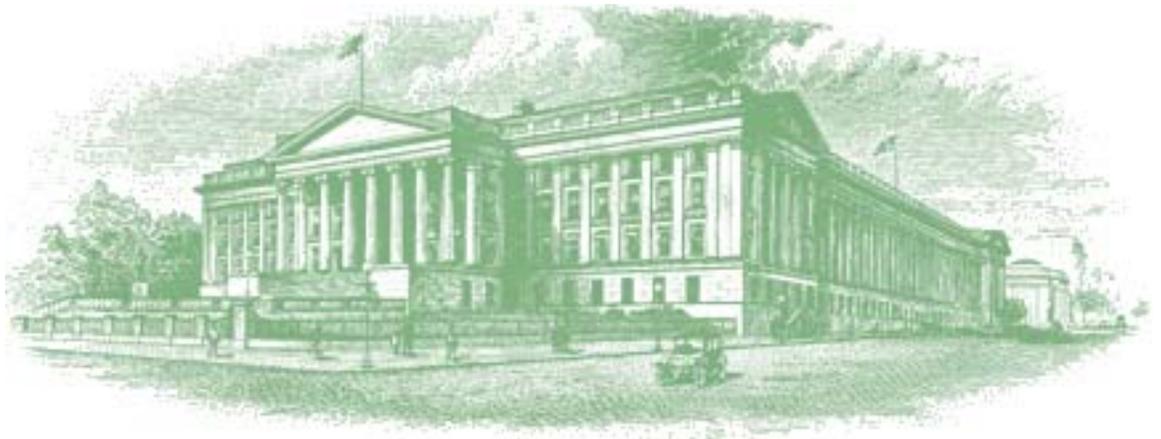




Audit Report



OIG-07-040

EXPORT CONTROLS: CFIUS and OFAC Implemented Prior OIG Recommendations

June 12, 2007

Office of
Inspector General

Department of the Treasury

Contents

Audit Report	3
Results in Brief.....	4
Background	5
Findings and Recommendations	8
CFIUS Established and Implemented Procedures to Help Identify Nonfilers	8
OFAC Has Taken Steps to Track Referrals to Other Agencies but Lacks Written Policy	9
Recommendations.....	10

Appendices

Appendix 1: Objective, Scope, and Methodology.....	12
Appendix 2: Management Comments	13
Appendix 3: Major Contributors To This Report	15
Appendix 4: Report Distribution.....	16

Abbreviations

CFIUS	Committee on Foreign Investments in the United States
ICE	United States Immigration and Customs Enforcement
NDAA	National Defense Authorization Act
OFAC	Office of Foreign Assets Control
OIG	Office of Inspector General
Treasury	Department of the Treasury

This page intentionally left blank.

*The Department of the Treasury
Office of Inspector General*

June 12, 2007

Clay Lowery
Acting Under Secretary for International Affairs

Adam J. Szubin
Director, Office of Foreign Assets Control

This report presents the results of an audit we conducted to follow up on recommendations from two prior Office of Inspector General (OIG) reports on the Department of the Treasury's enforcement of controls for the export of militarily sensitive technology to countries and entities of concern. We conducted this follow-up audit under the auspices of an interagency working group of OIGs that focused on federal agencies' implementation of such controls.¹ The working group was established to help carry out certain reporting requirements of the National Defense Authorization Act (NDAA) for Fiscal Year 2000,² as amended by the NDAA for Fiscal Year 2001.³

The objective of this audit was to determine whether Treasury had effectively implemented recommendations in audit reports issued during fiscal years 2000 and 2003.⁴ The fiscal year 2000 report contained one recommendation, addressed to the Chair of the Committee on Foreign Investment in the United States (CFIUS). The fiscal year 2003 report contained two recommendations,

¹ The participating agencies for the fiscal year 2007 working group consists of the OIGs of the Departments of Commerce, Defense, Energy, Homeland Security, State, Treasury, the United States Postal Service, and the Central Intelligence Agency.

² Pub. L. 106-65, § 1402, 113 Stat. 798 (Oct. 5, 1999).

³ Pub. L. 106-398, § 1204, 114 Stat. 1654A-325 (Oct. 30, 2000).

⁴ *Department of the Treasury Efforts to Prevent Illicit Transfers of U.S. Military Technologies*, OIG-00-072 (Mar. 23, 2000); *Export Enforcement: Numerous Factors Impaired Treasury's Ability to Effectively Enforce Export Controls*, OIG-03-069 (Mar. 25, 2003).

addressed to the Director of the Office of Foreign Assets Control (OFAC). The responding Treasury officials concurred with the recommendations and outlined actions planned in response to the recommendations.

We conducted our audit fieldwork from December 2006 through March 2007. We met with officials of the Office of Investment Security, which is part of the Office of International Affairs, and OFAC. We also reviewed relevant CFIUS and OFAC documentation. Appendix 1 contains a more detailed description of our objective, scope, and methodology.

Results in Brief

In our 2000 report, we recommended that the CFIUS Chair coordinate efforts with other committee members to identify and evaluate all sources of available data that could help identify Exxon-Florio non-filers. After identifying data sources, CFIUS was to develop a methodology and establish procedures for using these data sources effectively. We found the procedure that CFIUS implemented in response to our recommendation was effective.

In our 2003 report, we recommended that the Director of OFAC coordinate with State Department officials to implement an automated process to allow both agencies to track the status of license determination referrals. We also recommended that the Director of OFAC coordinate with Customs officials to ensure that OFAC investigative referrals can be linked to Customs' cases. We found that OFAC had implemented procedures that fulfilled the intent of these two recommendations but had not formalized the procedures as written policy. We recommend OFAC develop written policy to formalize the procedures. OFAC agreed to implement the recommendations in its response to our report.

We obtained written comments to a draft of this report from the Assistant Secretary of International Affairs and the Director of OFAC. The comments are provided in appendix 2.

Background

Reporting Under NDAA

The NDAA for Fiscal Year 2000 requires the President to submit annual reports to Congress through fiscal year 2007 on transfers of militarily sensitive technology to countries and entities of concern. The reports' contents are to include audits by the Inspectors General of the Departments of Commerce, Defense, Energy, and State of policies and procedures related to the export of technologies and technical information to countries and entities of concern.⁵ The reporting requirement was amended in fiscal year 2001 to require that the annual interagency report include OIG follow-up on the status or disposition of recommendations made in earlier reports.⁶

Although Treasury enforces export controls, Treasury OIG was not required to participate in the audits mandated by the 2000 and 2001 laws. Nevertheless, we chose to participate when the interagency working group addressed topics specifically relevant to the Department's enforcement efforts. The topics scheduled for review were decided by the interagency working group in 2000. For fiscal year 2007, the interagency working group decided that the report would include a review of how effectively agencies had addressed recommendations made in previously issued reports. The findings in this report represent our contribution to that effort.

Treasury OIG issued three audit reports in support of the NDAA. The reports contained a total of 16 recommendations, but only 3 remain applicable to Treasury. The other 13 recommendations were addressed to management of entities that are no longer part of Treasury – the legacy U.S. Customs Service and Bureau

⁵ Pub. L. 106-65, § 1402(b)(3), 113 Stat. 798 (Oct. 5, 1999).

⁶ Pub. L. 106-65, § 1402, was amended by Pub. L. 106-398, § 1204, 114 Stat. 1654A-325 (Oct. 30, 2000).

of Alcohol, Tobacco and Firearms.⁷ Of the 3 remaining recommendations, 1 was directed to CFIUS and the other 2 to OFAC.

CFIUS

CFIUS was established in 1975 mainly to monitor and evaluate the effect of foreign investment in the United States. The Secretary of the Treasury was designated the Chair of CFIUS.⁸ In 1988, Congress passed the Exon-Florio amendment to the Defense Production Act of 1950.⁹ The amendment authorized the President or his designee to (1) receive voluntary notices from companies engaged in transactions subject to Exon-Florio; (2) to determine whether a particular acquisition has national security issues; and (3) as appropriate, to undertake investigations. The President delegated these authorities to CFIUS. Exon-Florio also gave the President authority to prohibit or suspend a transaction if necessary to protect national security, and the President retained this authority.

In our 2000 report,¹⁰ we found that although CFIUS did deter some foreign acquisitions that may have had national security implications, it needed to do more to identify nonfilers engaged in activities subject to Exon-Florio. Our specific recommendation was as follows:

We recommend that the CFIUS Chair coordinate efforts with other Committee members to identify and evaluate all sources of available data that can assist in identifying Exon-Florio non-filers. Once data sources are identified, CFIUS needs to develop a

⁷ The border security and inspection arm of the U.S. Customs Service is now part of the Bureau of Customs and Border Protection; the enforcement and investigation arms of the U.S. Customs Service and the law enforcement arm of the Immigration and Naturalization Service is now part of U.S. Immigration and Customs Enforcement (ICE). Both Customs and Border Protection and ICE are within the Department of Homeland Security. The Bureau of Alcohol, Tobacco and Firearms is now within the Department of Justice and is known as the Bureau of Alcohol, Tobacco, Firearms and Explosives.

⁸ The other CFIUS member agencies are the Departments of State, Defense, Justice, Commerce, and Homeland Security; the Office of Management and Budget; the Council of Economic Advisers; the National Economic Council; the Office of the United States Trade Representative; the Office of Science and Technology Policy; and the National Security Council.

⁹ 50 U.S.C. App. § 2170.

¹⁰ OIG-00-072.

methodology and establish procedures as to how these data sources can be effectively used to meet its responsibilities.

CFIUS concurred with our recommendation.

OFAC

OFAC, located within Treasury's Office of Terrorism and Financial Intelligence, administers and enforces economic and trade sanctions against targeted foreign countries, organizations that sponsor terrorism, and international narcotics traffickers, based on U.S. foreign policy and national security goals. OFAC regulations require exporters, importers, and others under U.S. jurisdiction to obtain OFAC licenses before engaging in any type of commercial transactions with targeted countries or nationals.

During our 2003 audit,¹¹ we found that OFAC sent referrals to the State Department for license determinations when OFAC was unsure whether to grant licenses to exporters. The State Department, however, did not routinely process these referrals promptly, resulting in delays in OFAC license approvals. Both State Department and OFAC officials attributed the State Department's processing delays to (1) mandatory rotation cycles that required employees within the Bureau of Economic and Business Affairs, Office of Economic Sanctions Policy, to rotate every two years and (2) the State Department's lack of an automated system to track OFAC referrals.

We also found during our 2003 audit that OFAC referred approximately 30 cases to Customs each year for criminal investigation and that Customs initiated its own investigations of OFAC export violations. We determined that Customs did not always inform OFAC when Customs closed an OFAC investigative referral, decided not to take action on an OFAC referral, or initiated its own investigation of export violations. In addition, Customs and OFAC used different numbers to identify referrals; as a result, OFAC officials said they found it difficult to link their referrals to a Customs' investigative case number. The failure of Customs to notify OFAC officials about closed referrals and investigations

¹¹ OIG-03-069.

hampered OFAC's ability to assess civil penalties when it was determined that criminal prosecution was not warranted.

As a result of these findings, we made the following two recommendations:

1. The Director of OFAC should coordinate with State Department officials to implement an automated process to allow both agencies to track the status of license determination referrals.
2. The Director of OFAC should coordinate with Customs officials to ensure OFAC investigative referrals can be linked to Customs' cases.

OFAC concurred with these recommendations.

Findings and Recommendations

CFIUS Established and Implemented Procedures to Help Identify Nonfilers

In response to our recommendation, the CFIUS Chair established procedures for coordinating with other Committee members to identify and evaluate data sources to help identify Exon-Florio nonfilers. Specifically, CFIUS members met in May 2000 to identify available sources of data and developed a procedure for reporting non-notified transactions. The procedure requires CFIUS members to provide the Committee Chair with information on transactions they believe may be appropriate for review by the Committee under Exon-Florio. Upon receipt of the information, the Committee Chair is to add public information and develop a list of non-notified transactions. This list is then to be circulated to member agencies for review. If a CFIUS member believes that the parties in the transaction should file, CFIUS is to take appropriate action. This procedure has been used by members to identify non-notified transactions since 2000.

OFAC Has Taken Steps to Track Referrals to Other Agencies but Lacks Written Policy

We found that, in response to our recommendations, OFAC took steps to coordinate with the State Department on license referrals and with ICE on investigative referrals.

OFAC Coordination with the State Department

OFAC established regular meetings with the State Department to review license determination referrals and, since 2003, monthly meetings have been held and attended by Licensing Officers and office Directors. These meetings are used to elevate licensing policy issues between OFAC and the State Department. However, OFAC did not implement an automated process that allows both agencies to access each other's system to track the status of licensing determination referrals because it said that the cost was prohibitive. According to OFAC personnel, institution of the monthly meetings has resolved most of the timeliness issues that the recommendation was intended to address.

OFAC Coordination with ICE

OFAC has coordinated with ICE and held regular meetings to review the status of ICE-initiated investigations and OFAC referrals. During these meetings, ICE has provided its active embargo case reports to OFAC for review. These reports detail the status of both ICE-initiated investigations and OFAC referrals. To link OFAC referrals to ICE cases, OFAC assigns case names to their referrals and ICE utilizes these OFAC case names in their active embargo reports.

The steps OFAC took to coordinate with the State Department on license referrals and with ICE on investigative referrals fulfilled the intent of our recommendations. However, OFAC does not have written policy in place that formalizes these procedures. The meetings with the State Department and ICE represent an important internal control, defined in the Government Accountability Office's *Standards for Internal Control in the Federal Government* as the plans, methods, and procedures used to meet

missions, goals, and objectives. Further, internal control should be clearly documented and the documentation should be readily available for examination.¹² Without a written policy requiring continued coordination with the State Department and ICE, lapses in coordination could occur in the future.

Recommendations

To help ensure continuity of coordination between OFAC and the State Department and OFAC and ICE, we recommend the Director of OFAC do the following:

1. Ensure OFAC develops written policy to formalize the procedure of having monthly meetings with the State Department to review the status of license determination referrals.
2. Ensure OFAC develops written policy to formalize the procedure of having regular meetings with ICE to review the status of ICE-initiated investigations and OFAC referrals.

Management Response

OFAC concurred with the two recommendations. OFAC has drafted a policy memo to ensure continued implementation of their current practice of conducting monthly meetings with the Department of State to resolve issues relating to license applications submitted to OFAC that involve foreign policy issues. OFAC has also drafted a policy memo to ensure continued implementation of their current practice of coordinating with criminal law enforcement agencies, including ICE, concerning violations of OFAC regulations. OFAC was to distribute both policy memos no later than May 30, 2007.

OIG Comment

Management's planned actions are responsive to the intent of our recommendations.

¹² Government Accountability Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (November 1999).

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 927-5400 or Alain Dubois, Director of Banking Audits, at (202) 927-0382. Major contributors to this report are listed in appendix 3.

Marla A. Freedman
Assistant Inspector General for Audit

Our objective was to determine whether certain prior OIG recommendations directed to the Chair of the Committee on Foreign Investments in the United States (CFIUS) and to the Director of the Office of Foreign Assets Control (OFAC) had been implemented. These recommendations are restated on pages 6 and 8.

To accomplish this objective, we performed the following activities:

- Conducted interviews with Office of Investment Security personnel
- Reviewed CFIUS guidance on non-notified transactions
- Conducted interviews with current OFAC managers and one former OFAC manager
- Reviewed and analyzed an OFAC report on all outstanding referrals to the State Department
- Reviewed OFAC documentation related to monthly meetings with the State Department
- Reviewed a U.S. Immigration and Customs Enforcement report on Active Embargo Cases

We performed our audit from December 2006 through March 2007 in accordance with generally accepted government auditing standards.

Appendix 2
Management Comments



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

June 4, 2007

Marla A. Freedman
Assistant Inspector General for Audit
Office of the Inspector General
Department of the Treasury
740 15th Street, N.W., Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

This to acknowledge receipt of the draft audit report you sent me on May 3: Export Controls: CFIUS and OFAC Implemented Prior OIG Recommendations. I am pleased to learn your office's view that the Committee on Foreign Investment in the United States (CFIUS) has implemented effective procedures in response to the prior audit report's recommendations, and that there are no further recommendations directed to CFIUS.

I would like to express my appreciation for the work of you and your staff on this draft report. Your efforts ensure that Treasury meets the highest levels of excellence and that Treasury, as chair of CFIUS, continues to implement this process effectively.

Sincerely,

Clay Lowery
Assistant Secretary (International Affairs)



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FAC No GEN- 343251

MEMORANDUM FOR MARLA A. FREEDMAN
ASSISTANT INSPECTOR GENERAL FOR AUDIT
OFFICE OF INSPECTOR GENERAL

FROM: ADAM J. SZUBIN *AJS/shw*
DIRECTOR
OFFICE OF FOREIGN ASSETS CONTROL

SUBJECT: OFAC Comments on the OIG Draft Audit Report – OFAC
Implementation of Prior OIG Recommendations.

OFAC has received and reviewed the draft audit report "Export Controls – CFIUS and OFAC Implemented Prior OIG Recommendations," which was attached to your letter dated May 3, 2007. It concerns the implementation of prior OIG recommendations previously contained in report: "OIG-03-069, Export Enforcement – Numerous Factors Impaired Treasury's Ability to Effectively Enforce Export Controls." I am hereby submitting OFAC's response to the recommendations contained in your draft audit report. Pursuant to OFAC's review of the report and our recent discussions with you on the details of your recommendations, OFAC concurs with the recommendations as noted below:

1. "Ensure OFAC develops written policy to formalize the procedure of having monthly meetings with the State Department to review the status of license determination referrals."

OFAC has drafted a policy memo to be disseminated to OFAC's Licensing Division employees. It will ensure continued implementation of our current practice of conducting monthly meetings with the Department of State to resolve issues relating to license applications submitted to OFAC that involve foreign policy issues. Distribution of the memo will take place no later than May 30, 2007.

2. "Ensure OFAC develops written policy to formalize the procedure of having regular meetings with ICE to review the status of ICE-initiated investigations and OFAC referrals."

OFAC has drafted a policy memo to be disseminated to OFAC's Enforcement Division employees. It will ensure continued implementation of our current practice of coordinating with criminal law enforcement agencies, including ICE, concerning violations of OFAC regulations. Distribution of the memo will take place no later than May 30, 2007.

If we can be of any further assistance or if you have any questions, please contact Dale Thompson, Chief, General Investigations and Field Operations, at 622-1523.

Appendix 3
Major Contributors To This Report

Alain Dubois, Director, Banking Audits
Jeffrey Dye, Audit Manager
Amnoiphorn Bannavong, Program Analyst
Bobbie Gambrill, Auditor
Esther Tepper, Communications Analyst
Horace Bryan, Referencer

The Department of the Treasury

Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

Office of International Affairs

Office of International Affairs
Liaison Officer

Office of Foreign Assets Control

Office of Foreign Assets Control
Liaison Officer

Department of Defense

Department of Defense Office of Inspector General

Office of Management and Budget

OIG Budget Examiner