EXPORT CONTROLS

Processes for Determining Proper Control of Defense-Related Items Need Improvement
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September 20, 2002

The Honorable Christopher Shays
Chairman, Subcommittee on National Security,
    Veterans Affairs, and International Relations
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

The U.S. government controls the export of defense-related items to minimize the risk such exports may pose to its interests. The U.S. export control system is primarily divided between two regulatory regimes, one managed by the Department of State (State) for defense items’ and another managed by the Department of Commerce (Commerce) for dual-use items that have both military and commercial applications. Generally, State’s controls over defense items are more restrictive than Commerce’s controls over dual-use items. Companies are responsible for determining which department to use and what requirements apply when exporting their items, but when in doubt can obtain government assistance through two different processes. If companies have determined that their items are Commerce-controlled but are uncertain of export licensing requirements, they may request a classification from Commerce through the commodity classification process. Commerce can refer classification requests to State and the Department of Defense (Defense) to confirm that the items are Commerce-controlled. However, if companies are unsure of which department has jurisdiction over their items, they can request a determination through the commodity jurisdiction process from State, which consults with Commerce and Defense.

Determining which department has jurisdiction over an item and how that item is controlled is fundamental to the proper implementation of the bifurcated U.S. export control system. Yet over the years, the U.S. government has experienced interagency disagreements over proper jurisdiction for items, and companies have been uncertain about which department controls the export of their items. In response to your request, we assessed how government departments assist companies in

1 For the purposes of this report, “defense items” refers to defense articles and services as specified in the Arms Export Control Act.
determining the proper controls for defense-related items, specifically, (1) how Commerce implements the commodity classification process and (2) how State implements the commodity jurisdiction process.

In implementing the commodity classification process, Commerce has improperly classified some State-controlled items as Commerce-controlled and has not adhered to regulatory time frames for responding to requests. Improper classifications have occurred because Commerce rarely obtains input from State and Defense before making decisions. Only 40 out of over 12,000 classification requests were referred by Commerce to State and Defense during the 4-year period covered by our review, even though at least 250 nonreferred requests appear to meet Commerce’s referral criteria. Commerce officials told us the referral criteria are subjective and may not have been consistently applied. These officials stated they have sufficient experience to determine which items can be classified as Commerce-controlled without referring requests to State and Defense, which could delay the process. However, in several instances, Commerce improperly provided companies with classifications for State-controlled items, increasing the risk of such items being inappropriately exported. In some other instances, Commerce returned classification requests for State-controlled items to companies without notifying State, thereby limiting an opportunity for State to ensure that companies comply with statutory requirements. Commerce is also required by regulation to complete classification requests within 14 calendar days; however, Commerce took a median of 39 days to complete requests during our review period.

State has not adhered to established time frames when implementing the commodity jurisdiction process and has been unable to issue determinations for some items due to interagency disputes occurring outside the process. State exceeded the maximum 95 days established in guidance for 62 percent of the jurisdiction determinations made during our review period. Causes for delays included late input from Defense and Commerce, disagreements over the appropriate jurisdiction for an item, need for sufficient information to make determinations, and untimely initial determinations to Defense and Commerce before finalizing an item’s jurisdiction. Delays in the process can discourage companies from requesting determinations, as well as affect their ability to compete in certain markets. Additionally, over 30 commodity jurisdictions for space-related items were placed on hold when the National Security Council intervened to resolve a disagreement between Commerce and State. Pending resolution of this disagreement, companies that requested
jurisdiction determinations have exported their space-related items under different controls.

This report contains recommendations to the Secretaries of Commerce, State, and Defense to improve the transparency, consistency, and timeliness of the commodity classification and commodity jurisdiction processes. In commenting on a draft of this report, Commerce disagreed with our findings and conclusions, but it agreed to work with State, Defense, and companies to implement our recommendations. State, in its comments on our draft report, partially concurred with our recommendations. Defense concurred with our recommendations.

Background

The U.S. government’s controls on the export of defense-related items are primarily divided between two departments. Commerce, through its Bureau of Industry and Security, controls the export of dual-use items under the authority granted by the Export Administration Act.\(^2\) Commerce’s Export Administration Regulations\(^3\) establish the Commerce Control List, which generally contains detailed specifications for dual-use items. State, through its Office of Defense Trade Controls, regulates exports of defense items under the authority of the Arms Export Control Act.\(^4\) State’s International Traffic in Arms Regulations\(^5\) provide controls over defense items, which are identified in broad categories on the U.S. Munitions List. Both departments’ control lists are developed with the Defense Technology Security Administration, which represents Defense on export control issues. Defense reviews both State and Commerce export licenses for national security concerns.

Commerce and State control exports differently in several key areas. Commerce seeks to balance national security, foreign policy, and economic interests when considering how to control items and review export licenses. By contrast, State gives primacy to U.S. national security and foreign policy interests. In most cases, Commerce’s controls over

\(^2\) 50 U.S.C. App. secs. 2401 et seq. Authority granted by the act terminated on August 20, 2001. Executive Order 13222 continues the export control regime established under the act and the Export Administration Regulations.

\(^3\) 15 C.F.R. secs. 730-774.

\(^4\) 22 U.S.C. secs. 2751 et seq.

\(^5\) 22 C.F.R. secs. 120-130.
dual-use items are less restrictive than State’s controls over defense items. State requires licenses for exports and re-exports to all destinations with few exceptions, while many items under Commerce’s jurisdiction do not require licenses to most destinations. Also, some sanctions and embargoes only apply to items on the U.S. Munitions List and not to those on the Commerce Control List. For example, most exports of defense items to destinations such as China are prohibited under State, while Commerce can allow the export of many dual-use items to China.

Companies are responsible for determining whether the item they seek to export is on the Commerce Control List and, therefore, subject to Commerce’s jurisdiction, or on the U.S. Munitions List and subject to State’s jurisdiction. Under Commerce regulations, companies may request a commodity classification when unsure of the requirements for exporting a Commerce-controlled item. After reviewing the characteristics of the item, Commerce provides an export control classification number from the Commerce Control List, which indicates the applicable controls and licensing requirements. Under State regulations, companies may request a commodity jurisdiction determination from State when unsure whether an item is subject to State or Commerce controls or when requesting that an item be transferred from State to Commerce jurisdiction. State is to consult with Defense and Commerce to determine the proper jurisdiction of an item based on several criteria, including its civil applications and military significance. State is the arbiter in the commodity jurisdiction process and is the only department that may change the jurisdiction of an item.

In 1996, the National Security Council issued guidance to improve the transparency and interagency coordination of the commodity classification and commodity jurisdiction processes. The Council’s guidance was prompted by State and Commerce disagreement over jurisdictional determinations. This guidance also came after Commerce issued a commodity classification for State-controlled missile technology, which resulted in harm to U.S. national security when this technology was improperly transferred to China. The guidance provides referral criteria

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6 15 C.F.R. 748.3.

7 Some items may also be designated “EAR99,” which serves as a general designation for items that are covered by the Export Administration Regulations but are not specified on the Commerce Control List.

8 22 C.F.R. 120.4.
for when Commerce should consult with State and Defense on commodity classification requests before making a decision. In addition, the guidance establishes time frames for making commodity jurisdiction determinations as well as an interagency dispute resolution process.

Commerce Improperly Classified Items and Has Not Adhered to Regulatory Time Frames

Commerce rarely referred classification requests to State and Defense, even though some items appear to meet referral criteria. Commerce officials said they usually do not obtain input from State and Defense since they have sufficient experience to properly classify items. As a result of the limited referrals, Commerce has improperly classified some State-controlled items as Commerce-controlled. Some of these improper classifications have been identified through the license application review process. However, since many items exported under Commerce do not require licenses to most destinations, the commodity classification process is sometimes the only opportunity for State and Defense to become aware of what companies are exporting. Therefore, other improper classifications may not have been identified. In addition, Commerce has not adhered to regulatory time frames for issuing commodity classifications.

According to the National Security Council guidance, Commerce is to refer to State and Defense all commodity classification requests for “items/technologies specifically designed, developed, configured, adapted and modified for a military application or derived from items/technologies specifically designed, developed, configured, adapted or modified for a military application.” State and Defense can then provide input on whether the items are State-controlled and therefore cannot be classified on the Commerce list or need to be reviewed through the commodity jurisdiction process. The guidance also directs Commerce to promptly forward to State requests from companies asking if an item is under Commerce or State jurisdiction.

Commerce Rarely Referred Classification Requests That Appear to Meet Criteria

Commerce has referred a limited number of commodity classification requests to State and Defense. Of the 12,457 commodity classification requests completed during fiscal years 1998 through 2001, only 40 requests were referred by Commerce to State and Defense for review.9 Commerce cited several reasons for referring these cases, including that the items had

9 Commerce referred another request in fiscal year 2001 that has not been completed.
military applications or origins, were to be exported to military end-users, or were under State control. Through the referral process the departments agreed that 12 of the requests involved items under State jurisdiction,\(^9\) 9 involved items under Commerce jurisdiction, 18 required additional review through the commodity jurisdiction process, and 1 was withdrawn by the company after it was referred. Commerce did not refer the remaining 12,417 commodity classification requests it completed during this period. Table 1 shows the number of commodity classifications and referrals by fiscal year.

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Commodity classifications completed</th>
<th>Commodity classifications referred</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>2,721</td>
<td>6</td>
</tr>
<tr>
<td>1999</td>
<td>3,004</td>
<td>5</td>
</tr>
<tr>
<td>2000</td>
<td>3,411</td>
<td>12</td>
</tr>
<tr>
<td>2001</td>
<td>3,321</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,457</strong></td>
<td><strong>40</strong></td>
</tr>
</tbody>
</table>

Source: GAO's analysis of Commerce classification data.

Commerce has based its criteria for referring commodity classification requests to State and Defense on its interpretation of the National Security Council guidance. Commerce officials told us that they follow the guidance to refer classification requests for items specifically designed for military use. For example, Commerce referred a request involving software designed to analyze and simulate submarines. However, under their interpretation of the guidance, Commerce officials do not refer all requests involving items derived from military technology, only those that have been recently adapted for civilian use. For example, Commerce referred a classification request for a military vehicle that was converted for civilian use in the early 1990s. In addition to the guidance, Commerce officials stated they refer requests involving items where jurisdiction is unclear.

In contrast, State and Defense officials said that under their interpretations of the National Security Council guidance, Commerce should be referring most, if not all, commodity classification requests to

\(^9\) One of the requests involved multiple items, most of which were determined to be State-controlled.
them. For example, Defense officials stated that Commerce should refer classification requests for all items derived from military technology regardless of how long ago this occurred. They added that most items on the Commerce Control List were derived from items designed for the military. The officials also stated that Commerce should refer all classification requests involving items with unclear jurisdiction.

Commerce has not consistently applied its referral criteria for implementing the National Security Council guidance. We identified 253 commodity classification requests that appear to meet Commerce’s stated criteria for referral but were not referred to State and Defense.

- Commerce returned 123 requests to companies without providing a classification and informed these companies that State should review the items through the commodity jurisdiction process. In other instances, Commerce has referred requests when it needed to confirm which department has jurisdiction over an item.
- Commerce returned 89 requests to companies without providing a classification and informed these companies that the items were subject to State control. By definition, an item that is State-controlled meets the referral criteria of being specifically designed for a military application. Also, Commerce has referred other requests to State and Defense for items it considered to be State-controlled.
- We identified 37 requests involving items that Commerce classified without referral to State and Defense but that are included in categories that appear on both State and Commerce control lists. For example, Commerce provided companies with classifications for two sensitive missile technology items that we had previously identified as subject to unclear jurisdiction since they appear on both Commerce and State’s control lists.\[11\]
- We found 4 classifications issued by Commerce where the requests were not referred to State and Defense, involving items with military applications, military origins, or unclear jurisdiction—all of which were reasons Commerce cited when referring other requests. For example, one request involved night vision technology, which has military origins and applications and is currently under jurisdictional review by State.

Commerce officials stated that the referral criteria are subjective and have not always been applied consistently by Commerce officials that review classification requests. These officials acknowledged that their implementation of the referral criteria may pose some risk of improperly classifying a State-controlled item, but the risk is minimal because Commerce reviewers have sufficient experience with classifying and licensing items. They also stated that increased referrals would limit their ability to meet the regulatory requirement to process commodity classification requests in a timely manner. State and Defense officials told us that they have the necessary expertise to review classification requests to ensure proper jurisdiction. Furthermore, only State, with Defense’s concurrence, has been delegated the statutory authority to determine which items are under its jurisdiction.

Commerce does not always receive sufficient information from companies to identify all classification requests that meet referral criteria. Commerce regulations require companies to provide precise technical specifications on an item when submitting a commodity classification request. However, Commerce regulations do not require companies to submit information that relates to referral criteria such as whether an item’s applications are predominantly military or civil or whether an item was originally developed for military use. Commerce officials stated that they do not need this information to make classification decisions but would need additional information in some cases to determine whether to refer requests to State and Defense.

Classification of items without input from State and Defense has resulted in Commerce improperly classifying some State-controlled items. We identified several instances in which companies have received classifications from Commerce for State-controlled items without input from State and Defense. For example, one company received classifications for items that can be used to analyze missile flight test data and subsequently submitted several license applications to Commerce to export these items. During its review of the license applications, Defense questioned Commerce’s jurisdiction over the items and the company agreed to seek licenses from State to export these items in the future. Two other companies received classifications from Commerce for items containing night vision technology. However, when these companies submitted export license applications to Commerce, Defense objected to Commerce jurisdiction and recommended that the items be licensed through State. Commerce returned one license application to the company because the item may be State-controlled and advised the company to
seek a commodity jurisdiction determination from State. The item in the other license application is currently under jurisdictional review by State.

While Defense officials can identify some improper classifications through the license review process, most Commerce-controlled items do not require export licenses. Therefore, the referral of commodity classification requests could provide State and Defense their only opportunity to become aware of what companies are exporting through Commerce. Of the total classifications provided to companies during fiscal years 1998 through 2001, about two-thirds involved classifications for items that generally would not require export licenses to most destinations. A State-controlled item that is classified as a Commerce item that generally does not require a license can then be improperly exported without the appropriate government review. We identified one company that received a commodity classification for explosive detection devices that would allow the company to export them to most destinations without Commerce licenses. Another company that exports the same devices through State’s licensing process notified State of its competitor’s activities. This prompted State to issue a commodity jurisdiction determination that the devices are State-controlled. Until this jurisdiction determination was issued, the company obtaining licenses from State experienced a competitive disadvantage because the other company could meet customer demands more quickly by not obtaining licenses.

By not referring classification requests, Commerce also does not provide State with an opportunity to ensure that companies comply with State’s governing export control statute and regulations. Pursuant to the Arms Export Control Act, State’s regulations require all manufacturers of defense items to register with State, even if they are not planning to export their items. The U.S. government then uses registration information to ensure compliance with export control laws. Based on our review of classification data, we identified several companies that did not register with State, as required by law, after Commerce advised them that their items were State-controlled. State officials said that they will determine what actions are needed to have these companies comply with the regulations and whether any violations occurred. In addition, a senior State official told us that Commerce’s limited referrals and improper classifications may limit State’s ability to have enforcement actions taken

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13 22 C.F.R. 122.1.
against companies for possible export control violations since the companies have already obtained government direction to export through the Commerce system.

Commerce Has Not Met Required Commodity Classification Time Frames

Commerce has not adhered to regulatory time frames for responding to commodity classification requests from companies. The Export Administration Regulations require Commerce to provide companies with a classification within 14-calendar days.\(^{14}\) However, during fiscal years 1998 through 2001, Commerce completed only 13 percent of the commodity classifications within 14 days. Commerce took a median of 39 days to respond to classification requests during this 4-year period. Figure 1 shows the median number of days Commerce took to respond to classification requests by fiscal year.

\(^{14}\) 15 C.F.R. 750.2.
Figure 1: Median Processing Times for Commodity Classifications, Fiscal Years 1998-2001

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>1998-2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of processing days</td>
<td>31</td>
<td>37</td>
<td>43</td>
<td>42</td>
<td>39</td>
</tr>
</tbody>
</table>

Source: GAO's analysis of Commerce classification data.

Commerce officials stated that delays in responding to classification requests are due to other priorities, limited staff resources, and companies not providing required information. Commerce officials, who review commodity classification requests, assign highest priority to processing licenses because companies rely on the timely issuance of licenses to meet customers’ orders. These officials have other duties that delay their review of classification requests, which include providing information for enforcement cases. Commerce officials noted that they recently received additional hiring authority for personnel to review commodity classification requests and perform other duties, but they have not yet completed the hiring process. Commerce officials also attributed delays to companies not providing required technical specifications with their commodity classification requests, estimating that about 80 percent of requests require officials to perform additional research. If companies provided the required information, then Commerce could spend less time
processing each commodity classification request. Commerce officials told us that they have implemented a new procedure to place requests on hold while they obtain additional information from companies, thereby reflecting Commerce’s actual processing time.

Commodity Jurisdiction Process Exceeded Time Frames and Is Affected by External Disagreements

The commodity jurisdiction process has exceeded established time frames and is affected by external disagreements. State has often not adhered to the 95-day time frame established by the National Security Council for providing companies with commodity jurisdiction determinations. Factors that delay determinations have included late input from Defense and Commerce, disagreements among the departments over the appropriate jurisdiction for an item, need for sufficient information to make determinations, and initial determinations to Defense and Commerce not issued in accordance with guidance. Delays in resolving jurisdiction requests can discourage a company from using the process and affect its ability to compete in certain markets. In addition, an interagency disagreement being resolved outside the commodity jurisdiction process has affected the resolution of some requests.

According to the National Security Council guidance, all commodity jurisdiction requests are to be resolved through a State-led process within a maximum 95-calendar day time frame. During that period, State refers requests to Commerce and Defense, providing them up to 45 days to recommend the appropriate jurisdiction for an item.15 State is also to resolve any disagreements over jurisdiction between the departments and issue a determination to the company. If the departments disagree on the appropriate jurisdiction for an item, they can escalate initial jurisdiction determinations to higher levels within State and ultimately to the President. Figure 2 shows each step in the commodity jurisdiction process and the associated time frames for issuing determinations.

15 The National Security Council guidance indicates that Commerce and Defense should provide their recommendations within 35 calendar days, but they may request 10 additional days to submit recommendations for extraordinary cases.
Figure 2: Commodity Jurisdiction Process and Time Frames

Source: Based on National Security Council guidance.

- No later than 65 calendar days from the receipt of the commodity jurisdiction request, the Director of DTC will make an initial determination and circulate notice of that determination to participating departments. If those departments do not escalate in writing within 5 days, then the determination becomes final.

- Once a determination has been circulated to participating departments, those departments have 5 days to escalate the decision. Silence is deemed as no objection to the determination.

- The National Security Council guidance does not provide time frames for the resolution of requests escalated to the President.

- If State, Commerce, and Defense conclude that additional information from the company is required, the time that lapses between the date the information is requested and received is not counted toward the recommendation time frame.
Commodity Jurisdiction Determinations Have Not Been Timely

State has not adhered to the time frames established in guidance for responding to commodity jurisdiction requests. Of the 802 commodity jurisdiction determinations made by State between October 1, 1997, and May 31, 2001, 62 percent took over the maximum 95 days to resolve.\(^{16}\) State took a median of 118 days to issue a jurisdiction determination, with 25 percent taking twice as long as the established maximum time frame. Figure 3 shows the total number of determinations and those that took over 95 days to resolve by fiscal year.

**Figure 3: Commodity Jurisdiction Determinations and Timeliness, Fiscal Years 1998-2001**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>More than 95 days</th>
<th>95 days or less</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>1999</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>2000</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>2001</td>
<td>25</td>
<td>25</td>
</tr>
</tbody>
</table>

Note: Fiscal year 2001 includes only those cases resolved by May 31, 2001.

Source: GAO’s analysis of State commodity jurisdiction data.

\(^{16}\) We requested data on jurisdiction determinations made during fiscal years 1998 through 2001. However, State only provided data on determinations made from fiscal year 1998 through May 31, 2001.
While State consistently referred jurisdiction requests to Defense and Commerce in a timely manner, State has not adhered to established time frames for issuing commodity jurisdiction determinations generally due to four contributing factors. First, for the majority of determinations made between October 1, 1997, and May 31, 2001, Commerce and Defense did not provide their recommendations on the appropriate jurisdiction within 45 calendar days. Specifically, Commerce took a median of 81 days while Defense took 69 days to provide State with their respective recommendations. State officials explained that they are reluctant to make jurisdictional determinations without input from the other departments, particularly since Defense has a statutory role in developing the U.S. Munitions List. Defense and Commerce officials told us they are sometimes late because commodity jurisdictions are low priority. According to these officials, their limited staff resources are primarily devoted to reviewing export license applications. For example, during our review period, Defense had one official responsible for administering the commodity jurisdiction process and coordinating input from technical experts, but it has recently hired an additional staff person. Additional time may be needed for the departments to provide their recommendations in certain cases. For 3 of the 34 commodity jurisdiction files we reviewed, Defense officials requested additional time to provide their recommendations, citing either internal disagreements about the appropriate jurisdiction or the precedent setting nature of the case.

Second, State’s ability to resolve jurisdiction requests has been delayed by disagreements between the departments over the appropriate jurisdiction for an item. When Commerce and Defense both provided recommendations to State, they conflicted 35 percent of the time. In such cases, State took a median of 51 additional days to issue a determination. According to State officials, they attempted to reconcile the departments’ positions by discussing the cases with the departments and conducting further research on the military applications and origins of the item. In one of the commodity jurisdiction files we reviewed where there was disagreement between the departments, State indicated that it was suspending the established time frame because the case was complex.

Third, the issuance of commodity jurisdiction determinations has been delayed by the need for sufficient information. In some instances, State officials told us that they have not always found the information and justifications from Commerce to be sufficient for them to make determinations. In several of the commodity jurisdiction files we reviewed, Commerce did not fully address whether the items have predominate civil applications or performance equivalents to those used in civil applications,
which are among the criteria State uses when determining jurisdiction. According to Commerce and State officials, Commerce has recently improved the quality of input to State. Furthermore, State officials told us they need to conduct additional research on an item before making a determination, regardless of the quality of input from Commerce and Defense.

Fourth, State has not always issued initial determinations in accordance with the guidance. State is to provide Commerce and Defense with initial jurisdiction determinations no later than 55 calendar days after receiving a request, even when those departments have not provided their input. If Commerce and Defense do not object within 5 days, State’s decision becomes final. According to Commerce and Defense officials, commodity jurisdictions become a priority when they receive State’s initial determinations, so they can provide input before the determinations become final. A senior State official told us that State would prefer to receive Commerce and Defense’s input as set out in the guidance before issuing an initial determination. Our review of commodity jurisdiction files indicated that most did not contain documentation on initial determinations. Those files that did contain documentation indicated that State issued initial determinations more than 75 days after receiving the request. Additionally, State has not tracked the issuance of initial determinations in its commodity jurisdiction database.

While the commodity jurisdiction process is used to assist companies, State’s delays may discourage companies from requesting jurisdiction determinations. For example, officials from two companies told us that they are reluctant to request determinations in the future because of delays they have experienced in the process. Officials with other companies expressed dissatisfaction with the process because they were unable to obtain information from State on the status of their pending requests. Therefore, companies may determine jurisdiction on their own or seek jurisdiction guidance outside the process.

Delays in the commodity jurisdiction process may also affect a company’s ability to compete in certain markets. An item is generally subject to State’s export controls until State determines otherwise. As a result, pending the resolution of a commodity jurisdiction request, the item is subject to State’s restrictions and generally requires a license to be exported. Under current U.S. law, most items subject to State’s jurisdiction
cannot be licensed for export to China.\textsuperscript{17} Commerce does not have a comparable restriction on the export of dual-use items to China. For example, officials with one company informed us that they were unable to compete for a significant contract in China while waiting over a year for a commodity jurisdiction determination. State eventually determined that the item in question was subject to Commerce’s jurisdiction, which it did in 36 percent of the cases resolved during our review period. Officials with other companies also stated that delays in receiving jurisdiction determinations have affected their ability to compete in certain markets.

Interagency Disagreement Outside the Process Affects Resolution of Some Commodity Jurisdiction Requests

Commodity jurisdiction requests for space-related items have remained unresolved for several years due to an interagency jurisdictional debate occurring outside the established commodity jurisdiction process. In March 1999, State and Commerce issued regulations pursuant to a change in law that transferred commercial satellites and related items from Commerce’s jurisdiction to State’s jurisdiction.\textsuperscript{18} Commerce and State disagreed on what constituted “related items” and whether the law transferred certain space-related items to State. The National Security Council initiated an interagency review to resolve the disagreement and determine jurisdiction over these items. At the direction of the National Security Council, State placed commodity jurisdiction cases for space-related items on hold until an interagency agreement could be reached and implemented. As a result, State officials said they placed 33 commodity jurisdiction cases on hold, most of which have been open since 1999. In 2001, State and Commerce announced the resolution of the disagreement, and they are currently developing regulations to specify control over these items.

While their commodity jurisdiction requests remain on hold, companies have exported their space-related items through both departments. Officials with four companies told us that they have been exporting their space-related items through State. Officials with another company told us, that based on advice from Commerce, they have been exporting their space-related items through Commerce. State and Commerce officials confirmed that companies could export such items through Commerce.

\textsuperscript{17} P.L. 101-246, Feb. 16, 1990. Under the statute, licensing of State-controlled items for export to China is prohibited unless the President reports to Congress that (1) China has achieved certain political and human rights reforms or (2) it is in the U.S. national interest.

\textsuperscript{18} P.L. 105-261, Oct. 17, 1998.
However, neither department issued written guidance specifying what companies with pending commodity jurisdiction requests should do.

While the origins of the jurisdictional disagreement over space-related items were unique, disagreements between departments over the jurisdiction of other items could limit State’s ability to make determinations through the commodity jurisdiction process. For example, State has placed a jurisdiction request involving night vision technology on hold until jurisdiction for that technology is decided through the ongoing review of the U.S. Munitions List. State officials said they expect this review of night vision technology to be difficult and time-consuming to complete. Defense and Commerce officials also told us that there is considerable interagency debate on how night vision technology should be controlled.

Conclusions

The bifurcated U.S. export control system seeks to manage risks by balancing national security and foreign policy with economic interests. Commerce has altered this balance by not implementing the commodity classification process in a manner that considers other stakeholder interests. While State’s implementation of the commodity jurisdiction process allows for the consideration of multiple interests, it is slow to reach decisions and, in some cases, has been affected by larger interagency disputes occurring outside of the process. Existing guidance was intended to improve transparency and coordination within these processes, but problems persist. If the U.S. export control system is to effectively manage risk, these processes have to balance stakeholder interests, be transparent to stakeholders, and efficiently reach and communicate decisions. In the absence of this, the U.S. government faces the possibility of defense-related items being exported without the proper level of government review and control to protect national interests. Also, companies may export similar items under different controls, placing some companies at a competitive disadvantage or at risk of violating U.S. export control laws.

State and Defense are reviewing and revising different portions of the U.S. Munitions List on an annual basis, as part of the Defense Trade Security Initiative, to ensure that coverage on the list is appropriate. See General Accounting Office, Defense Trade: Analysis of Support for Recent Initiatives, GAO/NSIAD-00-191 (Washington, D.C.: Aug. 31, 2000).
To increase transparency to stakeholders and minimize the risk of Commerce making jurisdictional determinations through the commodity classification process, we recommend that the Secretary of Commerce direct the Bureau of Industry and Security to promptly review existing guidance and develop, with the concurrence of the appropriate entities within State and Defense, criteria for referring commodity classification requests to those departments. In developing the criteria, the departments should agree on a common definition of terms to be contained in the criteria. Until the departments develop and implement referral criteria, the risk of Commerce improperly classifying State-controlled items will continue to exist.

To increase transparency and assist State in enforcing its statutory requirements, we recommend that the Secretary of Commerce direct the Bureau of Industry and Security to develop, with the concurrence of State’s Office of Defense Trade Controls, procedures for referring requests that are returned to companies because the items are State-controlled or require a commodity jurisdiction review.

To ensure that Commerce has sufficient information to make timely and appropriate commodity classifications, we recommend that the Secretary of Commerce direct the Bureau of Industry and Security to revise guidance for companies on the information to be provided with commodity classification requests and consider including a requirement for information on an item’s origins and applications.

To comply with existing time frames for responding to classification requests, we recommend that the Secretary of Commerce direct the Bureau of Industry and Security to assess the amount of resources needed, then reallocate resources as appropriate.

To improve the timeliness of the commodity jurisdiction process, we recommend that the Secretaries of State, Commerce, and Defense direct the respective entities within their departments to assess the amount of resources needed to make jurisdiction recommendations and determinations within established time frames, then either reallocate resources as appropriate or seek changes to the established time frames that are consistent with available resources. We also recommend that the Secretary of State direct the Office of Defense Trade Controls to issue initial determinations in accordance with the guidance.

To improve transparency and consistency of the commodity classification and jurisdiction processes, we recommend that the Secretaries of State,
Agency Comments and Our Evaluation

Commerce, and Defense revise interagency guidance to incorporate any changes to the referral process and time frames for making decisions.

We received written comments on a draft of this report from Commerce, State, and Defense, which are reprinted in appendixes I, II, and III, respectively, along with our detailed evaluation of their comments. Commerce disagreed with our findings and conclusions, which it believes are based on erroneous facts and, therefore, are fundamentally flawed. Specifically, Commerce did not agree with our finding that 253 classification requests, which were not referred, appear to meet Commerce’s referral criteria and, therefore, should have been referred. Commerce asserts that it did not improperly classify State-controlled items. Additionally, Commerce indicated that State and Defense’s position that most commodity classifications should be referred does not reflect the National Security Council guidance. However, Commerce agreed to work with other departments and companies to implement our recommendations and noted it has allocated resources to ensure the timely issuance of its classifications and State’s jurisdiction determinations. In responding to our draft, State partially concurred with our findings and recommendations. State noted that it has made progress in reducing the amount of time needed to issue jurisdiction determinations. Citing improved timeliness and deference to Defense’s national security views, State did not agree that it needs to implement our recommendation to issue initial determinations in a timely manner, but it did agree to enlist greater cooperation from other departments in meeting established time frames. In its comments, Defense concurred with our recommendations.

We disagree with Commerce’s characterization of our findings and conclusions and are confident that our report accurately assesses Commerce’s implementation of the commodity classification process. As stated in our report, we identified at least 253 classification requests that appear to meet the referral criteria. By Commerce’s own admission, requests involving State-controlled items or those in need of a jurisdictional review were returned to the companies without referral to State and Defense, which is not consistent with the referral criteria. In addition, Commerce inconsistently applied the criteria because in some instances it referred requests that met the criteria. Our report highlights the risk of Commerce improperly classifying State-controlled items through the commodity classification process. We identified several instances in which Commerce classified State-controlled items, including explosive detection devices that were determined to be State-controlled through the commodity jurisdiction process. Commerce’s position
regarding the interpretation of the National Security Council guidance by State and Defense demonstrates that the criteria are subjective and that the departments have not reached a consensus on which requests should be referred. While we cannot verify whether State has decreased the amount of time needed to process jurisdiction requests, we agree that State should enlist the cooperation of other departments to improve timeliness. We continue to recommend that State issue initial determinations in accordance with established guidance because this is a mechanism to improve timeliness, while still providing Defense and Commerce with an opportunity to provide input before a final determination is made.

Scope and Methodology

To assess how Commerce implements the commodity classification process, we reviewed relevant laws, regulations, and the National Security Council guidance to identify the criteria for the process and examined how Commerce implemented the criteria. We discussed the process and the referral criteria with officials from Commerce’s Bureau of Industry and Security, State’s Office of Defense Trade Controls, and Defense’s Defense Technology Security Administration. We reviewed 41 commodity classification requests Commerce referred to State and Defense during fiscal years 1998 through 2001 and identified the reasons for referral. We analyzed commodity classification data for fiscal years 1998 through 2001 and selected 34 cases to review that were not referred to State and Defense. We compared the characteristics of the items in the 34 cases with Commerce’s stated referral criteria, as well as items identified as State-controlled in Defense’s review of Commerce licenses. We reviewed the data and identified nonreferred requests returned to companies without classifications because the items either were State-controlled or needed a commodity jurisdiction review. We then confirmed whether the companies involved in these cases appeared in State’s registration database. In addition, we reviewed the classification data to identify the export control classification numbers provided to companies. We then compared those classification numbers with classification numbers that cover items appearing on both the Commerce and State control lists. To determine Commerce’s timeliness in providing classifications, we analyzed the time elapsed between the receipt of the classification request and the issuance of the classification. To assess the reliability of Commerce’s classification data, we compared information in selected files to the data. During our analysis, we found some minor inaccuracies with Commerce’s data, which did not adversely affect its overall reliability.
To assess how State implements the commodity jurisdiction process, we identified the steps in the commodity jurisdiction process as established in relevant regulations and the National Security Council guidance and discussed the implementation of the process with officials from the relevant offices at State, Defense, and Commerce. We requested State’s data for commodity jurisdiction determinations and open cases during fiscal years 1998 through 2001. However, State did not provide complete data for fiscal year 2001. We analyzed the data to determine the time taken to complete key steps in the process. We reviewed 34 selected commodity jurisdiction files. We discussed reasons for delays as well as the interagency disagreement over space-related items with State, Commerce, and Defense officials. We also reviewed documents related to the history of the space-related interagency disagreement. To assess the reliability of State’s commodity jurisdiction data, we compared the information in the files reviewed to the data and found inconsistencies. However, we determined that these are the best available data and are sufficiently reliable for assessing timeliness.

We discussed the commodity classification and jurisdiction processes with companies. To select companies, we analyzed Commerce and State data to identify companies that had experience with one or both processes. We also obtained recommendations from industry associations and others to develop a list of additional companies that had used these processes. We then conducted structured interviews with officials from 31 companies, which included small, medium, and large companies with varying degrees of experience in using the export control processes.

We conducted our work from May 2001 through September 2002 in accordance with generally accepted government auditing standards. The time taken by State, Commerce, and Defense to respond to our requests for information and data adversely affected the timeliness of our reporting.

We will send copies of this report to the Chairmen and Ranking Minority Members of the House Committees on Government Reform, on International Relations, and on Armed Services and Senate Committees on Governmental Affairs, on Foreign Relations, on Armed Services, and on Banking, Housing, and Urban Affairs. We will also send copies to the Secretaries of State, Commerce, and Defense; the Director, Office of Management and Budget; and the Assistant to the President for National Security Affairs. In addition, this report will be made available at no charge on the GAO Web site at http://www.gao.gov.
If you or your staff have questions concerning this report, please contact me at (202) 512-4841. Others making key contributions to this report are listed in appendix IV.

Sincerely yours,

Katherine V. Schinasi
Director, Acquisition and Sourcing Management
Appendix I: Comments from the Department of Commerce

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Ms. Katherine V. Schinasi  
Director, Acquisition and Sourcing Management  
United States General Accounting Office  
Washington, D.C. 20548

Dear Ms. Schinasi:

Thank you for the opportunity to comment on the draft General Accounting Office (GAO) report titled EXPORT CONTROLS: Processes for Determining Proper Control of Defense-Related Items Need Improvement.

The report reaches two principal conclusions with respect to the Commerce Department’s commodity classification practices: (1) that the Commerce Department has failed to refer to the Departments of State and Defense certain commodity classification requests received from exporters during the period 1998-2001 that should have been referred, consistent with guidance issued by the National Security Council (NSC) in 1996, and (2) that, “as a result of the limited referrals, Commerce has improperly classified some State-controlled items as Commerce-controlled.” We believe that both conclusions are based on erroneous facts and, therefore are fundamentally flawed.

The report’s conclusions are all premised on the GAO’s identification of 253 (out of over 12,000) commodity classification requests that the Commerce Department received that the GAO believes, “appear to meet Commerce’s referral criteria” but that the Commerce Department did not refer. Commerce Department staff has reviewed these 253 requests. It turns out that in 212 of these cases Commerce did not issue the requester a commodity classification at all, but instead referred the requester to the State Department. With respect to the remaining, 41 cases – more accurately, 39 cases, as the GAO appears to have double-counted two cases – the report provides a superficial explanation of why the GAO believes referral was merited in those cases or how the products in those cases were classified incorrectly. In fact, after review, we have determined that those 39 requests did not require referral under either the 1996 NSC guidance or the Commerce Department’s own criteria. Moreover, those 39 requests were, in any event, classified correctly.

To be sure, there may be differences among the agencies as to what ideally the referral practice should be with respect to commodity classification requests. The report itself cites unnamed representatives of the Departments of State and Defense who believe that the Commerce Department “should be referring most, if not all, commodity classifications to them.” Whatever the potential merits of such a broad referral policy (which would likely entail substantial lengthening of the classification process with concomitant economic costs), this approach clearly does not reflect the guidance set forth by the NSC in 1996 and should not be used as the benchmark against which to judge Commerce Department practices.
Ms. Katherine V. Schinasi
Page 2

For the reasons stated above, we would urge that, prior to finalization of this report, the GAO meet with Commerce Department technical experts and clarify misunderstandings regarding the classification requests that purportedly form the basis of the report’s conclusions. More detailed comments on the report are attached.

Sincerely,

Mathew S. Borman
Deputy Assistant Secretary

Attachment
Appendix I: Comments from the Department of Commerce

Department of Commerce Comments on the Draft GAO Report
EXPORT CONTROLS: Processes for Determining Proper Control of Defense-Related Items Need Improvement
(GAO Code 120062)

GENERAL COMMENTS

1. The Report’s Conclusions about Commerce’s Classification Processes Are Fundamentally Flawed because They Are Based on Erroneous Facts. The Report’s conclusions are premised on its assertion that during the period 1998-2001, the Commerce Department failed to refer to other agencies 253 commodity classification requests that should have been referred. The Report states that, “as a result of the limited referrals, the Commerce Department has improperly classified some State-controlled items as Commerce-controlled.”

We have reviewed the 253 classification requests identified by the GAO and believe that they do not support the GAO’s conclusions. 212 of the 253 requests identified by the GAO never resulted in the issuance of a classification by the Commerce Department at all and, therefore, could not have been “improperly classified” by Commerce. Rather, upon an initial review of these classification requests, the requests were returned to the applicants and the applicants were referred directly to the State Department.¹

We have determined that the 41 remaining cases (which are in fact only 39 cases because the GAO “double counted” two of the cases) did result in issuance of a commodity classification but did not require referral to the other agencies. The GAO’s premise for believing that these requests should have been referred was apparently that the items at issue in those requests appear to be covered by both the U.S. Munitions List (USML) and the Commerce Control List (CCL). However, as the Commerce Department noted in response to a previous GAO report (GAO Code 707550), the fact that an item might appear to be covered by both the USML and the CCL does not necessarily mean that jurisdiction over the item is unclear (and thus that a referral is required). The CCL describes – in far greater specificity than the USML – relevant technical control parameters agreed upon by the Departments of Commerce, State, and Defense. An item that meets those parameters is not on the USML by interagency agreement. For example, one of the non-referred classifications that the GAO identified was for AFLATOXIN. Although toxins

¹ Classification requests that clearly involve items specifically designed, developed, configured, adapted, or modified for a military application are returned to the exporter without action and with instructions that the exporter consult with the State Department. It is not necessary to consult with the Departments of State or Defense when it is clear that the Commerce Department does not have jurisdiction. In these cases, the applicant is directed to the Department of State. Putting such cases into the referral process would likely prolong the process for the exporter and needlessly consume limited government resources. It remains the exporter’s responsibility to comply with all export laws, regardless of whether the Commerce Department or the State Department has jurisdiction.
that fall outside the CCL control parameters might be covered by the USML, this toxin is clearly on the CCL (Export Control Classification Number (ECCN) 1C351.d.11). This item, therefore, is not under State jurisdiction and did not require referral.

In any event, we have reviewed the 39 remaining cases and determined that they were correctly classified because they all clearly fell within the relevant CCL entries. The GAO’s report provides no evidence to the contrary.2

2. The Report Erroneously Faults Commerce for “Rarely” Referring Commodity Classification Requests. As noted above, the Report’s conclusion — that the Commerce Department did not refer classification requests that it should have — is fundamentally erroneous. More generally, the Report suggests that the Commerce Department refers classification requests too “rarely.” In fact, the Commerce Department refers inter-agency those requests that it is required to refer under the National Security Council’s (NSC) 1996 Guidance.

The NSC Guidance provides that the Commerce Department will share commodity classification requests with the Departments of State and Defense for items specifically designed, developed, configured, adapted, or modified for a military application, or derived from items specifically designed, developed, configured, adapted, or modified for a military application. These criteria define a narrow category of items and clearly belie the assertions of representatives of State and Defense, as provided in the Report, that the Commerce Department “should be referring most, if not all, commodity classifications to them.”

The dual-use export control system administered by the Commerce Department is broad in scope — covering all items in the U.S. economy, except items specifically under the jurisdiction of other Departments. Commodity classification requests cover the full range of these items. With respect to many of these requests, there is no issue about the item potentially being “designed . . . for a military application” or “modified for a military application,” and thus subject to referral under the NSC Guidance. Rather, these requests concern whether an item is appropriately classified under one CCL sub-category or another. Accordingly, it is appropriate that Commerce Department referrals be relatively “rare.”

To be sure, the NSC Guidance could be interpreted in such an awkward fashion as to merit referral of a larger array of commodity classification requests. For example, a product such as the Barbie Chat With Me walkie talkie could require referral because the first portable FM two-

See comment 3.

See comment 4.

See comment 5.

2 The GAO Report also made reference to an additional four cases that will be discussed later in these comments.

3 It should be noted that, even if GAO were correct about the 253 requests discussed above (which it is not), Commerce Department referrals would still be relatively rare — i.e., they would occur in approximately 2 percent of the cases.
way radio was originally designed by Motorola for the U.S. Army Signal Corps in 1940. This is not how the NSC Guidance has been traditionally interpreted, and such an interpretation would result in inefficient use of scarce government resources and an unnecessary burden on U.S. exporters.

See comment 6.

3. The Report Fails to Evaluate Compliance with All NSC-Mandated Referral Processes. Although the Report reviews Commerce Department referral and classification decisions under the 1996 NSC guidance, it does not evaluate implementation of the reciprocal NSC requirement that the State Department refer certain munitions license applications to the Commerce Department for review. Since 1996, the Commerce Department has received only one informal referral of a munitions license from the State Department. The Report also fails to evaluate whether jurisdictional decisions by the State Department or jurisdictional assertions by the Defense Department are consistent with jurisdictional criteria set forth in the International Traffic in Arms Regulations (ITAR). If incorrect, such decisions could adversely affect U.S. economic welfare, and could also skew perceptions of what types of items appropriately merit commodity classification referrals.

See comment 7.

4. The Report Fails to Recognize the Nature of Commodity Classification Determinations. Commodity classification requests are not licensing determinations. Rather, they are objective, determinations as to whether an item meets the technical parameters of a specific ECCN. The Report fails to note that the Commerce Department officials responsible for commodity classifications are seasoned engineers with experience in industry and the military. Commerce Department engineers have the ability to properly evaluate the technical specifications of a commodity and match those specifications to one of the detailed ECCN entries on the CCL. It is also important to note that the ITAR does not define what is meant by specifically designed, developed, configured, adapted, or modified for a military application.

See comment 8.

5. Commerce Cannot Confirm GAO’s Assertions regarding Median Processing Times for Commodity Jurisdiction Cases. The Commerce Department is unable to verify the GAO’s assertions regarding the median processing time of the Commerce Department for commodity jurisdiction responses to State. The Commerce Department does not have access to data used by the GAO for its review. We would note, however, that the data should exclude the time the case was not under the Commerce Department’s control (i.e., the time between the Commerce Department’s initial response and when the Commerce Department might reopen the case to appeal the State Department’s initial determination); otherwise, the median processing time will be overstated. We would further note that the amount of time between the Commerce Department’s recommendation and the State Department’s initial determination is considerable. For example, on one commodity jurisdiction case, the Commerce Department provided its initial response to the State Department on November 6, 2000, and reopened the case on February 15, 2001 to appeal the State Department’s initial determination. Because the Commerce Department’s electronic database used to track these cases is old and relatively unsophisticated, it shows the Commerce Department as taking 126 days to process this case.

See comment 9.
Appendix I: Comments from the Department
of Commerce

This figure represents the number of days from initial referral to the Commerce Department until
the Commerce Department’s appeal of State Department’s initial determination was completed.
This number is far greater than the actual number of days the Commerce Department had the
case. For this case, the Commerce Department’s actual review time was 24 days; the State
Department’s was 102 days. This limitation will be addressed in the redesign of the Commerce
Department’s Export Control Classification System (ECASS); however, it is an important
characteristic for the GAO to note in calculating median processing time.

SPECIFIC COMMENTS

Page 2

As noted above, the Commerce Department disagrees with the assertion that it has improperly
classified some State-controlled items. The Commerce Department also disagrees that 253 that
were not referred commodity classification requests appear to meet the referral criteria.

Regarding classification processing times, the Commerce Department is taking several steps to
reduce such times, including hiring additional engineers (six in fiscal year 2002 and an additional
four, if the budget request is appropriated, in fiscal year 2003), implementing the ability to place
commodity classifications on hold without action status in ECASS while licensing analysts wait
for additional information from the exporter, and improving the electronic commodity
classification system as part of the ECASS upgrade.

As noted above, the Commerce Department cannot evaluate GAO’s calculation of our median
processing time for commodity jurisdiction requests. For commodity jurisdiction requests for
space qualified items, the Department of Commerce, State, and Defense have reached agreement
on this issue. The Departments of Commerce and State will be issuing implementing rules soon.

Page 3

It should be noted that the export control system administered by the Commerce Department has
considerable input from the Department of State and the Department of Defense, which clear on
all substantive changes to the Export Administration Regulations (EAR), including changes to
the CCL. Under Executive Order 12981, as amended, those Departments can make
recommendations on all license applications submitted to the Commerce Department.

Page 4

On the specific case referenced, jurisdiction on the specific technical data at issue was not clearly
delineated in the EAR and the ITAR.
See comment 13.

As noted above, the Commerce Department disagrees that it has improperly classified items. The GAO has only one example of a case in which it alleges the Commerce Department classified an item as on the CCL and the State Department subsequently issued an inconsistent commodity jurisdiction determination. However, the GAO refused to provide the Commerce Department any information on this case; thus, the Commerce Department cannot evaluate the GAO’s assertion. The Commerce Department notes that when this item was placed on the CCL, through an interagency cleared rule, there was no corresponding change to the USML. The GAO also failed to review whether the State Department’s determination comported with the USML criteria set forth in the ITAR.

See comment 14.

Regarding the classification request for a military vehicle converted for civilian use, it should be noted that this involves the civil derivative of that vehicle. The Commerce Department properly referred this request because it was not for the finished vehicle (which has been classified under the EAR for nearly 10 years), but rather for the frame and power transfer systems which have a higher percentage of commonality between the civil and the military versions of the vehicle.

See comment 15.

As noted above, the notion that most, if not all, classifications should be referred to the Departments of State and Defense is inconsistent with the scope and establishment of the CCL and Commerce Department jurisdiction.

Pages 7-10

In addition to the 253 licenses referenced above, GAO also discusses “several” non-referred classifications that it claims were improperly classified (page 8 of the Report). Despite Commerce Department requests, GAO refused to provide either the classification numbers or the related license application numbers for these cases. As a result, the Commerce Department is unable to address in detail GAO’s assertions. Nonetheless, several comments can be made based on the information in the Report. First, if the State Department or the Defense Department raise a jurisdictional claim in processing a license application submitted to the Commerce Department, the application generally must be returned without action to the exporter to apply for a commodity jurisdiction determination from the State Department. Returning such applications to the applicant does not reflect agreement by the Commerce Department that the item may be on the USML. Rather, it reflects the practical reality that the application cannot be further processed without a commodity jurisdiction determination. Second, for the four classifications noted on page 7 of the Report, three of which involved night vision equipment, there is an interagency MOU on night vision items that the Commerce Department applies to such commodity classifications. In the case of the explosive detection devices covered under ECCN 2A993 (page 7 and 9), this CCL control was approved interagency, but there was no counterpart revision of the USML. Classifications for such items were likely proper under existing guidelines. The
Appendix I: Comments from the Department of Commerce

Commerce Department also notes that GAO did not discuss any of these cases with Commerce Department technical experts during this review. Such a discussion would have led to a better informed analysis of these cases.

Also see above comments on steps the Commerce Department is taking to improve the timeliness of its classifications. Specific to Commerce Department actions having an impact on State Department enforcement actions, the Commerce Department fails to see how returning classification requests to applicants and informing them to contact State could affect enforcement actions. If anything, Commerce Department responses should strengthen enforcement cases by putting companies on notice to contact the State Department.

See comment 16.

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See above comments on Commerce Department commodity jurisdiction processing times.

See comment 17.

Page 18

The Commerce Department has not altered the balance of the dual-use export control system. Even by GAO's calculations, only a very small percentage of classification requests would be referred to the Departments of State and Defense. Not considering the cases for which the Commerce Department told applicants to contact the State Department, the number of cases identified is less than one-third of 1 percent. This hardly represents an altering of the balance. Moreover, of the cases GAO identified to the Commerce Department, our review indicates these classifications were properly not referred and properly classified based on the interagency cleared criteria in the EAR. Consequently, although improvements can be made to the classification review system, it does not represent a risk to national security. Regarding the impact on industry, the Commerce Department notes that GAO failed to review how the Departments of State and Defense apply the ITAR criteria for USML items and State Department’s sharing of munitions license applications with the Commerce Department under the NSC guidance.

COMMENTS ON GAO’S RECOMMENDATIONS

As set forth above, the Commerce Department believes that the draft report is fundamentally flawed with respect to its conclusions concerning the Commerce Department’s commodity classification processes, and urges further consultation between GAO and the Department before finalizing the study. Such further consultation may affect the GAO’s recommendations. In the event that GAO decides not to seek further consultation, we offer the following comments on the recommendations provided.

Recommendation: Promptly review existing guidance and develop, with the concurrence of the appropriate entities within State and Defense, criteria for referring commodity classification requests to those departments.
Comment: The Commerce Department supports an interagency review of the NSC guidance, including referral of munitions license applications and application of the ITAR criteria for the USML, to address any misperception that the Commerce Department does not refer enough classifications.

Recommendation: Develop with the concurrence of State’s Office of Defense Trade Controls, procedures for referring requests that are returned to companies because the items are State-controlled or require a commodity jurisdiction review.

Comment: The Commerce Department will discuss this recommendation with the State Department to determine the most effective way to address this issue.

Recommendation: Revise guidance for companies on the information to be provided with commodity classification requests and consider including a requirement for information on an item’s origins and applications.

Comment: The Commerce Department will solicit public comment on this recommendation. Note that the EAR provides exporters detailed guidance in Section 748.3 and Supplement No.1 to part 748 on the correct way to submit classification requests and the type of information needed to conduct a technical analysis. On GAO’s suggestion that exporters should be required to provide information on an item’s origin and applications, exporters are currently required to provide the name of the manufacturer, if known, and a technical description of the items. Applying this recommendation too broadly could have the unintended consequence of catching clearly commercial items, such as the toy described above.

Recommendation: Assess the amount of resources needed to comply with the regulations, then either reallocate resources as appropriate or make a regulatory change that reflects a time frame that is consistent with available resources.

Comment: The Commerce Department has already done this in its fiscal year 2002 and 2003 budget requests. The time frame for commodity classifications is set by statute.

Recommendation: Direct the respective entities within their departments to assess the amount of resources needed to make jurisdiction recommendations and determinations within established time frames, then either reallocate resources as appropriate or seek changes to the established time frame that are consistent with available resources.

See comment 19.
Appendix I: Comments from the Department of Commerce

Comment: As noted above, the Commerce Department has already done so.

Recommendation: Revise interagency guidance to incorporate any changes to the referral process and time frames for making decisions.

Comment: This recommendation will be covered in addressing the first recommendation.
The following are GAO’s comments on the Department of Commerce’s letter dated September 9, 2002.

1. Commerce misrepresented our findings and conclusions because it incorrectly combined two different findings related to the commodity classification process by suggesting that we concluded that all 253 requests resulted in improper classifications. The 253 requests identified in our report represent cases that appear to meet the National Security Council or Commerce’s stated referral criteria but were not referred to State and Defense for interagency review. Separately, our report discusses several instances in which Commerce improperly classified State-controlled items. We concluded that not referring commodity classification requests that appear to meet the referral criteria increases the risk of improper classification. As already noted in our report, 212 commodity classification requests were returned to companies without classifications because Commerce determined that the items involved were either State-controlled or possibly State-controlled. Commerce’s footnote acknowledges that these requests clearly meet the National Security Council referral criteria as they involve items “specifically designed, developed, configured, adapted, or modified for a military application,” yet Commerce stated that it is not necessary to refer such requests. However, as stated in our report, we identified instances in which Commerce referred similar requests to State and Defense. We also found that by not consistently referring such requests, Commerce does not provide State with an opportunity to ensure that companies comply with the Arms Export Control Act. For example, we identified several companies that did not register with State after Commerce returned their classification requests and advised them that their items were State-controlled.

The identification of the remaining 41 classification requests that were not referred, despite appearing to meet the referral criteria, was based on our analysis of Commerce’s data. We did not find any duplicates and were not able to independently verify Commerce’s statement. We, therefore, have no basis for revising the numbers contained in our report.

2. Commerce maintains that an item appearing on both control lists does not necessarily mean that it is unclear which department has jurisdiction over the item, because Commerce’s control list contains
technical control parameters that differentiate jurisdiction. We do not agree because Commerce’s control list does not always provide such technical control parameters. For example, the requests we identified as having unclear jurisdiction were classified in Commerce Control List categories that either contain technical control parameters identical to those on the U.S. Munitions List or do not contain specific parameters to clearly differentiate those items that are Commerce-controlled.

3. As discussed in comment 1, these cases were identified as appearing to meet the referral criteria but were not referred to State and Defense.

4. We disagree that Commerce refers requests as required by the National Security Council guidance. As noted in our report, Commerce officials admitted that they inconsistently apply the guidance. Defense and State officials informed us that under their interpretations of the guidance, Commerce should be referring most, if not all, commodity classifications. The guidance does not provide a common definition of terms to be used when applying the criteria. Commerce officials informed us that they have never met with Defense or State officials to define key terms or to agree on a common interpretation of the guidance. Further, we disagree with Commerce’s assertion that the 253 commodity classification requests that we identified represent all the requests that should have been referred. After reviewing a subset of Commerce data, we found at least 253 requests that appear to meet the referral criteria, but we did not conclude that this represents all the requests that should have been referred.

5. As discussed in our report, the departments have different interpretations of the National Security Council guidance, particularly as it relates to items derived from military applications. There is no “traditional” interpretation of the guidance. The example Commerce provides in its comments does not reflect the complexity or sensitivity of the types of items, such as night vision devices, which may meet the referral criteria.

6. The objectives of our report were to assess how Commerce and State, respectively, implement the commodity classification and commodity jurisdiction processes, not to assess the implementation of the National Security Council guidance as it relates to other processes such as licensing.
7. We assessed the implementation of the commodity jurisdiction process and did not evaluate the resulting determinations. In its implementation of the commodity jurisdiction process, State provides Commerce and Defense the opportunity to provide input on jurisdiction determinations and to escalate requests when there is a disagreement over the appropriate jurisdiction for an item.

8. Our report clearly reflects the nature of commodity classifications and the fact that they are not licensing determinations. We would note, however, that of the classifications provided by Commerce during our review period, about two-thirds involved classifications for items that generally would not require export licenses to most destinations. As a result, the classification process may be the only opportunity for State and Defense to become aware of what companies are exporting. While Commerce officials may be knowledgeable about the Commerce Control List, State and Defense officials have the authority and expertise to determine whether an item is covered by the U.S. Munitions List. The National Security Council guidance was issued to improve interagency coordination and transparency by providing State and Defense a role in the commodity classification process.

9. Our analysis of Commerce’s median processing time for commodity jurisdiction cases is based on data provided by State. The median processing time, as contained in the report, reflects the amount of time that lapsed between when State referred the case to Commerce and when Commerce provided its initial input. Therefore, our calculation does not need to be revised.

10. See comments 1 and 15.

11. While Commerce notes that State and Defense have roles in reviewing Commerce’s regulations and license applications, we are not incorporating this comment because it is not relevant to understanding the roles of these departments in the commodity classification process.

12. The technical data that Commerce refers to in its comment involved State-controlled missile technology that was exported to China based on an improper Commerce classification. A congressional inquiry determined that U.S. national security was harmed as a result. This incident highlights the risk of Commerce making commodity classification decisions without input from State and Defense. We note
that Commerce admits that jurisdiction is not always clearly delineated between Commerce and State regulations.

13. Our report identifies several instances in which Commerce improperly classified State-controlled items. The one case referred to in Commerce’s comments involved explosive detection devices that were classified by Commerce but were later determined to be State-controlled through the commodity jurisdiction process. When these devices were reviewed through the commodity jurisdiction process, Commerce provided its recommendation on the appropriate jurisdiction and chose not to escalate State’s determination that the items were State-controlled. As we explained to Commerce officials, we were unable to provide Commerce with documents or other evidence related to this case due to our policy to protect proprietary information.

14. As noted in comment 8, the National Security Council guidance provides a role for State and Defense in the commodity classification process. Furthermore, Commerce’s comment reflects a disagreement with State and Defense as to which commodity classification requests should be referred in accordance with the guidance.

15. In our report, we identified three instances in which jurisdictional questions were raised during the license application review process. These license applications involved items for which Commerce had previously issued commodity classifications, but were identified by Defense in the license review process as being State-controlled. While Commerce may not agree with Defense’s position, Commerce does not have the authority to determine which items are not subject to State’s jurisdiction. By law, Commerce can only control, and therefore classify, items that are not controlled by another department. In its comments, Commerce refers to an interagency memorandum of understanding regarding which department has jurisdiction over certain night vision devices. However, there is currently an interagency disagreement on how the memorandum should be interpreted and, as mentioned in our report, an interagency debate on how night vision devices are to be controlled. Commerce also refers to the case involving the explosive detection devices and suggests that it did not improperly classify the devices. However, the devices were ultimately determined to be State-controlled through the commodity jurisdiction process, as discussed in comment 13. Also, we did not provide Commerce with the requested information because it was proprietary information obtained from other sources. While we did not discuss
these specific cases with Commerce officials to protect the identity of the companies involved, we did review government documents related to the cases and discussed the cases with company and other government officials.

16. Commerce states that when it returns a classification request to a company indicating that the item is subject to State’s jurisdiction, it puts the company on notice. However, Commerce’s practice does not provide State with an opportunity to obtain information on companies that need to register with State.

17. Our conclusion considers the effects our findings have on the entire export control system, which consists of separate regulatory regimes for defense and dual-use items. As noted in comments above, we did not attempt to identify all commodity classification requests that appear to meet referral criteria or those that resulted in improper classifications. The examples contained in the report are illustrative of weaknesses in Commerce’s implementation of the commodity classification process. Furthermore, one improper classification can have serious implications for U.S. national security, as demonstrated by the release of missile technology to China discussed in the report. In discussing the impact on industry, Commerce’s comments do not acknowledge that improper classifications can place companies at a competitive disadvantage. Specifically, a company may be exporting through State while its competitor may be exporting the same item through Commerce, based on an improper classification from Commerce.

18. The findings contained in our draft report were discussed in detail with Commerce officials before the draft was provided to Commerce for official comment. After considering Commerce’s written comments, we are confident that the report accurately reflects information provided by Commerce, Defense, State, and company officials during our review.

19. We have revised our recommendation because Commerce believes that it cannot change the time frame for responding to commodity classification requests.
Appendix II: Comments from the Department of State

United States Department of State
Washington, D.C. 20520

SEP 10 2002

Dear Ms. Westin:

We appreciate the opportunity to review your draft report, “EXPORT CONTROL: Processes for Determining Proper Control of Defense-Related Items Need Improvement,” GAO-02-996, GAO Job Code 120062.

The Department's comments are enclosed for incorporation, along with this letter, as an appendix to the GAO final report.

If you have any questions regarding this response, please contact Peter Berry, Office of Defense Trade Controls, Bureau of Political Military Affairs on (202) 663-2806.

Sincerely,

[Signature]

Christopher B. Smith
Assistant Secretary and
Chief Financial Officer

Enclosure:

As stated.

cc: GAO/ASM - Ms. Schinasi
    State/OIG - Mr. Berman
    State/PM - Mr. Maggi

Ms. Susan S. Westin,
Managing Director,
    International Affairs and Trade,
    U.S. General Accounting Office.
Department of State Comments on GAO Draft Report

EXPORT CONTROLS: Processes for Determining Proper Control of Defense-Related Items Need Improvement
(GAO-02-996, GAO Code 120062)

State Department comments on this draft report are set forth in detail. As always, Department officers are prepared to discuss and elaborate on these comments in person at any time.

The State Department welcomes the opportunity to comment on the draft report, entitled “Processes for Determining Proper Control of Defense-Related Items Need Improvement.” We agree with your observation that what is controlled is fundamental to proper implementation of the system and we are committed to meeting established timelines. Over the past year have take steps to better do so. We appreciated the finding that the commodity jurisdiction (“CJ”) requests managed by the Department were consistently transparent and coordinated interagency with Defense and Commerce in all instances. It would appear appropriate to highlight this more visibly in the draft report because the specific purpose of the April 15, 1996, NSC procedures on commodity jurisdiction and commodity classification is, as stated in that document, “to improve interagency coordination and transparency.”

Your report recommended that the Department consider either assigning additional resources to the Office of Defense Trade Controls in order to meet the goal established in the NSC procedures of a 95-day cumulative timeline for responding to commodity jurisdiction requests submitted by exporters or revising the goal. We agree with the spirit of this objective and in March 2001, in response to a recommendation from the Department of State’s Office of Inspector General, Office of Audits, did, in fact, assign an additional full time officer to the CJ function. Since then, there has been steady progress made in reducing timelines, as reflected in the following data (which we shared with the GAO team):

Table 1: Progress Toward 95-Day Cumulative Timeline

<table>
<thead>
<tr>
<th>Date</th>
<th>STATE/DTC</th>
<th>DOD/DTSA</th>
<th>DOC/BIS</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/01/00-09/30/01</td>
<td>148 days</td>
<td>87 days</td>
<td>98 days</td>
</tr>
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</table>
The Department believes that at the current rate, the median overall timeline for CJs will be consistent with the NSC goal of 95 days by the end of the first half of fiscal year 03. If it is not, the Department will consider whether additional resources should be assigned or the timeline revised at that time. We are also instituting other enhancements consistent with our commitments to State’s OIG. For example, we have entered into discussions with Commerce (BIS) to map-out a pilot program for full electronic CJ submissions. This program should be initiated during 2003. Similarly, as noted to the GAO audit team, we are developing an approach for making greater information available as a matter of public record on CJ determinations via the DTC Internet web site, while protecting those business interests accorded confidentiality under Section 38(e) of the AECA. This approach will also be initiated during 2003, subject to further consultation with the Department’s Office of the Legal Adviser and with the U.S. defense industry through the relevant advisory committee (i.e., Defense Trade Advisory Group).

Your report also recommended that “the Secretary of State direct the Office of Defense Trade Controls to issue initial determinations in accordance with the guidance” (even when other departments have not provided their input). We disagree with this recommendation in view of the overall improvement in CJ timelines (noted above) and in light of the longstanding policy and practice of ODTC, which the Department believes should continue, to accord great deference in this area to the national security views of the Department of Defense. A better approach, which we are following, is to enlist greater cooperation from other departments in meeting established timelines consistent with U.S. foreign policy and security interests. The Bureau of Political-Military Affairs is committed to adhering to established time lines and is approaching senior DoD officials to emphasize the importance of timely responses in CJ decision-making, and will also continue to

03/12/01-07/30/02 133 days 86 days 88 days
10/01/01-07/31/02 113 days\(^1\) 83 days 79 days

See comment 3.

See comment 4.

\(^1\)113 days represents the total median time required for all CJ processing in FY 2002 to date. For example, the 83 day median review time at DoD is included within the 113 days.
remind other interagency participants of the established
guidelines. If our approach does not produce the desired
results over the next twelve months, we will re-examine
your recommendations.

Related to your recommendations in this area, please
allow us to point out also that the draft report appears to
omit that ODTC is consistently meeting the 5-day timelines
for initial referral of CJ applications to other agencies
and that these referrals are for the express purpose
(spelled-out in the NSC Procedures) of providing other
departments with a basis upon which to submit
recommendations to ODTC, preparatory to ODTC’s initial
determination. In this respect, it is not the case, as the
draft report may unintentionally imply, that CJ submissions
are not being acted upon until after the notional 55-day
period for initial determination. The data on this point
indicate that ODTC has consistently acted upon all CJ
requests received from US exporters in a timely fashion:

Table 2: Referrals by State Now Beat 5-Day Initial Timeline

<table>
<thead>
<tr>
<th>Interagency Referral by DTC</th>
<th></th>
</tr>
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<tbody>
<tr>
<td>10/01/97-09/30/01</td>
<td>6 Days</td>
</tr>
<tr>
<td>03/12/01-Present</td>
<td>4 Days</td>
</tr>
</tbody>
</table>
The following are GAO’s comments on the Department of State’s letter dated September 10, 2002.

1. While State consistently referred commodity jurisdiction requests to Commerce and Defense, we found indications in State’s data that a limited number of requests were not referred to both departments. However, we could not confirm with State whether these cases were not referred because State officials did not provide responses to questions regarding specific jurisdiction requests.

2. During our review, State officials showed us the information contained in State’s table 1. However, they did not provide us with the supporting data that would be needed to verify State’s progress in reducing the amount of time to process jurisdiction requests. Furthermore, as noted in the report, State officials did not provide us with complete data for fiscal year 2001, despite our requests.

3. While we recognize State’s efforts to reduce the amount of time to process jurisdiction requests, we note that the National Security Council guidance establishes 95 days as the maximum amount of time in which escalated cases are to be resolved. According to the guidance, final jurisdiction determinations should be issued in less than 65 days after a request is received, unless the case is escalated.

4. The issuance of an initial determination prior to receiving input from Defense or Commerce still provides Defense and Commerce an opportunity to express their views on the appropriate jurisdiction for an item, as those departments can escalate the initial determination if they disagree. Also, as discussed in the report, the issuance of an initial determination serves to increase the priority level Defense and Commerce assign to commodity jurisdiction reviews and is, therefore, a mechanism for facilitating the timely resolution of jurisdiction requests. We agree that State should emphasize to the other departments the importance of receiving timely input.

5. We revised the text to reflect the amount of time taken by State to refer jurisdiction requests to Defense and Commerce once it received the requests. Our analysis of State’s data indicates that State took a median of 5 days to refer a request to Defense and 6 days to refer a request to Commerce for our review period.
Note: A GAO comment supplementing those in the report text appears at the end of this appendix.

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

SEP 3 2002
1-02/011713

Ms. Katherine Schinasi
Director, Acquisition and Sourcing Management
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Schinasi:

This is the Department of Defense (DoD) response to the GAO draft report, “EXPORT CONTROLS: Processes for Determining Proper Control of Defense-Related Items Need Improvement,” dated August 8, 2002 (GAO Code 120062/GAO-02-996).”

Specific remarks related to your recommendations are attached. Thank you for the opportunity to comment on this draft report.

Sincerely yours,

Lisa Bronson
Deputy Under Secretary of Defense,
Technology Security Policy and
Counterproliferation

Attachment:
As stated
GAO DRAFT REPORT – DATED AUGUST 8, 2002
GAO CODE 120062/GAO-02-996

“EXPORT CONTROLS: Processes for Determining Proper Control of
Defense-Related Items Need Improvement”

COMMENTS
TO THE RECOMMENDATIONS

RECOMMENDATION 1: To increase transparency to stakeholders and minimize the
risk of Commerce making jurisdictional determinations through the commodity
classification process, the GAO recommended that the Secretary of Commerce direct the
Bureau of Industry and Security to promptly review existing guidance and develop, with
the concurrence of the appropriate entities within State and Defense, criteria for referring
commodity classification requests to those departments. In developing the criteria, the
departments should agree on a common definition of terms to be contained in the criteria.
Until the departments develop and implement referral criteria, the risk of Commerce
improperly classifying State-controlled items will continue to exist. (p. 19/GAO Draft
Report)

RESPONSE: In many respects the existing guidance is generally straightforward. The
larger problem is the lack of sufficient information contained in commodity classification
requests. We are prepared to work with Commerce to develop and implement additional
referral criteria.

RECOMMENDATION 3: To insure that Commerce has sufficient information to make
timely and appropriate commodity classifications, we recommend that the Secretary of
Commerce direct the Bureau of Industry and Security to revise guidance for companies
on the information to be provided with commodity classification requests and consider
including a requirement for information on an item’s origins and applications.

RESPONSE: Although this recommendation is not directed to DoD, we concur with
this recommendation, particularly regarding the inclusion of a requirement for
information on an item’s origins and applications to be mandatory information submitted
with commodity classification requests. Such information should not only improve the
timeliness and quality of the Commerce response, but also reduce the number of
classification requests referred to the commodity jurisdiction process due to insufficient
information. We are prepared to assist Commerce in revising guidance related to
commodity classification requests and suggest that this could be done in conjunction with
the GAO’s recommended development and implementation of commodity classification
referral criteria (see Recommendation 1).
Appendix III: Comments from the Department of Defense

RECOMMENDATION 5: To improve the timeliness of the commodity jurisdiction process, the GAO recommended that the Secretaries of State, Commerce, and Defense direct the respective entities within their departments to assess the amount of resources needed to make jurisdiction recommendations and determinations within established time frames, then either reallocate resources as appropriate or seek changes to the established time frame that are consistent with available resources. (p. 19/GAO Draft Report)

RESPONSE: As noted in your report, DTSA has recently hired an additional staff person to work on commodity jurisdiction requests. While we anticipate that this action will greatly contribute to reducing Defense processing time, we will continue to monitor and assess the overall commodity jurisdiction review process and take further action as necessary.

RECOMMENDATION 6: To improve transparency and consistency of the commodity classification and jurisdiction processes, the GAO recommended that the Secretaries of State, Commerce, and Defense revise interagency guidance to incorporate any changes to the referral process and time frames for making decisions. (p. 20/GAO Draft Report)

RESPONSE: We are prepared to work with State and Commerce to improve transparency and consistency of both the commodity classification and commodity jurisdiction processes.
The following is GAO's comment on the Department of Defense's letter dated September 3, 2002.

1. Because Commerce, State, and Defense officials expressed different interpretations of the National Security Council guidance during our review, we do not agree that the existing guidance is generally straightforward.
## Appendix IV: GAO Contact and Staff

### Acknowledgments

<table>
<thead>
<tr>
<th>GAO Contact</th>
<th>Anne-Marie Lasowski, (202) 512-4146</th>
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<tbody>
<tr>
<td>Acknowledgments</td>
<td>John Neumann, Johana R. Ayers, Raymond H. Denmark, W. William Russell IV, Richard K. Geiger, Markques Y. McKnight, and Christina Sklarew also made significant contributions to this report.</td>
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