern Officer had completed the Blue Lantern check that was more than 300 days past due but could not complete the check that was more than 600 days past due because the Foreign Service Officer with contacts at the relevant host-government entity had departed post and reestablishing host-government contacts was difficult. In (b) (7)(F) seven overdue Mission (b) (7)(F) Blue Lantern checks ranged from 77 to 343 days late. The Blue Lantern Officer stated that delays were due to Mission (b) (7)(F) lack of a Blue Lantern Officer for at least 3 months and delayed responses from the (b) (7)(F) Government, which typically took 2 months to answer. The Blue Lantern Officer stated that, at the time of her arrival in (b) (7)(F) some Blue Lantern checks were already 6 months old because of these factors. Lengthy delays in completing pre-license checks can be costly to U.S. exporters and foreign end-users and ultimately affect U.S. competitiveness in the delivery of these commodities.

~~(SBU)~~ In addition, OIG found that in both Mission (b) (7)(F) and Mission (b) (7)(F) the Blue Lantern Officers had never served in this capacity and had received the assignment on an ad hoc duty after arriving at post. They had not received any training on the Blue Lantern Program before that time. DTCP management stated to OIG that, overall, such lack of training was a concern. According to DTCP management, assigning Foreign Service Officers to the Blue Lantern Program before they depart for a post would allow them to include DTCP in their consultations in Washington, DC, and thereby obtain additional information on the program. DTCP management stated that it is in the process of establishing a program to identify Blue Lantern Officers and provide them with training, through the Foreign Service Institute, while they are still in the United States. For officers who are already overseas, DTCP is developing a distance learning course.

Recommendation 10: (U) OIG recommends that the Office of Defense Trade Controls Policy (a) establish and maintain a database of all current Blue Lantern Officers, their expected arrival and departure dates from assigned posts, and the date when they received Blue

⁴³ (U) According to DTCP's internal policy, DTCP analysts should review all outstanding Blue Lantern inquiries on a continuous basis in order to identify overdue checks and contact posts to follow up. The analyst should document updates from post in the Blue Lantern database. If a post is not responsive, then the analyst should send follow-up cables or emails to post to request the status of the Blue Lantern check and the reason for the delay. OIG reviewed DTCP's Blue Lantern database and interviewed the DTCP analyst in charge of these overdue checks and found that the analyst was following up with post via cables and emails, as required.

Lantern Program training and (b) develop and implement a process to notify posts when a Blue Lantern Officer will be departing in order to begin the reassignment process.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it transmitted a cable to all diplomatic posts that included the updated Blue Lantern Guidebook and requested that posts provide the name, title, phone number, e-mail, and estimated departure date for the person responsible for oversight of the Blue Lantern program in-country no later than October 31, 2018.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has (a) established and maintained a database of all current Blue Lantern Officers, their expected arrival and departure dates from assigned posts, and the dates when they received Blue Lantern Program training and (b) developed and implemented a process to notify posts when a Blue Lantern Officer will be departing in order to begin the reassignment process.

Recommendation 11: (U) OIG recommends that the Office of Defense Trade Controls Policy develop and implement a training program for new Blue Lantern Officers.

(U) Management Response: The Bureau of Political-Military Affairs concurred with the recommendation, stating that it is exploring opportunities, such as online computer-based training and web-based seminars, to train Blue Lantern Officers who have not received training prior to arrival to their duty station.

(U) OIG Reply: On the basis of the Bureau of Political-Military Affairs concurrence with the recommendation and planned actions, OIG considers this recommendation resolved pending further action. This recommendation will be closed when OIG receives and accepts documentation demonstrating that the Bureau has developed and implemented a training program for new Blue Lantern Officers.

(U) RECOMMENDATIONS

Recommendation 1: (U) OIG recommends that the Office of Defense Trade Controls Licensing update its license application review standard operating procedures to provide uniform guidance to Licensing Officers for their review of export license applications.

Recommendation 2: (U) OIG recommends that, once its license application review standard operating procedures have been updated (Recommendation 1), the Office of Defense Trade Controls Licensing (a) train all Licensing Officers in the new procedures and (b) develop and implement an annual refresher training program for its Licensing Officers on the procedures.

Recommendation 3: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to annually review and update its license application review standard operating procedures.

Recommendation 4: (U) OIG recommends that the Office of Defense Trade Controls Licensing a) determine the capacity of its Licensing Officers to meet the license application workload, b) establish the appropriate Licensing Officer staffing level needed to meet that workload, and c) develop and implement an action plan to attain the established Licensing Officer staffing level and related resources needed to be successful.

Recommendation 5: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a "second signature" process for licenses in all Divisions to segregate duties and reduce the risk of errors.

Recommendation 6: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to assign Licensing Officers license applications that correspond with their levels of authority.

Recommendation 7: (U) OIG recommends that the Office of Defense Trade Controls Licensing establish a central repository to document Licensing Officers' signature authority.

Recommendation 8: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement controls for license applications that are referred to other Department bureaus and offices, as required.

Recommendation 9: (U) OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to document, keep current, and communicate referral guidance to all Licensing Officers.

Recommendation 10: (U) OIG recommends that the Office of Defense Trade Controls Policy a) establish and maintain a database of all current Blue Lantern Officers, their expected arrival and departure dates from assigned posts, and the date when they received Blue Lantern Program training and b) develop and implement a process to notify posts when a Blue Lantern Officer will be departing in order to begin the reassignment process.

Recommendation 11: (U) OIG recommends that the Office of Defense Trade Controls Policy develop and implement a training program for new Blue Lantern Officers.

~~(SBU)~~ APPENDIX A: (b) (7)(F) EXPORT LICENSE

~~(SBU)~~ (b) (7)(F) an American manufacturer of semi-automatic weapon systems, applied for a permanent license on July 25, 2017.¹ The purpose of the (b) (7)(F) license was to supply the Philippines Bureau of Customs with the following commodities for "military use":

- (U) 400,000 FDR-15 sporting rifles.
- (U) 2,000,000 30-round magazines for the FDR-15 sporting rifles.
- (U) 454,400,000 rounds of XM193 Ball ammunition.
- (U) 131,600,000 rounds of M855 Green Tip ammunition.
- (U) 426,448 cleaning and maintenance kits.

(U) A Licensing Officer reviewed the application and supporting documentation on July 26, 2017, and found that it met all requirements. The Licensing Officer also determined that the application should be referred to the Bureau of Democracy, Human Rights, and Labor; the Bureau of Political-Military Affairs, Office of Regional Security and Arms Transfers; and the Bureau of East Asian and Pacific Affairs. By August 21, 2017, the bureaus and office had entered their positions—the Bureau of Democracy, Human Rights, and Labor deferred to the Bureau of East Asian and Pacific Affairs and the Office of Regional Security and Arms Transfers. Both approved the transaction because current foreign policy did not restrict the commodities from going to the Philippines Bureau of Customs. On August 23, 2017, the Licensing Officer issued the license. The standard operating procedures in effect at the time the application was reviewed did not require a second signature for approval.

~~(SBU)~~ In October 2017, Embassy Manila personnel contacted the Bureau of Political-Military Affairs, Directorate of Defense Trade Controls (DDTC), because (b) (7)(F) could not reach the transaction's intermediary and was seeking assistance from embassy personnel. DDTC learned that the transaction's intermediary and a company in Florida that was a party to the application had "disappeared" and that a Philippines Bureau of Customs officer involved in the transaction had been terminated. Finally, DDTC realized that, because the application included firearms under United States Munitions List Category I valued at (b) (7)(F) it required congressional certification, but Congress had not, in fact, been notified before the license was issued. On November 7, 2017, DDTC revoked the license and the DDTC Deputy Assistant Secretary requested the Office of Inspector General (OIG) to assess their license application review process.

~~(SBU)~~ The (b) (7)(F) application and supporting documentation and found that the application did not include all information required by standard operating procedures. Specifically, the purchase order did not state the end-use of the items, as required. Furthermore, a supporting document was not correctly signed by the foreign government. Instead, a Bureau of Customs representative signed under the foreign consignee and end-user lines but not the

¹ ~~(SBU)~~ This was the third application from (b) (7)(F) for the same license. Licensing Officers returned the first two applications without action because of errors.

foreign government line. The Licensing Officer stated that his management provided verbal guidance that, as long as the required information was provided somewhere in the application package, it was acceptable.

(SBU) Regarding congressional certification, the Licensing Officer who adjudicated the (b) (7)(F) application stated that he did not fulfill the congressional certification requirement because his computer screen "dropped" the last zero in (b) (7)(F). According to the officer, this meant that the total license value appeared as (b) (7)(F) and he read the total value of the firearms in the application as (b) (7)(F) rather than (b) (7)(F). Because the threshold for congressional certification is \$1 million or more for the type of firearms in the application, this error meant that he did not prepare the necessary certification.

(SBU) OIG also found that the Licensing Officer did not have the authority to issue the (b) (7)(F) license. The value of the (b) (7)(F) application was more than (b) (7)(F). Yet the Licensing Officer assigned the app to another Licensing Officer, who had a signature authority limit of \$50 million. The Licensing Officer who made the assignment stated that he did so because the Division Chief had instructed him verbally that all applications for the Philippines—as was the case here—should be assigned to one particular Licensing Officer. The assigning officer stated that he did not know the limitations of the other Licensing Officer's signature authority.

(U) APPENDIX B: PURPOSE, SCOPE, AND METHODOLOGY

(U) The Office of Inspector General (OIG) conducted this audit to determine whether the Directorate of Defense Trade Controls (DDTC) has implemented sufficient internal controls to ensure export license applicants have provided complete and accurate information, other Department of State (Department) bureaus and offices involved with the license application review process are effectually engaged, and the end-use and end-user of exports are appropriately vetted.

(SBU) The Office of Audits conducted this audit from December 2017 to August 2018. Audit work was performed in the Washington, DC, metropolitan area, at U.S. Consulate General (b) (7)(F) and U.S. Embassy (b) (7)(F). OIG conducted this performance audit in accordance with generally accepted government auditing standards. These standards require that OIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. OIG believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective.

(SBU) To obtain background information, including criteria, OIG researched and reviewed policies and standard operating procedures relating to permanent export license applications. To obtain an understanding of DDTC's permanent export license application review process, OIG met with DDTC officials; regional bureau officials;¹ Bureau of Democracy, Human Rights, and Labor, Office of Security and Human Rights, officials; Bureau of Political-Military Affairs, Office of Regional Security and Arms Transfers, officials; and Blue Lantern Officers and supporting staff at U.S. Consulate General (b) (7) and U.S. Embassy (b) (7)(F)

(U) To validate whether DDTC implemented sufficient internal controls to ensure permanent export license applicants had provided complete and accurate information, other Department bureaus and offices involved with the license application review process were effectually engaged, and the end-use and end-user of exports were appropriately vetted, OIG selected applicable internal control standards from the Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book) and compared these standards to the internal controls DDTC established for processing permanent export license applications. If DDTC did not have internal controls that aligned with the standards, auditors explained the deficiency in Finding A of this report. OIG then selected 21 permanent export license applications and compared them to each internal control DDTC established to determine if all internal controls were followed and if the internal controls were sufficient to provide reasonable assurance that DDTC's objectives would be achieved.

¹ (U) OIG met with officials from the Bureaus of African Affairs, East Asia and Pacific Affairs, European and Eurasian Affairs, Near Eastern Affairs, and South and Central Asian Affairs.

(U) Prior Reports

(U) The Office of Audits has not completed any audits related to DDTC in the past 5 years. However, the Office of Investigations concluded an investigation into allegations that a diplomat stationed in his nation's embassy in Washington, DC, evaded legal licensing requirements for the export of firearms because the Department does not limit the number of firearms exports by foreign diplomats.

(U) Work Related to Internal Controls

(U) OIG reviewed the U.S. Government Accountability Office publication *Standards for Internal Control in the Federal Government* to identify the components of internal control and required principles that fit within the context of the permanent export license application review process and the audit objectives. Table B.1 illustrates the components and principles of internal control evaluated in this audit.

(U) Table B.1: Selected Internal Control Components and Principles

Component	Principles
Risk Assessment	Management should identify, analyze, and respond to risks related to achieving objectives.
	Management should consider the potential for fraud when identifying, analyzing, and responding to risks.
Control Activities	Management should design control activities to achieve objectives and respond to risks.
	Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
Information and Communication	Management should implement control activities through policies.
	Management should use quality information to achieve the entity's objectives.
Monitoring	Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

(U) Source: OIG-generated from *Standards for Internal Control in the Federal Government* and OIG's audit objectives.

(U) OIG reviewed DDTC policies, procedures, and guidance to identify internal controls relevant to the audit. OIG developed audit steps to determine whether existing internal controls were implemented and whether internal controls were lacking. Additionally, OIG interviewed Department officials to determine any gaps in DDTC's implementation of internal controls. OIG's conclusions are presented in the Audit Results section of this report.

(U) Use of Computer-Processed Data

(U) OIG used computer-processed data from DTrade2 and USXPORTS. OIG found both systems to be sufficient and appropriate for the scope of the audit. To assess the validity of data from DTrade2 and USXPORTS, OIG obtained statements from the system managers regarding the data quality of both DTrade2 and USXPORTS. The Department's DTrade2 managers stated that DTrade2 consistently captures all data occurrences and all data elements and that controls exist to ensure that users enter data accurately. USXPORTS managers stated that USXPORTS also consistently captures all data occurrences and all data elements and that controls exist to ensure that users enter data accurately.

(U) OIG used DTrade2 to determine whether selected applications had been vetted through DDTC's watch list, prior to the Licensing Officer's adjudication. OIG used USXPORTS to confirm information regarding the selected applications. This included reviewing the referral case assignments to other Department bureaus and offices, their positions, and any comments they may have entered for each application.

(U) Detailed Sampling Methodology

~~(SBU)~~ The objective of the sampling process was to select a sample of permanent export license applications that were approved or approved with provisos for review. OIG selected applications using specified audit related criteria and non-statistical sampling. OIG obtained a universe of 29,649 permanent export license applications that were received by DDTC in FY 2017. From this universe, OIG focused on applications that were approved or approved with provisos, which resulted in an updated universe of 24,489 applications. OIG scoped down the universe using three risk variables: 1) "countries of concern,"² 2) significant military equipment, and 3) high dollar amount.³ Combining these three criteria resulted in 112 applications. The data were then stratified using three variables: 1) commodity, 2) watch list hits, and 3) referrals to other Department bureaus and offices. Twenty-eight applications were identified as high in all three variables. From these 28 applications, OIG selected the 6 applications with a Blue Lantern check. The remaining 22 applications, from which 14 were chosen using a block sampling⁴ design, did not have a Blue Lantern check. Table B.2 illustrates the target universe and methodology for these 20 applications. Additionally, OIG included the (b) (7)(F) application as part of the sample, resulting in 21 total applications reviewed.

² (U) OIG identified 134 "countries of concern" on the basis of a review of C.F.R. Part 126.1, DDTC's internal guidance, and referral guidance from other Department bureaus and offices.

³ (U) A dollar amount cutoff was developed by the OIG statistician when an application was considered "high" dollar with a total commodity amount greater than (b) (7)(F)

⁴ (U) Block sampling is a technique wherein the auditor applies audit tests to items that occur in the same block of sequence or time.

(U) Table B.2: Sample Selection

Methodology	Application Type	Total Applications in Target Universe	Total Applications Reviewed
100-percent selection	With Blue Lantern Check	6	6
Block Non-statistical Sampling Design	Without Blue Lantern Check	22	14
Total Applications		28	20

(U) Source: OIG-generated.

~~(SBU)~~ To validate whether DDTC implemented sufficient internal controls to ensure the end-use and end-user of exports were appropriately vetted during the license application review process, OIG coordinated with DDTC to select a sample of Blue Lantern checks. DDTC reviewed its database to identify Blue Lantern checks that had not been completed yet and provided OIG a list of possible site visits on the basis of whether the end-user was in a "country of concern," the commodity was significant military equipment, and the license had a high dollar value (i.e., for the purpose of selecting site visits, \$100,000 and greater). On the basis of the list, OIG conducted site visits to (b) (7)(F) and (b) (7)(F) in June and July 2018.⁵

⁵ (U) OIG also intended to observe Blue Lantern checks in the Philippines. However, Embassy Manila officials stated that, during the proposed OIG site visit dates, their primary and secondary Blue Lantern Officers were not available because of unexpected departures from post. Therefore, OIG canceled the site visit.

(U) APPENDIX C: BUREAU OF POLITICAL-MILITARY AFFAIRS RESPONSE



United States Department of State

Washington, D.C. 20520

~~SENSITIVE BUT UNCLASSIFIED~~

October 31, 2018

☐ Read by _____

INFORMATION MEMO FOR THE INSPECTOR GENERAL

FROM: PM – Marik String, Senior Bureau Official *MS*

SUBJECT: Response to OIG Inspection of PM/DDTC

BLUF: At PM's request, the OIG conducted an audit of the bureau's Directorate of Defense Trade Controls to examine export licensing processes, and PM concurs with all of OIG's recommendations.

Thank you for your review of the Directorate of Defense Trade Controls' (DDTC) responses. The Bureau of Political-Military Affairs (PM) believes that we have resolved three of the recommendations (No. 5, 10, and 11), and we have partially implemented one recommendation (No. 2b). We are currently updating and implementing actions on Recommendation Nos. 1, 2a, 3, 4, 6, 7, 8, and 9. Our responses to all the recommendations are below. The point of contact for any questions or follow up is Catherine Hamilton, Director of Licensing, 202-663-2839.

Recommendation 1: OIG recommends that the Office of Defense Trade Controls Licensing update its license application review standard operating procedures to provide uniform guidance to Licensing Officers for their review of export license applications.

Response: PM concurs with this recommendation. DDTC Licensing will review and update standard operating procedures to provide uniform guidance to Licensing Officers for their review of export license applications. (Action: DTCL)

Recommendation 2: OIG recommends that, once its license application review standard operating procedures have been updated (Recommendation 1), the Office of Defense Trade Controls Licensing (a) train all Licensing Officers on the new procedures and (b) develop and implement an annual refresher training program for its Licensing Officers on the procedures.

Response: PM concurs with this recommendation. DDTC Licensing will train all Licensing Officers on the new procedures as the standard operating procedures are updated and as policies change. Licensing developed a refresher training program to discuss licensing trends and best practices and held the first session at the end of September. (Action: DTCL)

Recommendation 3: OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to annually review and update its license application review standard operating procedures.

~~SENSITIVE BUT UNCLASSIFIED~~

SENSITIVE BUT UNCLASSIFIED

-2-

Response: PM concurs with this recommendation. DDTC Licensing will develop and implement a process to review and update its license application review standard operating procedures on an annual basis. (Action: DTCL)

Recommendation 4: OIG recommends that the Office of Defense Trade Controls Licensing (a) determine the capacity of its Licensing Officers to meet the license application workload, (b) establish the appropriate Licensing Officer staffing level needed to meet that workload, and (c) develop and implement an action plan to attain the established Licensing Officer staffing level and related resources needed to be successful.

Response: PM concurs with this recommendation. DDTC Licensing will continue to examine the capacity of its Licensing Officers to ensure they are able to meet the license application workload and work with Human Resources and the Office of the Director General to establish requirements and obtain appropriate resources for its operations. (Action: DTCL, in coordination with PM Front Office)

Recommendation 5: OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a “second signature” process for licenses in all Divisions to segregate duties and reduce the risk of errors.

Response: PM concurs with this recommendation. In September, DDTC Licensing implemented a standing process of second level review (SLR) for license applications. The SLR process mandates that a second individual, in addition to the processing licensing officer, review all license applications, with some highly supervised, limited exceptions. In executing the SLR, the reviewer follows a defined checklist to ensure a timely review while decreasing the likelihood of overlooking problematic issues. PM expects that the additional measures will increase the effectiveness and accuracy of State’s export licensing process.

Recommendation 6: OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to assign Licensing Officers license applications that correspond with their levels of authority.

Response: PM concurs with this recommendation. DDTC Licensing will develop and implement a process to assign Licensing Officers license applications that correspond with their levels of authority. Licensing is currently reviewing the signature progression authority and will ensure that supervisors assign cases according to those levels of authority. (Action: DTCL)

Recommendation 7: OIG recommends that the Office of Defense Trade Controls Licensing establish a central repository to document Licensing Officers’ signature authority.

Response: PM concurs with this recommendation. DDTC Licensing will establish a central repository to document Licensing Officer’s signature authority. The central repository will be maintained by the Director of Licensing, rather than at the Division Chief level, to ensure consistency in recordkeeping practices. (Action: DTCL)

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Recommendation 8: OIG recommends that the Office of Defense Trade Controls Licensing develop and implement controls for license applications that are referred to other Department bureaus and offices, as required.

Response: PM concurs with this recommendation. DDTC Licensing will develop and implement controls for license applications that are referred to other Department bureaus and offices. Licensing is currently reviewing the existing guidance and coordinating with the interagency on what licenses require staffing. The guidance will be maintained on a shared drive so that all personnel are able to access the files. (Action: DTCL, in coordination with Department bureaus and offices)

Recommendation 9: OIG recommends that the Office of Defense Trade Controls Licensing develop and implement a process to document, keep current, and communicate referral guidance to all Licensing Officers.

Response: PM concurs with this recommendation. DDTC Licensing will develop and implement a process to document, keep current, and communicate referral guidance to all Licensing Officers. (Action: DTCL)

Recommendation 10: OIG recommends that the Office of Defense Trade Controls Policy (a) establish and maintain a database of all current Blue Lantern Officers, their expected arrival and departure dates from assigned posts, and the date when they received Blue Lantern Program training and (b) develop and implement a process to notify posts when a Blue Lantern Officer will be departing in order to begin the reassignment process.

Response: PM concurs with this recommendation. DTCL On October 19, 2018, the Department transmitted an ALDAC cable, drafted by DDTC Policy, which included a copy of the updated Blue Lantern Guidebook. The ALDAC included the following text:

RAA intends to update this guidebook annually ... Additionally, we respectfully request all U.S. diplomatic posts provide us with the name, title, phone number, e-mail, and estimated departure date for the person responsible for oversight of the Blue Lantern program in-country no later than October 31, 2018.

This request for information will be included in the accompanying cable for each annual update of the guidebook. Additionally, we will use the data collected from this request to engage posts shortly before the scheduled transfer of their Blue Lantern Officers to obtain point of contact information for replacement officers. When received, the database will be updated with this new data. (Action: DTCL)

Recommendation 11: OIG recommends that the Office of Defense Trade Controls Policy develop and implement a training program for new Blue Lantern Officers.

Response: PM concurs with this recommendation. DDTC Policy actively supports all training programs for new Blue Lantern Officers held within the DC Metro Area. Additionally, when its analysts are in-country on temporary duty, we routinely seek out opportunities to provide initial,

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supplemental, and/or recurring training for Officers and support staff whose schedules can accommodate such training.

Because not all Blue Lantern Officers are designated as such prior to their arrival on station overseas, we are exploring additional opportunities for providing the requisite education. These include, but are not limited to, online computer-based training and web-based seminars. Additionally, when publishing its annual updates of its Blue Lantern Guidebook (and accompanying ALDAC cable to posts), DDTC encourages Blue Lantern Officers to contact DDTC Policy analysts with any questions or concerns they may have regarding new and existing program requirements. Further, the development of a database of Blue Lantern Officer information (discussed above) will greatly enhance our ability to monitor the status of all oncoming Officers. As part of this outreach to these individuals, the office's analysts will inquire as to the level of training received by each person. In cases where the training is deemed insufficient, the analyst will work with the officer to provide whatever data is necessary for them to reach and maintain the appropriate level of proficiency. (Action: DDTC Policy)

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Approved: PM: Marik String, SBO(MS)

Drafted: PM/DTCL – Angela Countee Brown, ext. 3-2477

Cleared:	PM/DDTC: MMiller	OK
	PM/DTCL: Chamilton	OK
	PM/DTCP: RKoelling	OK

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(U) ABBREVIATIONS

C.F.R.	Code of Federal Regulations
DDTC	Directorate of Defense Trade Controls
DRL	Bureau of Democracy, Human Rights, and Labor
DTCC	Office of Defense Trade Controls Compliance
DTCL	Office of Defense Trade Controls Licensing
GAO	Government Accountability Office
OIG	Office of Inspector General
RSAT	Office of Regional Security and Arms Transfers
SOP	standard operating procedures
USML	United States Munitions List

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