



Testimony

Before the Subcommittee on Fisheries,  
Wildlife, Oceans and Insular Affairs,  
Committee on Natural Resources,  
House of Representatives

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**COMPACTS OF FREE  
ASSOCIATION**

**Actions Needed to  
Improve Oversight and  
Accountability of U.S.  
Assistance to Micronesia  
and the Marshall Islands**

Statement of David Gootnick, Director  
International Affairs and Trade

# GAO Highlights

Highlights of [GAO-14-243T](#), a testimony before the Subcommittee on Fisheries, Wildlife, Oceans and Insular Affairs, Committee on Natural Resources, House of Representatives

## Why GAO Did This Study

In 2003, the U.S. government approved amended Compacts of Free Association with the FSM and the RMI, providing for a total of \$3.6 billion in assistance over 20 years. This testimony draws from GAO's September 2013 report on the use and accountability of these funds to review (1) the FSM's and RMI's use of compact funds in the education and health sectors; (2) the extent to which the FSM and RMI have made progress toward stated goals in education and health; and (3) the extent to which oversight activities by the FSM, RMI, and U.S. governments ensure accountability for compact funding. Like the report, this testimony also provides information on infrastructure spending in the education and health sectors. GAO reviewed relevant documents and data, including single audit reports; interviewed officials from Interior, other U.S. agencies, and the FSM and RMI; assessed data reliability for subsets of both countries' education and health indicators; and visited compact-funded education and health facilities in both countries.

## What GAO Recommends

GAO is not making new recommendations. In its September 2013 report, GAO recommended that, among other actions, Interior should (1) take all necessary steps to ensure the reliability of FSM and RMI indicators in education and health, (2) assess whether to designate each country as high risk, and (3) take actions to correct its disproportionate staffing shortage related to compact grant implementation and oversight. Interior generally agreed with the recommendations and identified actions taken, ongoing, and planned.

View [GAO-14-243T](#). For more information, contact David Gootnick at (202) 512-3149 or [gootnickd@gao.gov](mailto:gootnickd@gao.gov).

January 7, 2014

## COMPACTS OF FREE ASSOCIATION

### Actions Needed to Improve Oversight and Accountability of U.S. Assistance to Micronesia and the Marshall Islands

## What GAO Found

In fiscal years 2007 through 2011, the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) spent at least half their compact sector funds in the education and health sectors. Because both countries spent significant amounts of compact funds on personnel in those sectors, the U.S.–FSM and U.S.–RMI joint management and accountability committees capped budgets for personnel in those sectors at fiscal year 2011 levels due to concerns about the sustainability of sector budgets as compact funding continues to decline through fiscal year 2023. As required by the committees, the FSM states completed plans to address annual decreases in compact funding; however, as of August 2013, the FSM National Government and the RMI had not submitted plans to address the annual decreases. Without such plans, the countries may not be able to sustain essential services in the education and health sectors.

Data reliability issues hindered GAO's assessment of each country's progress in the education and health sectors for fiscal years 2007 through 2011. Although both countries tracked annual indicators in these sectors during this period, GAO determined that many of these data were not sufficiently reliable for the purpose of measuring progress for the compacts as a whole over the time frame. In education, GAO found 3 of 14 indicators in the subsets of indicators it reviewed for both countries to be sufficiently reliable. GAO found a variety of education data reliability problems; for example, the four FSM states did not use common definitions for some indicators, resulting in inconsistent data for those indicators, and in the RMI some indicators lacked data from the outer islands. In the health sector, GAO determined that data for all 5 of the subset of indicators it reviewed in the FSM were not sufficiently reliable, and in the RMI, 1 health indicator was sufficiently reliable, 2 were not sufficiently reliable, and for 2 others, GAO had no basis to judge due to insufficient information. The joint management and accountability committees have raised concerns about the reliability of FSM's education and health data and RMI's health data and required each country to obtain an independent assessment and verification of these data; both countries have yet to meet that requirement. Without reliable data, the countries cannot assess progress toward their goals in the education and health sectors.

The single audit reports GAO reviewed indicated challenges to ensuring accountability of U.S. funds in the FSM and RMI. For example, the governments' single audits showed repeat findings and persistent problems in noncompliance with U.S. program requirements, such as accounting for equipment. The Department of the Interior (Interior) has taken steps regarding accountability of compact funds, such as establishing a financial control commission in one FSM state, but Interior has not coordinated with other U.S. agencies about the risk status of the FSM and RMI and whether to designate either country as a high-risk grantee. Furthermore, the FSM, RMI, and U.S. offices responsible for compact administration faced limitations hindering their ability to conduct compact oversight. For example, Interior's Office of Insular Affairs (OIA) experienced a staffing shortage that disproportionately affected compact grant oversight compared to other OIA activities, leaving 6 of 11 planned positions for compact oversight unfilled as of 2012 and 5 of 11 still unfilled as of 2013.

Chairman Fleming, Ranking Member Sablan, and Members of the Subcommittee:

Thank you for this opportunity to discuss our recent work reviewing the use and accountability of U.S. grant funds provided under the amended Compacts of Free Association to the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI). The amended compacts, approved by Congress in 2003, provide for a combined total of \$3.6 billion in U.S. grant funds for the FSM and RMI during fiscal years 2004 through 2023.<sup>1</sup> The purpose of the funds is to assist the FSM and RMI governments in their efforts to promote the economic self-sufficiency and budgetary self-reliance of their people. The amended compacts provide sector grants, and associated fiscal procedures agreements<sup>2</sup> require that grant funding support the countries in six core sectors—education, health, infrastructure, environment, private sector development, and public sector capacity building, with the education and health sectors having the greatest priority.

My remarks today are based on our September 2013 report, which was issued at about the midpoint of the amended compacts' 20-year grant period.<sup>3</sup> In our report, we examined (1) the FSM's and RMI's use of compact funds in the education and health sectors; (2) the extent to which the FSM and RMI have made progress toward stated goals in education and health; and (3) the extent to which oversight activities by the FSM, RMI, and U.S. governments ensure accountability for compact funding. In reporting on these objectives, our time frame was generally fiscal years 2007 through 2011, and we also included information on both countries' infrastructure projects during that period. To perform this work, we reviewed FSM and RMI single audits and subsets of FSM and RMI performance indicators for the education and health sectors.<sup>4</sup> We observed the 2012 annual meetings, the 2013 midyear meetings, and the 2013 annual meetings of the U.S.-FSM Joint Economic Management Committee (JEMCO) and the U.S.-RMI Joint Economic Management and Financial Accountability Committee (JEMFAC); these joint management and accountability committees allocate grants and provide oversight for the amended compacts. We interviewed officials from the U.S. Departments of the Interior (Interior), Health and Human Services, Education, and State, the FSM National Government and state governments, and RMI government. We also directly observed selected compact-funded education and health facilities in Chuuk and Pohnpei states in the FSM and Majuro and Kwajalein Atolls in the RMI.<sup>5</sup>

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<sup>1</sup>Compact of Free Association Amendments Act of 2003, Pub. L. No. 108-188 (Dec. 17, 2003).

<sup>2</sup>The agreements between the U.S. government and the FSM and RMI governments contain detailed requirements concerning implementation of the amended compacts' funding and accountability provisions.

<sup>3</sup>GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, [GAO-13-675](#) (Washington, D.C.: Sept. 20, 2013).

<sup>4</sup>Although the scope of the report was generally fiscal years 2007 through 2011, for our analysis of the single audits we included fiscal year 2006 because the last single audit report discussed in our prior report was for fiscal year 2005. See GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability*, GAO-07-163 (Washington, D.C.: Dec. 15, 2006).

<sup>5</sup>In the FSM, we focused our review on the National Government and the state governments of Chuuk and Pohnpei. Chuuk and Pohnpei account for 82 percent of the total population of the FSM. We did not include in our review the state governments of Yap and Kosrae. The observations we made during our site visits to facilities such as hospitals, dispensaries, and schools in the FSM and RMI are not generalizable. We determined that the financial data examined in our report were sufficiently reliable for our purposes. However, our reviews of performance data from both the FSM and RMI and interviews with FSM and RMI officials revealed important limitations in the data in the countries' annual reports on education and health indicators, and therefore we determined that many of these data

The work on which this testimony is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Background

The FSM and the RMI are located in the Pacific Ocean just north of the equator, about 3,000 miles southwest of Hawaii and about 2,500 miles southeast of Japan. The FSM is a federation of four states and has a population of approximately 103,000 (as of 2010) scattered over many small islands and atolls. The RMI comprises 29 constituent atolls and five islands with a population of approximately 53,000 as of 2011. U.S. relations with the FSM and the RMI began during World War II when the United States ended Japanese occupation of the region. Beginning in 1947, the United States administered the region under a United Nations trusteeship. The four states of the FSM voted in a 1978 referendum to become an independent nation, while the RMI established its constitutional government and declared itself a republic in 1979. Under the trusteeship agreement, both newly formed nations remained subject to the authority of the United States until 1986. The United States, the FSM, and the RMI entered into the original Compact of Free Association in 1986, and from 1987 through 2003 the FSM and the RMI are estimated to have received about \$2.1 billion in compact financial assistance.<sup>6</sup>

In 2003, the United States approved separate amended compacts with the FSM and the RMI that went into effect on June 25, 2004, and May 1, 2004, respectively. The amended compacts provide for direct financial assistance to the FSM and the RMI from 2004 to 2023, decreasing in most years. The amounts of the annual decrements are to be deposited in trust funds established for the FSM and the RMI; the annual decrement in grant funding is intended to steadily increase the trust funds so that earnings from the trust can provide a source of annual revenue after the grants end in 2023 (see fig. 2 on page 8 of the report, [GAO-13-675](#)).<sup>7</sup> In addition to receiving compact sector grants, the FSM and the RMI are eligible for a supplemental education grant each year.<sup>8</sup> Separate from the funding authorized and appropriated under the amended compacts' enabling legislation, the countries also receive other grants and other assistance from U.S. agencies.<sup>9</sup>

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were not sufficiently reliable for the purpose of measuring progress for the compacts as a whole over our time frame. For additional details on our objectives, scope, and methodology, see app. I of the report, [GAO-13-675](#).

<sup>6</sup>This estimate represents total nominal outlays. It does not include payments for compact-authorized federal services or U.S. military use of Kwajalein Atoll land in the RMI, nor does it include investment development funds provided under section 111 of Pub. L. No. 99-239, the law enacting the original Compact of Free Association in 1986.

<sup>7</sup>Our earlier work provides additional details on the trust funds established for FSM and RMI, see GAO, *Compacts of Free Association: Trust Funds for Micronesia and the Marshall Islands May Not Provide Sustainable Income*, GAO-07-513 (Washington, D.C.: June 15, 2007).

<sup>8</sup>The supplemental education grant is awarded in place of grant assistance formerly awarded to the countries under several U.S. education, health, and labor programs.

<sup>9</sup>In fiscal years 2007 through 2011, the FSM spent about \$197 million and the RMI spent about \$46 million in noncompact grants from U.S. agencies, including Interior and the Departments of Education, Health and Human Services, Labor, and Transportation.

The legislation and fiscal procedures agreements for the amended compacts established oversight mechanisms and responsibilities for the FSM, RMI, and the United States. To strengthen the management and accountability and promote the effective use of compact funding, JEMCO and JEMFAC were jointly established by the United States and, respectively, the FSM and the RMI. Each five-member committee comprises three representatives from the United States government and two representatives from the corresponding country. JEMCO's and JEMFAC's designated roles and responsibilities include the following:

- reviewing the budget and development plans from each of the governments;
- approving grant allocations and performance objectives;<sup>10</sup>
- attaching terms and conditions to any or all annual grant awards to improve program performance and fiscal accountability;
- evaluating progress, management problems, and any shifts in priorities in each sector; and
- reviewing audits called for in the compacts.

The three countries are required to provide the necessary staff support to their representatives on JEMCO and JEMFAC to enable the parties to monitor closely the use of assistance under the compacts. Each country has established an agency dedicated to providing compact oversight and ensuring compliance with regulations in the amended compacts, grant award terms and conditions, and JEMCO and JEMFAC resolutions. Interior's Office of Insular Affairs (OIA) has responsibility for the administration and oversight of the FSM and RMI compact sector and supplemental education grants. The Director of OIA serves as Chairman of both JEMCO and JEMFAC.

The FSM and the RMI must adhere to specific fiscal control and accounting procedures and are required to submit annual audit reports, within the meaning of the Single Audit Act, as amended.<sup>11</sup> Single audits are a key control for the oversight and monitoring of the FSM and RMI governments' use of U.S. awards. As the U.S. agency with the largest grant awards to the FSM and the RMI, Interior is designated as the cognizant audit agency<sup>12</sup> for FSM and RMI single audits. All U.S. agencies providing noncompact grants to the FSM and the RMI are responsible for administering those grants in accordance with Office of Management and Budget (OMB) requirements<sup>13</sup> and agency regulations that include the Grants Management Common Rule. Under the common rule, U.S. agencies may consider a grantee as "high risk" if the grantee has a history of unsatisfactory performance, is not financially stable, has a management system that

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<sup>10</sup>JEMCO and JEMFAC render decisions by majority vote, except those decisions regarding the division of RMI grants among sectors, which are made by consensus. JEMCO and JEMFAC are also responsible for approving the plans that form the basis for the use of the supplemental education grants annually.

<sup>11</sup>31 U.S.C. § 7501 et seq. The single audit is an organization-wide financial statement audit that includes the audit of the Schedule of Expenditures of Federal Awards and also focuses on internal control and the recipient's compliance with laws and regulations governing the federal financial assistance received. The act requires grantees to address material noncompliance and internal control weaknesses in a corrective action plan, which is to be submitted to appropriate federal officials.

<sup>12</sup>The cognizant agency is the federal agency designated to carry out the federal responsibilities with regard to a single audit and is the agency that provides the predominant amount of direct funding to an entity, such as the FSM and the RMI. Grantees receiving more than \$50 million in federal assistance are assigned to a cognizant agency for audit supervision. See Office of Management and Budget, *Audits of States, Local Governments, and Non-Profit Organizations*, OMB Circular No. A-133 (revised 2007).

<sup>13</sup>See Office of Management and Budget, *Grants and Cooperative Agreements with State and Local Governments*, OMB Circular No. A-102 (revised 1997).

does not meet required standards, has not conformed to the terms and conditions of previous awards, or is otherwise irresponsible.

## **FSM and RMI Prioritized Education and Health Sectors in Spending Compact Funds**

In fiscal years 2007 through 2011, the FSM spent about two-thirds and the RMI spent about half of their total compact sector funds in the education and health sectors—\$158 million for the FSM and \$89 million for the RMI.<sup>14</sup> (For a breakdown of sector compact expenditures and supplemental education grant expenditures for both countries during this period, see pages 14 to 21 of the report, [GAO-13-675](#)).

In the FSM in fiscal year 2011, education sector compact and supplemental education grant funds together amounted to about 85 percent of total education expenditures, and health sector compact funds were about 66 percent of total health expenditures.<sup>15</sup> Compact funds in the RMI also supported a significant portion of government expenditures in the education and health sectors. Education sector compact funds, supplemental education grants, and Ebeye special needs education funds<sup>16</sup> constituted about 62 percent of the RMI's total education expenditures in fiscal year 2011, while health sector compact funds and Ebeye special needs health funds accounted for about 33 percent of the RMI's total health expenditures.<sup>17</sup>

In the education and health sectors, both the FSM and RMI spent significant amounts of compact funds on personnel. The FSM in fiscal years 2009 through 2011<sup>18</sup> spent about 61 percent of its education sector compact and supplemental education grant funds and about 41 percent of its health sector compact funds to pay personnel. In fiscal years 2007 through 2011, the RMI spent about 54 percent of the education sector compact and supplemental education grant funds and about 64 percent of the health sector compact funds for personnel. Concerned about the sustainability of sector budgets as compact funding declines through fiscal year 2023 due to the annual decrements, JEMCO and JEMFAC passed resolutions in 2011, capping budgetary levels for personnel in the education and health sectors of both countries at fiscal year 2011 levels.

**JEMCO and JEMFAC actions regarding annual decrement plans.** JEMCO and JEMFAC resolutions in fiscal years 2009 and 2010 required the FSM National Government and state governments and the RMI government to complete plans that would address the annual decrements in compact funding and identify new revenue sources to replace compact grant

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<sup>14</sup> Since we focused our review on the FSM National Government and the state governments of Chuuk and Pohnpei, the FSM expenditure amount includes data for these three governments. Data for the state governments of Kosrae and Yap are not included.

<sup>15</sup> Other noncompact U.S. grants represented an additional 10 percent of the FSM's education expenditures and 25 percent of its health expenditures in fiscal year 2011.

<sup>16</sup> In addition to the core sector grants, the RMI must also target grant funding to Ebeye and other Marshallese communities within Kwajalein Atoll: \$3.1 million annually for 2004 through 2013 and \$5.1 million annually for 2014 through 2023.

<sup>17</sup> Other noncompact U.S. grants represented an additional 6 percent of the RMI's education expenditures and 17 percent of its health expenditures in fiscal year 2011.

<sup>18</sup> We only reported specific expenditures for the FSM for fiscal years 2009 through 2011 because specific expenditure data for the FSM National Government and Chuuk were not presented in their single audits for fiscal years 2007 and 2008.

assistance in 2023. By the March 2013 JEMCO and JEMFAC midyear meetings, the four FSM states had completed plans to address the annual decrements in compact sector funding through 2023; however, the FSM National Government and RMI government had not completed their plans. Also, in fiscal year 2013, U.S. members of the JEMCO and JEMFAC announced that the United States would consider withholding certain fiscal year 2014 compact sector grant funds until the FSM National Government and RMI submitted their plans for addressing the annual decrements. Without such plans, the countries may not be able to sustain essential services in the education and health sectors.

At the annual JEMCO and JEMFAC meetings in August 2013, the committees withheld annual sector funds from the FSM National Government and RMI government because they failed to provide the required plans to address the annual decrements.<sup>19</sup> In September 2013, however, JEMCO allocated sector grant funds to the four FSM states, which provided the required plans, but continued withholding funds from the FSM National Government because it failed to meet the requirements of the JEMCO resolution requiring the plan.<sup>20</sup> In October 2013, JEMFAC provided sector grant funds to the RMI with the stipulation that no sector funds would be approved in fiscal year 2015 unless the RMI fulfilled the terms of the JEMFAC resolution requiring a decrement plan.<sup>21</sup> In November 2013, the FSM National Government provided OIA with a plan detailing the National Government's long-term fiscal framework, which includes a burden-sharing commitment to the four FSM states to help address the decrement. Among the actions the National Government has taken to address the decrement is a new law modifying the annual compact distribution formula, reducing its share of compact sector grants from 10 percent to 5 percent;<sup>22</sup> the goal in providing an additional 5 percent in compact grant funds to the states is to ensure that priority education and health service needs are not compromised as the annual compact allocations decrease. The U.S. members of JEMCO have yet to determine whether the long-term fiscal framework plan from the FSM National Government meets the decrement plan requirements.

**Reported FSM and RMI infrastructure spending.** In the FSM, in fiscal years 2004 through 2013, approximately \$229 million in compact funds were allocated to infrastructure, and of that about \$106 million has been expended, according to OIA.<sup>23</sup> Delays in establishing JEMCO-approved priorities and unresolved land titling issues affected the construction and maintenance of some health and education facilities in the FSM. During fiscal years 2007 through 2012, the FSM completed 6 education-related projects on a JEMCO-approved list of 19 priority projects, and other projects are under way. From 2004 through 2013, approximately \$106 million in compact funds were allocated to infrastructure in the RMI, and the RMI expended about \$95 million dollars on infrastructure projects, including infrastructure maintenance, according to OIA. The RMI stated it has constructed or renovated over 200 classroom facilities in the education

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<sup>19</sup>The RMI provided a plan to U.S. JEMFAC members 3 days prior to the annual meeting; however, according to the U.S. members, they did not have sufficient time to review it and determine whether or not it met the requirements of the JEMFAC resolution.

<sup>20</sup>The resolution was JEMCO 2010-2, and there were two exceptions to funds being allocated to the FSM National Government—the College of Micronesia and the supplemental education grant award.

<sup>21</sup>JEMFAC Resolution 2010-1.

<sup>22</sup>FSM Pub. L. No. 18-12 (Sep. 14, 2013).

<sup>23</sup>The infrastructure funds that OIA reported expended during this period were for projects in education and health, as well as road and water-related projects, among other things.

sector and 45 projects in the health sector and has also conducted essential maintenance at its two hospitals.

## **Data Inconsistencies Hindered Our Assessment of FSM and RMI Progress in the Education and Health Sectors**

Data reliability issues hindered our assessment of progress by the FSM and RMI in both the education and health sectors for fiscal years 2007 through 2011. Although both countries tracked annual indicators in these sectors to measure progress during this period, we encountered data reliability issues in the subsets of indicators we examined.

We determined that eight of the subset of nine FSM education indicators we reviewed could not be used to assess progress over time because of such issues as incomplete data and inconsistent definitions and data collection. For example, we found that the four FSM states did not use common definitions for some indicators; consequently, the education indicator reports we reviewed did not contain consistent data for these indicators and comparisons could not be made across states. In the RMI, we determined that data for three of the subset of five education indicators we reviewed could not be used to assess education sector progress for the compact as a whole because of issues such as lack of data from the country's outer islands, inconsistencies in reported data for some years, and revisions to data with no explanation.

For all five of the subset of FSM health indicators we reviewed, we determined that the data were not sufficiently reliable to assess progress for the compacts as a whole.<sup>24</sup> For example, for the indicator that all essential drugs were to be available 80 percent of days, we identified problems with the source documents used in the calculations in Chuuk and Pohnpei, calling into question the reliability of the data presented in the health indicators report. In the RMI, of the subset of five health indicators we reviewed, we determined one was sufficiently reliable and two were not sufficiently reliable to assess progress because of various issues with data collection and reporting. For example, we determined that data for immunization coverage for 2-year-olds and the child mortality rate were not sufficiently reliable due to the timeliness and accuracy of reporting and low coverage rates for data from the outer islands. For the remaining two FSM health indicators we examined, we had no basis to judge the reliability of the data.<sup>25</sup>

In much of their reporting on their education and health indicators, the FSM and RMI have noted data reliability problems and some actions they have taken to address them. JEMCO and JEMFAC have also raised concerns about the reliability of the FSM's education and health data and the RMI's health data and required that each country obtain an independent assessment and verification of these data; neither country has met that requirement. Without reliable data, the countries cannot assess progress toward their goals in the education and health sectors and cannot effectively use results data for setting priorities and allocating resources aimed at improving performance. The lack of reliable data also hampers the ability of JEMCO and JEMFAC to oversee compact expenditures and assess the countries' progress toward all their goals in the education and health sectors.

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<sup>24</sup>By "sufficiently reliable," we mean that the likelihood of significant errors or incompleteness is minimal, and the use of the data would not lead to an incorrect or unintentional message.

<sup>25</sup>We sent each country a series of specific follow-up questions related to the subset of indicators we examined to learn more about each country's data collection and verification activities, as well as to try to clarify discrepancies in the data we identified. In some instances, the responses we obtained did not provide sufficient information for us to determine that the data were reliable; in those instances, we classified the indicators as "no basis to judge."



## FSM and RMI Face Financial Accountability Challenges; Oversight Bodies Are Hindered by Limitations

The single audit reports we reviewed indicated challenges to ensuring accountability of compact and noncompact U.S. funds in the FSM and RMI. In the FSM, although the single audit reports for Chuuk and Pohnpei state governments demonstrated improvement in financial accountability, the FSM National Government single audit reports indicated that the government faced financial accountability challenges. For example, the FSM National Government's 2011 single audit report contained several repeat findings—problems noted in previous audits that had not been corrected for several years—and identified problems with the extent of noncompliance with program requirements, such as preparing required quarterly reports. RMI single audit reports for fiscal years 2006 through 2011 demonstrated an increase in material weaknesses in noncompliance with the requirements of federal programs. Some findings were related to compact grants and others to noncompact funding. Furthermore, several of the weaknesses were not corrected over several years.

To improve financial accountability, OIA led actions that resulted in the creation of the Chuuk Financial Control Commission, but OIA has not coordinated with other U.S. agencies regarding the risk status of the FSM and the RMI for noncompact funds. Although OIA has a lead role regarding audit matters, it has not formally coordinated with other U.S. agencies to address audit findings, nor has it assessed whether its own noncompact grants should be classified as high risk.<sup>26</sup> Moreover, other federal agencies whose grants may be at risk have not routinely considered designating either country as a high-risk grantee. Such consideration could enable U.S. agencies to enforce conditions and restrictions on noncompact grant funds they provide, thus improving the oversight and management of the funds.

We also found that the offices responsible for compact administration in the FSM, RMI, and United States faced limitations hindering their ability to conduct compact oversight. FSM officials told us that they need additional staff to be able to conduct more oversight activities and also noted that the Division of Compact Management is hampered by its lack of authority to ensure that the National Government and the four states comply with compact requirements. According to RMI officials, staff constraints in the Office of Compact Implementation limit its ability to conduct oversight and enforce compact requirements across multiple sectors and operations in numerous atolls. Additionally, this office told us they are hampered by their lack of authority to require that the RMI ministries implementing projects funded by sector grants comply with compact requirements. Finally, we found that OIA experienced a staffing shortage that disproportionately affected compact grant oversight compared to other OIA activities, with 6 of 11 planned positions unfilled in 2012 and 5 of 11 unfilled in 2013 (for details, see pages 51-53 of the report, [GAO-13-675](#)). Although the majority of grants administered by OIA are amended compact grants, OIA's amended compact oversight function was disproportionately affected by staffing shortages, which affected its ability to ensure compact funds were efficiently and effectively used.

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<sup>26</sup>According to the grants management common rule, a high-risk designation is authorized if a grantee has a history of unsatisfactory performance or otherwise irresponsible actions, such as failing to submit single audit reports in a timely manner or if single audits or other Inspector General investigations reveal substantial and pervasive problems. Such a designation allows the grantor to impose special terms and conditions or sanctions that could result in suspensions or terminations of federal awards.

## **Interior's Implementation of Recommendations Could Improve Oversight and Accountability of U.S. Assistance to FSM and RMI**

In our September 2013 report, we directed five recommendations to Interior to improve oversight and financial accountability of U.S. compact and noncompact funds allocated to the FSM and RMI.

**Improving oversight through JEMCO and JEMFAC.** We recommended that Interior take all necessary steps to improve the ability of JEMCO and JEMFAC to ensure that the FSM and RMI (1) complete satisfactory plans to address annual decrements in compact funds, (2) produce reliable indicator data used to track progress in education and health, and (3) address all single audit findings in a timely manner. Our recommendations suggested the Director of Insular Affairs could accomplish the accountability improvements by coordinating with other member U.S. agencies of both oversight committees to have the committees take all necessary steps, or by taking all necessary steps directly, acting in his capacity as administrator of compact grants. In its written response to a draft of our report, Interior noted examples of how it and other U.S. members of JEMCO and JEMFAC have worked to make improvements in the three areas mentioned in the recommendations. At both their annual meetings in August 2013, JEMCO and JEMFAC passed resolutions in response to the recommendations in our draft report related to decrement planning, data reliability, and addressing single audit findings.

**Consulting with other agencies about possible high-risk designation.** In order to improve financial accountability of noncompact U.S. grant assistance provided to the FSM and the RMI, we recommended that Interior consult with other grantor agencies to determine whether the FSM National Government, any FSM state government, or the RMI government meets the criteria to be designated as a high-risk grant recipient for noncompact funds, or whether other steps should be taken to improve accountability.

In its written response to a draft of our report, Interior noted that it cannot direct other agencies to take action with regard to any grant-specific issues and stated it was unaware of any precedent for federal agencies to jointly designate a grantee as high risk; however, Interior said it would discuss this approach with other federal agencies.

**Correcting the staffing shortage related to compacts oversight.** To ensure that Interior is providing appropriate resources for oversight and monitoring of the FSM and RMI compacts, we recommended that the Secretary of the Interior take actions to correct the disproportionate staffing shortage related to compact grant implementation and oversight. Interior concurred with this recommendation, as it did with the others. However, Interior's written response to this recommendation indicated that it considers corrective action to be contingent on its receiving funding for new positions through the annual budget process. The intent of our recommendation is to have Interior work within its actual funding levels, whatever they may be, to correct what we observed to be a misalignment in how it allocates its staff.

**FSM and RMI responses.** In its written comments on our draft report, the FSM National Government agreed on the importance of the three issues that were the focus of our JEMCO-related recommendation to Interior. The FSM identified activities under way to plan for the decrement and cited implementation of a contract to assess the national education system's ability to produce valid and reliable data, as well as efforts to review the quality of health indicators with government staff. The FSM remarked on our report's discussion of the possibility of achieving increased accountability over noncompact grant funds through a high-risk

designation, noting that it was assured because the process involved in a high-risk designation is not an arbitrary one.

In its written comments on our draft report, the RMI government stated its belief that it had submitted adequate plans to JEMFAC regarding the medium-term budget and investment framework and the decrement. The RMI generally agreed with our findings of data reliability problems in both the education and health sectors and cited challenges in data collection in both sectors, noting that its Ministry of Health was seeking external assistance to improve data quality. With regard to our recommendation that Interior should consult with other agencies to determine whether the RMI meets the criteria to be designated as a high-risk grant recipient for noncompact funds, or whether other steps should be taken to improve accountability, the RMI stated that internal controls are now in place to detect and deter fraud, waste, and noncompliance with the fiscal procedures agreement or other U.S. federal regulations. For that reason, the RMI Ministry of Finance does not believe that any special conditions or restrictions for unsatisfactory performance or failure to comply with grant terms are warranted. We addressed several of the comments in the RMI's letter by adding or updating information in the report, or to note areas of RMI concern. In reprinting the letter in the report, we also provided specific responses to a number of the comments.

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Chairman Fleming, Ranking Member Sablan, and Members of the Subcommittee, this concludes my prepared statement. I would be pleased to respond to any questions you may have at this time.

### **GAO Contact and Staff Acknowledgments**

If you or your staff have any questions about this testimony, please contact me at (202) 512-3149 or [gootnickd@gao.gov](mailto:gootnickd@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this testimony include Emil Friberg (Assistant Director), Ashley Alley, Christina Bruff, David Dayton, Martin De Alteriis, Julie Hirshen, Jeffrey Isaacs, and Kathleen Monahan.

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