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Report to the Committee on Energy and Natural Resources, U.S. Senate

December 2006

U.S. INSULAR AREAS

Economic, Fiscal, and Financial Accountability Challenges

GAO-07-119

December 2006

GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-07-119, a report to Committee on Energy and Natural Resources, U.S. Senate

U.S. INSULAR AREAS

Economic, Fiscal, and Financial Accountability Challenges

Why GAO Did This Study

The U.S. insular areas of American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the U.S. Virgin Islands (USVI), face long-standing economic, fiscal, and financial accountability challenges. GAO was requested to identify and report on the (1) economic challenges facing each government, including the effect of changing tax and trade laws on their economies; (2) fiscal condition of each government; and (3) financial accountability of each government, including compliance with the Single Audit Act, which applies to nonfederal entities that receive $500,000 or more a year in federal funding.

What GAO Recommends

The Secretary of the Interior should direct the Deputy Assistant Secretary for Insular Affairs to (1) coordinate with other federal grant-making agencies on issues related to the insular area governments; (2) conduct periodic evaluations of the Department of the Interior's Office of Insular Affairs conferences and business-opportunities missions; (3) develop a framework for conducting site visits to help ensure objectives are achieved, information is shared, and monitoring is more efficient and effective; and (4) implement procedures for evaluation of progress made by the insular areas in resolving audit findings and set a time frame for achieving clean audit opinions. DOI agreed with GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-119.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeanette Franzel at (202) 512-9471 or franzelj@gao.gov.

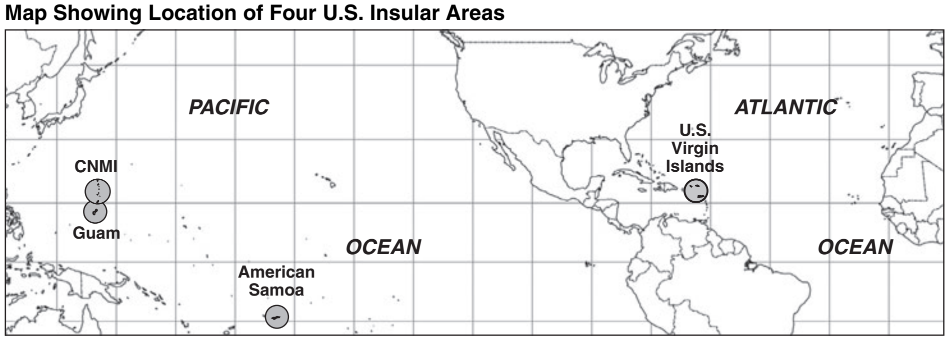
What GAO Found

The governments of the U.S. insular areas of American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the U.S. Virgin Islands face serious economic, fiscal, and financial accountability challenges. The economic challenges stem from dependence on a few key industries, scarce natural resources, small domestic markets, limited infrastructure, shortages of skilled labor, and reliance on federal grants to fund basic services. To help diversify and strengthen their economies, OIA sponsors conferences and missions to the areas to attract U.S. businesses; however, there has been little formal evaluation of these efforts.

After fiscal year 2001, government spending in the CNMI, Guam, and USVI exceeded revenues through fiscal year 2004 (the most recent year for which there is complete data on all four areas). As a result, their fiscal conditions weakened further during this period. CNMI and USVI ended fiscal year 2004 with negative net government assets. For American Samoa the picture was mixed, with more stability than the other areas in the period 2001 through 2003, but a downturn in the balance of governmental funds by the end of fiscal year 2004.

Efforts to meet formidable fiscal challenges and build strong economies are hindered by delayed and incomplete financial reporting that does not provide timely and complete information to management and oversight officials for decision making. The insular area governments have had long-standing financial accountability problems, including the late submission of required single audits, the receipt of disclaimer or qualified audit opinions, and the reporting of many serious internal control weaknesses. These problems have resulted in numerous federal agencies designating these governments as "high-risk" grantees. The Department of the Interior and the federal agencies are working to help these governments improve their financial accountability, but greater coordination among the agencies would increase the effectiveness of their efforts.

Map Showing Location of Four U.S. Insular Areas



Source: GAO and MapArt (map).

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Abbreviations

ACC	Annual Contributions Contract
ACF	Administration of Children and Families
AJCA	American Jobs Creation Act
APIPA	Association of Pacific Islands Public Auditors
ATPA	Andean Trade Preference Act
CDC	Centers for Disease Control and Prevention
CHC	Commonwealth Health Center
CNMI	Commonwealth of the Northern Mariana Islands
DOD	Department of Defense
DOI	Department of the Interior
DOL	Department of Labor
DOT	Department of Transportation
EDC	Economic Development Commission
EMO	Emergency Management Office

FAC	Federal Audit Clearinghouse
FMCSA	Federal Motor Carrier Safety Administration
FMS	Financial Management System
FNS	Food and Nutrition Service
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
GHURA	Guam Housing and Urban Renewal Authority
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IG	Inspector General
IGFOA	Island Government Finance Officers Association
IGIA	Interagency Group on Insular Areas
JAL	Japan Airlines
MCSAP	Motor Carrier Safety Assistance Program
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
OIA	Office of Insular Affairs
OMB	Office of Management and Budget
P&S	Division of Procurement and Supply
PHAS	Public Housing Assessment System
PITI	Pacific Islands Training Initiative
SAMHSA	Substance Abuse and Mental Health Services Administration
SARS	Severe Acute Respiratory Syndrome
SEMAP	Section Eight Management Assessment Program
U.S.	United States
USDA	Department of Agriculture
USVI	U.S. Virgin Islands
VIHA	Virgin Islands Housing Authority
VIHFA	Virgin Islands Housing Finance Authority
VITI	Virgin Islands Training Initiative
WIC	Women, Infants, and Children
WTO	World Trade Organization

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

December 12, 2006

The Honorable Pete V. Domenici
Chairman
The Honorable Jeff Bingaman
Ranking Member
Committee on Energy and Natural Resources
United States Senate

The U.S. insular areas[1] of American Samoa, Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the United States Virgin Islands (USVI) face key economic, fiscal, and financial accountability challenges. The three Pacific insular areas—American Samoa, CNMI, and Guam—are between 4,100 and 6,000 miles from the U.S. mainland. The fourth insular area, the USVI, is located in the Caribbean Sea about 1,000 miles southeast of Miami. All four governments face common challenges to strengthening their economy, fiscal condition, and financial accountability. As you requested, we are reporting on the (1) economic challenges facing each government, including the effect of changing tax and trade laws on their economies; (2) fiscal condition of each government; and (3) financial accountability, including compliance with the Single Audit Act, as amended (Single Audit Act).[2]

The economic and fiscal conditions of these insular areas are affected by destructive climatic events such as typhoons, cyclones, and hurricanes, as well as their economies' general dependence on a few key industries and their governments' reliance on federal grants to provide basic services to their citizens. In addition, although progress has been made in improving financial accountability, the insular area governments continue to have serious internal control and accountability problems that increase their risk of fraud, waste, abuse, and mismanagement.

[1]These four insular areas are the subject of this report. Not included in the scope of this report are Puerto Rico and nine smaller insular areas of the United States, Navassa Island in the Caribbean Sea, and Baker Island, Howland Island, Kingman Reef, Jarvis Island, Johnston Atoll, Midway Atoll, Palmyra Atoll, and Wake Island in the Pacific Ocean.

[2]31 U.S.C. Chp. 75.

Results in Brief

The governments of the insular areas of American Samoa, CNMI, Guam, and USVI face serious economic, fiscal, and financial accountability challenges. The insular area governments' abilities to strengthen their economies have been constrained by their lack of diversification in industries, scarce natural resources, small domestic markets, limited infrastructure, and shortages of skilled labor. The few key industries in each area were established partially due to favorable U.S. federal government trade and tax policies and are vulnerable to changes in these policies that would restrict such benefits. These key industries are also affected by various other external factors, such as fluctuations in the economies of the nearby countries; events such as the effect of the September 11, 2001, terrorist attacks in the United States on tourism in these areas; and U.S. Department of Defense (DOD) decisions to expand or reduce the number of troops at military bases, specifically on Guam. To help diversify and strengthen their economies, the Department of the Interior's (DOI) Office of Insular Affairs (OIA)[3] has in the last 3 years sponsored conferences in the United States and business opportunities missions in the insular areas to attract American businesses to these insular areas. However, the effectiveness of these conferences and business opportunities missions is uncertain due to the lack of formal evaluation of these efforts.

The governments of CNMI, Guam, and USVI experienced worsening fiscal conditions during fiscal years 2001 to 2004,[4] while in American Samoa the picture was mixed, with increases in government funds and assets during fiscal years 2001 through 2003 but a decrease in government funds by the end of fiscal year 2004. In CNMI and Guam, the fund balance[5] of total governmental funds declined as government spending rose. In CNMI, net

[3]OIA's mission is to promote sound financial management processes, boost economic development, and increase the federal government's responsiveness to the unique needs of the insular areas.

[4]The most recent year for which audited financial statements were available for all four insular areas was fiscal year 2004.

[5]Fund balance is the difference between assets and liabilities reported in the governmental fund. A fund is a separate self-balancing set of accounts used to account for resources that are segregated for specific purposes in accordance with special regulations, restrictions, or limitations.

assets[6] declined for fiscal years 2001-2004, and in Guam, net assets declined for fiscal years 2001-2003. The USVI government maintained positive balances of total government funds and reduced its negative balance of net assets by increased borrowing during the period. American Samoa's increase in government funds for fiscal years 2002 and 2003 was due to 2 years of strong surpluses of revenues over expenditures, stemming from an insurance settlement of claims from Hurricane Val, which hit the insular area in 1991. The audited financial statements used to analyze the fiscal condition of the four insular areas are subject to limitations cited by their auditors, which are discussed in the financial accountability section of this report.

The governments of the four insular areas have long-standing financial accountability problems, including the late submission of the reports required by the Single Audit Act, the inability to achieve unqualified ("clean") audit opinions on their financial statements, and numerous material weaknesses in internal control over financial reporting and compliance with laws and regulations governing federal grant awards. Several federal agencies have designated the insular areas as high-risk grantees due to their failure to submit the single audit reports by the statutory deadline and serious ongoing audit findings. The findings in the single audit reports clearly show that the insular area governments lacked effective internal controls to provide reasonable assurance that transactions are properly recorded; assets are safeguarded from fraud, waste, abuse, and mismanagement; and federal funds are expended in accordance with grant requirements. As a result, there is limited accountability over federal grants to the insular areas. Increased coordination between OIA officials and federal grant-making agencies on issues of common concern related to the insular area governments—such as late single audit reports, high-risk designations, and deficiencies in financial management systems and practices—would increase the effectiveness of their efforts.

Multiple federal offices oversee the insular areas' efforts to improve their financial accountability, including the OIA and DOI's Office of the Inspector General (IG), as well as inspectors general from other federal agencies that provide grants. OIA provides funding for technical assistance

[6]Net assets are the remaining amount after liabilities have been subtracted from assets. Revenues are changes in resources that increase net assets whereas expenses are changes in resources that reduce net assets. Financial statements describe how assets, liabilities, and net assets change over the course of a reporting period, such as a fiscal year.

provided by the Graduate School of the Department of Agriculture (USDA) to the insular area governments as well as direct grants to these governments to obtain technical assistance. The insular areas also have local auditing authorities that provide oversight over the governments' activities. While multiple entities oversee the insular areas' efforts to improve their financial accountability, there appears to be limited coordination of financial assistance programs and grants management across the many federal grant-making agencies.

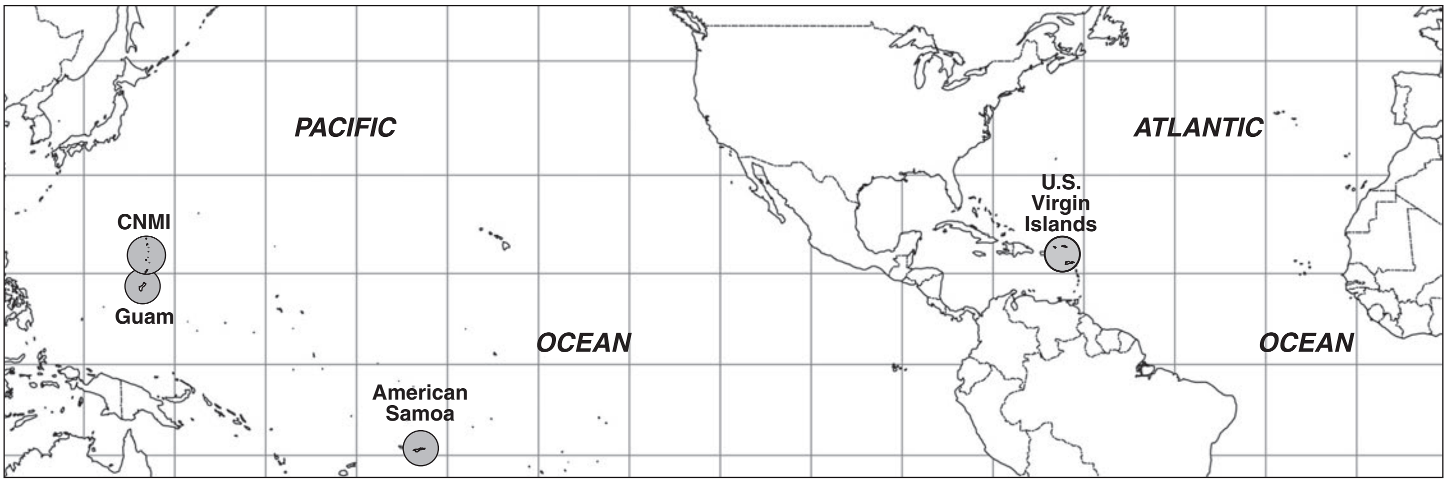
To help the insular area governments improve their financial accountability, we are making recommendations for increased coordination between OIA and other federal grant-making agencies on issues of common concern related to the insular areas, and the implementation by OIA of formal, periodic evaluations of the effectiveness of its efforts to improve the economy of the insular areas. We are also making recommendations for OIA to (1) monitor the insular areas' progress in improving financial accountability by setting a time frame for the governments to achieve clean audit opinions and (2) implement a framework for site visits to help ensure that monitoring objectives are achieved.

We received written comments from DOI on a draft of this report. DOI agreed with our conclusions and recommendations and stated that the four recommendations are consistent with OIA's top priorities and ongoing activities. The focus of our draft report, according to DOI's comments, reflects OIA's top two priorities for the insular areas—private sector economic development and accountability. DOI officials stated that progress is not easily achieved for these two priorities. DOI also provided examples of its current activities that it believes are directed at making the improvements that were the focus of our recommendations. We have reprinted DOI's comments, with our responses, in appendix IV.

Background

The U.S. insular areas of American Samoa, CNMI, and Guam are located in the Pacific Ocean, between 4,100 and 6,000 miles from the U.S. mainland. USVI is located about 1,000 miles southeast of Miami in the Caribbean Sea, as shown in figure 1.

Figure 1: Map Showing Location of Four U.S. Insular Areas



Source: GAO and MapArt (map).

According to U.S. Census Bureau data for 2000, the population of the U.S. insular areas ranges from about 57,000 in American Samoa, to about 155,000 in Guam. Residents born in CNMI, Guam, and USVI are citizens of the United States. Residents born in American Samoa are nationals[7] of the United States, but may become naturalized U.S. citizens. The population of both American Samoa and CNMI, which control their own immigration, included significant percentages of people who were foreign nationals.

According to U.S. Census Bureau data for 2000, median household incomes in the four insular areas ranged from less than half of the U.S. median household income of almost $41,000 for American Samoa to nearly equal for Guam, as shown in table 1. The percentage of individuals in poverty ranged from a low in Guam of 23 to a high in American Samoa of 61. Guam's 23 percent is nearly twice the rate of the continental U.S. rate of 12 percent.

[7]A U.S. national is either a citizen or someone who "owes permanent allegiance to the United States." 8 U.S.C. § 1101 (a) (21), (22). Citizenship is derived either from the Fourteenth Amendment to the Constitution ("All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States") or from a specific statute that confers citizenship on the inhabitants of an area that, although not a state, is under the sovereignty of the United States. No such legislation conferring citizenship has been enacted for American Samoa.

Table 1: Demographic and Economic Characteristics of American Samoa, CNMI, Guam, and USVI, 2000

	American Samoa	CNMI	Guam	Virgin Islands[a]
Population	57,291	69,221	154,805	108,612
Percentage who were non-U.S. citizens or nationals	35.3	56.5	18.1	12.0
Median household income	$18,219	$22,898	$39,317	$24,704
Per capita income	$4,357	$9,151	$12,722	$13,139
Percentage of individuals in poverty	61.0	46.0	23.0	32.5
Economic base	Manufacturing (tuna processing)	Manufacturing (apparel), tourism	Military bases, tourism	Tourism, manufacturing (oil refining), business/ financial services
Employment (percentage)				
Government	29.9	11.7	26.5	24.5
Manufacturing	35.3	40.7	2.0	5.9
Tourism[b]	3.7	13.6	18.0	15.8

Source: U.S. Census Bureau, "Population and Housing Profile: 2000" and GAO analysis.

[a]The USVI Bureau of Economic Research reports per capita personal income of $16,567 in 2000; the share of government in total employment (nonagricultural) is estimated at approximately 30 percent; and the share of tourism at around 20 percent. See U.S. Virgin Islands Annual Economic and Tourism Indicators available at http://www.usviber.org/publications.html.

[b]"Tourism" corresponds to the U.S. Census Bureau category "Arts, entertainment, recreation, accommodation and food services." This category is presented as a proxy for tourism's role in the insular area economies.

While the United States exercises sovereignty over the insular areas, each administers its local government functions through popularly elected governors. As shown in table 2, American Samoa and CNMI are self-governed under locally adopted constitutions. Guam and USVI have not adopted local constitutions and remain under organic acts[8] approved by Congress. Because each of the insular areas is an unincorporated territory,[9] its residents—although they have many of the rights of citizens of the 50 states—cannot vote in national elections and do not have voting representation in the final approval of legislation by the full Congress.

Table 2: Political Characteristics of American Samoa, CNMI, Guam, and USVI

	Relationship to United States	Constitutional development	Citizenship status	Representation in Congress
American Samoa	Unorganized territory[a]	Has a constitution.	U.S. nationals	Nonvoting delegate to House of Representatives[b]
CNMI	Commonwealth[c]	Has a constitution.	U.S. citizens	Resident representative[d]
Guam	Organized territory[e]	Does not have a constitution.	U.S. citizens	Nonvoting delegate to House of Representatives[b]
U.S. Virgin Islands	Organized territory[e]	Does not have a constitution.	U.S. citizens	Nonvoting delegate to House of Representatives[b]

Source: Congressional Research Service, *CRS Report for Congress: U.S. Insular Areas and Their Political Development* (Washington, D.C.: Library of Congress, 1996).

[a]An unorganized territory is an unincorporated U.S. insular area for which the U.S. Congress has not enacted an organic act.

[b]The nonvoting delegates for American Samoa, Guam, and USVI may vote in committees and party caucuses but not on the House floor.

[c]A commonwealth is an organized U.S. insular area that has established a more highly developed relationship—usually embodied in a written mutual agreement—with the federal government. The agreement between CNMI and the U.S. government was enacted by Pub. L. No. 94-241.

[d]CNMI's elected "Resident Representative to the United States," unlike the delegates from American Samoa, Guam, and USVI, is not a member of Congress.

[e]An organized territory is a U.S. insular area for which Congress has enacted an organic act. Guam and USVI are organized under, respectively, 48 USC §§1421 *et. seq*. and 48 USC §§ 1541 *et. seq*.

The insular areas receive substantial amounts in federal grants from a variety of federal agencies, as shown in table 3. Recipients that expend $500,000 or more a year[10] in federal awards under more than one federal

[8]Organic acts are federal laws that serve as the constitution or basic charter of the territory, thereby conferring the powers of government upon a territory. The organic acts of the insular areas usually include a bill of rights and provide for the establishment of the insular areas' tripartite government.

[9]An unincorporated territory is a U.S. territory or insular area to which Congress has determined that only selected parts of the U.S. Constitution apply.

[10]For fiscal years ending before December 31, 2003, the threshold that triggered the requirement for a single audit was expenditures of $300,000 or more in federal awards a year.

program are required by the Single Audit Act to undergo a single audit. Single audits are audits of the recipient organization—the government in the case of the insular areas—that focus on the recipient's internal controls and its compliance with laws and regulations governing federal awards.[11] As nonfederal entities expending more than $500,000 a year in federal awards, the insular areas are required to submit single audit reports[12] each year to comply with the Single Audit Act. One of the objectives of the act is to promote sound financial management, including effective internal controls,[13] with respect to federal awards administered by nonfederal entities. Single audits also provide key information about the federal grantee's financial management and reporting.

Recipient organizations are required by the act to submit their single audits reports to the Federal Audit Clearinghouse (FAC).[14] The single audit reporting package sent to the FAC includes (1) the auditor's reports; (2) the entity's audited financial statements and related notes; (3) the schedule of expenditures of federal awards, related notes, and the auditor's report on the schedule; (4) a schedule of findings and questioned costs; (5) reports on internal controls over financial reporting, and compliance with laws and regulations; and (6) a summary schedule of prior audit findings. The reporting package also includes corrective actions for findings identified for the current year as well as unresolved findings from prior fiscal years. Table 3 below shows the total amount of federal funds provided to each insular area and the largest five federal grant agencies for each insular area.

[11]Office of Management and Budget (OMB) Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, establishes policies for federal agencies to use in implementing the Single Audit Act and provides an administrative foundation for consistent and uniform audit requirements for nonfederal entities administering federal awards.

[12]The single audit replaces multiple grant audits with one audit of an entity as a whole.

[13]Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved—effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

[14]The Single Audit Act Amendments of 1996 resulted in the establishment of an automated database of single audit information at the Federal Audit Clearinghouse (FAC), the organization designated by the Office of Management and Budget to receive single audit reports from federal award recipients.

Table 3: Federal Grant Expenditures of the Insular Areas for Fiscal Year 2004

U.S. insular area and largest grantor agencies	Total federal expenditure amount (dollars in millions)
American Samoa	$140.2
• Department of the Interior	
• Department of Education	
• Department of Agriculture	
• Department of Transportation	
• Department of Health and Human Services	
CNMI	$62.3
• Department of the Interior	
• Department of Agriculture	
• Department of Homeland Security	
• Department of Health and Human Services	
• Department of the Treasury	
Guam	$163.4
• Department of Agriculture	
• Department of Health and Human Services	
• Department of Homeland Security	
• Department of Transportation	
• Department of the Interior	
USVI	$158.4
• Department of Health and Human Services	
• Department of Education	
• Department of Agriculture (nonmonetary programs)	
• Department of Labor	
• Department of Agriculture (monetary programs)	

Source: Schedule of Expenditures of Federal Awards, Single Audit Reports for fiscal year 2004 for each of the four insular areas.

The Secretary of the Interior has administrative responsibility over the insular areas for all matters that do not fall within the program responsibility of another federal department or agency. DOI's OIA and IG carry out the Secretary's responsibilities. OIA was established to foster the efficiency and effectiveness of the insular area governments and to provide technical and financial assistance. In this role, OIA coordinates activities with other federal agencies in the development and implementation of programs and policies pertaining to the insular areas. DOI's IG has the authority to audit all insular area accounts pertaining to revenue and receipts and all expenditures; may report all findings of government failures to collect amounts owed; and may report improper and illegal expenses to the Secretary.[15] DOI's IG has issued many audit reports covering issues on individual insular areas. See appendix III for a list of reports on the insular areas issued by the DOI IG between calendar years 2000 and 2005.

Scope and Methodology

To identify the economic challenges the insular areas face, we reviewed relevant literature dealing with economic conditions in the insular areas, including the potential impact of recent changes in tax and trade laws. We also interviewed officials at OIA and specialists at the U.S. Census Bureau and analyzed various documents and studies from these agencies, including estimates of gross domestic product (GDP). We reviewed analyses prepared by the U.S. Department of Labor (DOL) of the tuna industry in American Samoa and gathered military personnel data from DOD. In addition, we obtained economic data from insular area officials, such as CNMI plant closings, employment statistics, and tourism indicators.

We studied the fiscal condition of each of the insular area governments by identifying and analyzing the revenues, expenditures, government fund balances, and net assets data, as reported in their single audit reports issued for fiscal years 2001 through 2004. We used benchmark estimates of 2002 GDP, prepared by the U.S. Census Bureau for each of the insular areas, to calculate revenues and expenditures as a percentage of GDP. After our work was completed, American Samoa, CNMI, and Guam issued their single audit reports for fiscal year 2005. We did not update our information on the insular areas' fiscal conditions because the USVI single audit report for fiscal year 2005 had not been issued.

We reviewed the financial accountability of the insular area governments by (1) determining the timeliness of submission of the single audit reports, (2) analyzing the contents of the single audit reports issued for fiscal years 2001-2004,[16] (3) identifying those insular area governments designated as high-risk grantees through U.S. federal agency contacts, (4) obtaining information about OIA's efforts to help the insular areas improve financial management, and (5) identifying the relevant auditing organizations at the federal and local levels. We determined the timeliness of submission of the

[15]Pub. L. No. 97-357, 96 Stat. 1705 (Oct. 19, 1982).

[16]Reports for these fiscal years were generally available to be downloaded from the FAC.

single audit reports using the FAC's "Form Date," which is the most recent date that a required SF-SAC data collection form[17] or a revised form was received by the FAC. We did note that the "Form Date" is updated if revised SF-FACs for that same fiscal year are subsequently filed. Our review of the contents of the single audit reports identified the auditors' opinions on the financial statements, matters cited by the auditors in their qualified opinions, the numbers and nature of material weaknesses and reportable conditions reported by the auditors, and the status of corrective actions. We interviewed OIA officials to identify their role in assisting the insular area governments in efforts to improve financial accountability, including training and technical assistance funded by OIA and provided by the USDA's Graduate School. To identify the federal and local auditing authorities with oversight over the four insular area governments, we reviewed the information on the authorities' Web sites and reports that had been recently issued.

Because high-risk designations are made at the individual agency or program level, and this information is not consolidated at the federal government level, we contacted officials at the largest five federal grant agencies for each insular area to determine whether they had designated any of these four insular area governments or agencies of these governments as high-risk grantees, and whether special conditions had been placed on them. We used the schedules of expenditures of federal awards included in the fiscal year 2004 single audit reports to identify the largest five federal grant agencies for each insular area.

We conducted our work from September 2005 through August 2006 in accordance with U.S. generally accepted government auditing standards.

[17]The insular area governments submit a data collection form (SF-SAC) that includes information about the auditee, its federal programs, and the results of the audit.

Narrow Economic Base and Intrinsic and External Factors Limit Economic Progress in the U.S. Insular Areas

Several factors common to all four U.S. insular areas constrain their economic potential. These factors include lack of diversification, scarce natural resources, small domestic markets, limited infrastructure, and shortages of skilled labor. The labor markets of all four insular areas face competition with U.S. mainland wage levels because natives from the insular areas are free to migrate to the United States.[18] Therefore, the insular areas' private and public sectors face chronic difficulties retaining well-trained and highly educated workers. Two of the insular areas, American Samoa and CNMI, control their own immigration and have developed industries that depend on foreign labor paid a minimum wage below that of the United States. Although geographic isolation is frequently mentioned as a factor restraining economic progress in the insular areas, it does not appear to apply to CNMI, Guam, or USVI. CNMI and Guam are well positioned to integrate with the regional economies of East Asia; and USVI is surrounded by the Caribbean Basin countries and the United States. On the other hand, American Samoa is more geographically isolated, with Australia, more than 2,000 miles away, and New Zealand, 1,600 miles away, as the closest large economies.

Although the type of industries and extent of dependence varies, the local economies of the insular areas rely on one or two primary industries. The result of this dependence is economies that are vulnerable to changes in international trade agreements, tax laws, and other external events. For example, American Samoa's private sector is largely based on two tuna canneries. Although these tuna canneries have been an integral part of American Samoa's private sector for decades, they are likely to face increased foreign competition from existing and pending trade agreements established to advance free trade, which could have a serious negative effect on them. Similarly, CNMI's economy is highly dependent on the garment manufacturing industry, which is facing the challenge of remaining internationally competitive against low-wage nations given recent changes in trade agreements. Guam's economy depends on two main sectors—tourism and the provision of services to the U.S. military. Guam's tourism sector is currently stable, but has been affected by several external events, such as the terrorist attacks on the United States on September 11, 2001, and the Severe Acute Respiratory Syndrome (SARS)

[18]For example, U.S. Census Bureau data show that in 2000 there were over 55,000 people in the United States who reported ancestry from Guam and CNMI, as compared to about 81,000 native born residents in Guam and 25,000 in CNMI. There were also over 85,000 Samoans in the United States—from American Samoa, Western Samoa, and elsewhere—compared to 32,500 born and living in American Samoa.

epidemic. The stability of the sector that provides services to the U.S. military is tied to Guam's status as a strategic U.S. military base. USVI has a more diverse economy than American Samoa, CNMI, or Guam, with several sources of revenue—primarily tourism, petroleum refining, and international business and financial services. However, USVI's tourist sector, like that of CNMI and Guam, has experienced volatility due to the terrorist attacks on the United States on September 11, 2001, and the impact of hurricanes. USVI is also facing challenges resulting from recent tax law changes that could cause a reduction in U.S. businesses operating in the insular area.

American Samoa

American Samoa's economy depends primarily on the tuna canning industry.[19] The industry is the insular area's largest source of income and, with the government sector, one of its two largest sources of employment. According to DOL, the two tuna canneries in the insular area employ about one-third of the workforce, with another one-third employed by other businesses, many of which support the tuna industry. The government sector in American Samoa accounts for about 20 percent of the insular area's GDP and employs around one-third of its labor force.[20] Noncitizens make up a large portion of the canneries' employees, about 80 percent in 2000.[21] Several changes in federal trade and tax law may adversely affect the American Samoa tuna industry, in turn affecting the insular area's economy and government.

Trade Law Changes

Since the 1950s, tuna canned in American Samoa has been permitted to enter the United States duty free. However, changes scheduled to take effect in existing free trade agreements, as well as several pending agreements, are likely to increase competition for the tuna canneries in

[19]According to DOI officials, the tuna industry generated directly or indirectly about 85 percent of the territory's private sector activity in 2004. A DOL study indicates that the two canneries, owned by Starkist and Chicken of the Sea, supply more than 60 percent of the canned tuna consumed in the United States. For details, see http://www.dol.gov/esa/whd/AS.

[20]M. Rubin, *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in American Samoa* (Washington, D.C.: U.S. Census Bureau, 2005).

[21]*Impact of Rapid Population Growth in American Samoa: A Call for Action*, May 2000, by the Governor's Task Force on Population Growth, Pago Pago, American Samoa.

American Samoa. For example, according to a DOL study,[22] the elimination of tuna tariffs in 2008 for Mexico under the North American Free Trade Agreement (NAFTA) could, in concert with other factors, result in Mexico's becoming a major exporter of canned tuna to the United States. Likewise, the Andean Trade Preference Act (ATPA), as amended in 2002,[23] allows the U.S. President to exempt Bolivia, Colombia, Ecuador, and Peru from paying U.S. tariffs on shipments of pouched tuna, which is expected to gain market share in the United States.[24] According to DOL, Congress may choose to gradually eliminate tariffs on canned tuna for these countries in the future. In that case, Ecuador—ATPA's major tuna exporter—could become, like Mexico, a significant supplier of canned tuna to the United States.[25] In addition, the U.S.-Thailand Free Trade Agreement now being negotiated could further challenge the American Samoa tuna industry if it grants Thailand—the biggest exporter of tuna to the United States—the right to ship canned tuna to the United States duty free.

Tax Law Changes

The canneries in American Samoa have benefited from possession tax credits under section 936 of the Internal Revenue Code,[26] which is designed to encourage U.S. corporations to invest in the U.S. insular areas and create jobs by reducing the federal taxes on income earned by qualifying U.S. corporations.[27] However, the credit expired for taxable years beginning after December 31, 2005. Although the House passed

[22]Department of Labor, *American Samoa Economic Report 2005*, Section VI, "Economic Factors for Consideration that May Favor Minimum Wage Increases," http: www.dol.gov/esa/whd/AS/sec6.htm.

[23]19 U.S.C. §§ 3201, 3202(b)(1), 3203(b)(3),(4).

[24]According to DOL, pouched tuna, an alternative new technology in tuna packaging, is becoming popular among consumers. *American Samoa Economic Report 2005*, Section III, "The Tuna Processing Industry."

[25]*American Samoa Economic Report 2005*, Section VI, "Economic Factors for Consideration That May Favor Minimum Wage Increases." The U.S. Census Bureau estimates that the majority of profits generated by the tuna canneries are repatriated. Income payments going abroad represent almost 25 percent of GDP.

[26]26 U.S.C. § 936. The possessions tax credits originated in the 1920s as a tax incentive for businesses in the U.S. possessions.

[27]According to an Interior official, the canneries also benefit from several local tax exemptions and subsidies related to water and rent that, combined with duty-free access to the United States, provide other important advantages to the canneries. However, the value of these exemptions and subsidies is not publicly available.

legislation to extend the credit for American Samoa for 1 year,[28] the provision was removed in conference and was not included in the final version of the bill, which was signed by the President on May 17, 2006.[29] According to the DOL study,[30] the loss of the federal income tax credit will reduce the canneries' after-tax profitability and could prompt them to move to countries with a lower minimum wage.[31] The economic and social impact associated with a significant downturn in its major industry may be severe in American Samoa because the large foreign workforce has relatively strong roots in the insular area and, as a result, may remain in the insular area even if unemployed.[32]

CNMI

The CNMI economy depends on two industries, garment manufacturing and tourism, for its employment, production, and exports. These two industries rely heavily on a noncitizen workforce that represents more than three quarters of the labor pool.[33] The garment industry, for example, uses textiles and labor imported mostly from China. Garment manufacturing and tourism account for about 85 percent of CNMI's total

[28]H.R. 4297, 109th Cong. § 111 (2005).

[29]Pub. L. No. 109-222, 120 Stat. 345 (May 17, 2006). On December 7, 2006, the House introduced another measure extending possession tax credits for American Samoa's canneries for 2 years. H.R. 6408, 109th Cong. § 119 (2006). This language of section 119 was subsequently rolled into H.R. 6111, which ultimately passed the House and Senate, and was sent to the President for signature on December 9, 2006. As of the date of this report, no action had been taken by the President.

[30]*American Samoa Economic Report 2005*, Section VI, "Economic Factors for Consideration That May Favor Minimum Wage Increases."

[31]Although the minimum wage in American Samoa is below that of the contiguous United States ($3.26 per hour versus $5.15), the lower labor rates in countries such as the Philippines and Thailand—about $.67 and $.66, respectively—makes such locations attractive to corporations seeking lower labor costs.

[32]As in CNMI, a large number of noncitizens live and work in American Samoa, representing over 35 percent of the population, according to the 2000 U.S. Census. However, unlike the situation in CNMI, about half of American Samoa's foreigners have been living on the island for a relatively long time, with the other half entering after 1990. Western Samoans represent the majority of noncitizens. Also, many American Samoans emigrate to the United States.

[33]The 2000 U.S. Census shows that noncitizens, predominantly Chinese and Filipinos, make up over half of CNMI's population. Almost all of these temporary foreign workers came to CNMI after 1990.

economic activity and 96 percent of its exports.[34] Recent estimates of CNMI's GDP suggest that, in 2002, the garment industry contributed to roughly 40 percent of CNMI's GDP and 47 percent of payroll.[35] The rapid growth of tourism between 1988 and 1996, with visitor arrivals rising from over 245,000 to over 735,000, an average annual increase of 14.7 percent, fueled economic expansion. However, recent alterations in trade law have increased foreign competition for CNMI's garment industry and caused its exports to fall, while other external events have negatively impacted its tourism sector.

Trade Law Changes

Several recent developments in international trade law have affected CNMI's garment industry. Historically, while other garment exports faced quotas and duties in shipping to the U.S. market, CNMI's garment industry benefited from quota-free and duty-free access to U.S. markets for shipments of goods in which 50 percent of the value was added in CNMI.[36] Recently, however, U.S. agreements with other textile-producing countries have liberalized the textile and apparel trade. For example, in January 2005, in accordance with one of the 1994 World Trade Organization (WTO) Uruguay Round agreements, the United States eliminated quotas on textile and apparel imports from other textile-producing countries, leaving CNMI's apparel industry to operate under stiffer competition, especially from low-wage countries such as China.[37] With its trade advantage lessened, CNMI's garment industry has shrunk. According to a DOI official, more than 3,800 garment jobs were lost between April 2004 and

[34] *An Economic Study for the Commonwealth of the Northern Mariana Islands*, Business Development Center, Northern Marianas College, with funding provided by the Office of Insular Affairs, U.S. Department of the Interior, October 1999.

[35] See M. Rubin and S. Sawaya, *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in the Commonwealth of the Northern Mariana Islands* (Washington, D.C.: U.S. Census Bureau, 2005). Many businesses, including the garment factories, are owned and operated by foreigners. As in American Samoa, profits generated by foreign-owned businesses are often repatriated.

[36] According to the U.S. Harmonized Tariff Schedule, certain items of which at least 50 percent of the value was added in a U.S. possession are eligible for duty-free shipment to the United States.

[37] GAO, *U.S.-China Trade: Textile Safeguard Procedures Should be Improved*, GAO-05-296 (Washington, D.C.: Apr. 4, 2005.)

the end of July 2006, with 10 out of 27 garment factories closing.[38] U.S. Department of Commerce data show that the value of CNMI shipments of garments to the United States dropped by more than 16 percent between 2004 and 2005, from about $807 million to $677 million, and down from a peak of $1 billion in 1999-2000. In the first 7 months of 2006, garment exports to the United States dropped by more than 27 percent compared to the same period in 2005, with sales declining from $419 million to $305 million. Given that the taxes and fees from the garment industry account for about 35 to 40 percent of the insular area's revenues, these developments will likely have significant financial and economic impacts, according to OIA officials.

Other Events

Various external events have affected CNMI's tourism industry in recent years. Due to CNMI's proximity to Asia, Asian economic trends have a direct impact on CNMI's economy. For example, tourism in CNMI experienced a sharp decline in the late 1990s with the Asian financial crisis. According to the Marianas Visitors Authority, total visitor arrivals dropped from a peak of 736,117 in 1996 to 501,788 in 1999. After a modest recovery in 2000, tourism faltered again with the September 11, 2001, terrorist attacks on the United States, bringing the number of visitors to 444,284 in 2001. In 2003, according to CNMI officials, tourism slowed—with a double-digit decline in arrivals for several months—in reaction to the SARS epidemic, which originated in Asia, and the war in Iraq. At the same time, CNMI has experienced an influx of Chinese tourists in recent years, with the potential to reenergize the industry. The Chinese share of visitors increased significantly from 0.4 percent in 1997 to 6.5 percent in 2005. CNMI officials are optimistic that the trend will continue in the future, especially on the island of Tinian, which already has gambling and hotel facilities owned and operated by Chinese interests from Hong Kong.

Tourism in CNMI is also subject to changes in airline practices. For example, Japan Airlines (JAL) withdrew its direct flights between Tokyo and Saipan in October 2005, raising concerns because roughly 30 percent of all tourists and 40 percent of Japanese tourists arrive in CNMI on JAL

[38]The burden of this job loss on the government may be mitigated to some extent by the fact that garment industry workers are almost exclusively foreigners on temporary guest visas. Also, data we obtained from the U.S. Census Bureau indicate that foreign workers send much of their earnings back to their countries of origin in the form of remittances; the remainder, which is spent on local goods and services, is relatively small, and as a result, has limited effect on local economic activity. Remittances were estimated at about $80 million for 2002, roughly 10 percent of GDP, and at over $100 million in 2005.

flights, according to CNMI and DOI officials. The Marianas Visitors Authority's June 2006 data show that the downward trend in Japanese arrivals is not being offset by the growth in other tourism markets such as China and South Korea, with the total number of foreign visitors dropping from 43,115 in June 2005 to 38,510 a year later.[39] A mitigating factor is Northwest Airlines' new daily nonstop flights between Osaka and Saipan, which are expected to replace about 40 percent of the seats lost from JAL's action.[40]

Guam

Guam's economy is dominated by two sectors—tourism and government. Tourism provided about 65 percent of business activity in 2004, according to the Guam Economic Development and Commerce Authority Administrator. A 2002 U.S. Census Bureau study indicates that the government sector of Guam represented more than 36 percent of the island's GDP.[41] The U.S. military accounted for more than 40 percent of total government expenditures and about 90 percent of U.S. federal expenditures in Guam.

Although Guam's tourism sector is currently stable, it has been affected by several external events since the late 1990s. The government sector, which is projected to grow in the near future, has historically been sensitive to significant changes in the U.S. military presence.

Factors Affecting Tourism

Guam's tourism sector is vulnerable to external events. In 1997-1998, the Asian financial crisis and a severe typhoon slowed tourist arrivals. According to the Guam Visitors Bureau data, tourist arrivals dropped by almost 18 percent from 1.38 million in 1997 to 1.14 million the following year.[42] After a modest recovery in 1999-2000, the terrorist attacks on the United States in September 2001, two more typhoons in 2002, and the

[39]China Southern Airlines' August 2006 decision to suspend its flights from Guangzhou City in China to Saipan in September because of low load factor, high fuel costs, and low yield in fares is likely to slow the growth of Chinese visitors and hinder CNMI's efforts to attract more tourists from China.

[40]Northwest Airlines has flights from Nagoya, Japan to Saipan as well, and is planning to add flights between Tokyo and Saipan.

[41]M. Rubin and S. Sawaya, *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in Guam* (Washington, D.C.: U.S. Census Bureau, 2005).

[42]http://www.visitguam.org/members/?pg=research.

SARS epidemic in 2003 caused further setbacks in the tourism sector.[43] However, in 2004, with the economic recovery in Japan and a resulting increase in Japanese tourists—which make up the bulk of foreign visitors—tourism on the island increased to about 100,000 arrivals per month, according to Guam's Visitors Bureau.

Military Decisions

Although the number of active-duty military personnel in Guam is currently increasing, the island's economy is vulnerable to policy changes regarding the U.S. military presence. Even though military personnel in Guam remained relatively stable from 1978 to 1992, averaging around 8,400, it declined by about 60 percent between 1992 and 2002, according to DOD. A 2003 economic report[44] states that this decline in the numbers of military personnel may have contributed to Guam's GDP shrinking by as much as 25 to 35 percent over the same period. Military spending, aimed primarily at repairing aging facilities and those damaged by typhoons, rose in 2004. In addition, DOD, in October 2005, announced its plans to transfer 7,000 Marines from Okinawa, Japan, to Guam over the next 6 years, a move that would more than triple the number of military personnel and raise the amount of DOD's spending in the insular area.

USVI

With several sources of revenue, primarily tourism, petroleum refining, and international business and financial services, USVI has a more diversified economy than American Samoa, CNMI, or Guam.[45] Tourism accounts for more than one half of USVI's income and, according to 2002 data from the USVI Bureau of Economic Research, over 20 percent of USVI employment.[46] Exports of refined petroleum, reaching $4.8 billion in

[43]The number of visitors declined from 1,286,807 in 2000 to 1,159,071 in 2001; 1,058,704 in 2002; and 909,506 in 2003.

[44]*Guam Economic Report 2003*, Bank of Hawaii and East-West Center, available at http://www.eastwestcenter.org/stored/pdfs/OsmanGuamEconomicReport2003.pdf. The report indicates that total payroll employment decreased from around 70,000 to 56,000 between 1992-2002, with most of the losses taking place in the private sector and national defense.

[45]Rum distillation is another source of income for USVI. The watch industry, once relatively important for the USVI economy, has been declining over the past 10 years. Watch exports decreased from over 1,000,000 before 1997 to about 320,000 in 2004, with shipments going down further in 2005, according to the USVI Bureau of Economic Research.

[46]The USVI Bureau of Economic Research 2002 data report 8,910 total tourism-related jobs in the following four categories: hotels and other lodging places; gift shops; eating and drinking places; and transportation by air. Nonagricultural wage and salary employment in 2002 was 43,129.

2003, made up almost 90 percent of USVI's total exports.[47] Companies selling international services benefit from a special tax incentive program established by the USVI government in 2001. They accounted for about 29 percent of all USVI corporate and individual income receipts in 2003, but less than 2 percent of USVI employment.[48]

While it is diversified, USVI's economy faces several challenges. First, recent U.S. tax law changes may negatively affect businesses operating in the insular area. Second, the tourism sector, which experienced several setbacks in 2001 through 2004, may be experiencing increased volatility as a result of local tourism trends and other factors.

U.S. Tax Law Changes

As a result of tax changes that ensued from the American Jobs Creation Act of 2004 (AJCA),[49] a growing number of U.S. businesses are projected to suspend operations in USVI, thus reducing local government revenues and jobs. U.S. businesses operating in USVI calculate their income under a coordinated U.S. and USVI income tax policy, but pay their taxes exclusively to the USVI government, if certain requirements are met. These coordinated rules allow the USVI government to reduce the amount of taxes payable to the USVI government provided the businesses are bona fide USVI residents whose income is derived from sources within USVI or is effectively connected with the conduct of a trade or business in USVI. For example, qualifying businesses receive a 90 percent exemption from USVI income taxes and a 100 percent exemption from property and gross receipts taxes under this program operated by USVI's Economic Development Commission (EDC). Such provisions are designed to encourage economic development in the insular area. Effective January 2005, however, AJCA imposed stricter requirements on U.S. businesses for establishing residency and limited the types of income eligible for the

[47]The USVI Economic Review and Industry Outlook indicates that refined petroleum exports grew to $6.7 billion in 2004.

[48]This may be due to the fact that to qualify for tax benefits, businesses need to employ only 10 USVI residents. Eligible businesses in the service category (category IIA or Designated Services Businesses (DSBs)) include business investment managers and advisors, research and development, business and management consultants, software developers, e-commerce, call centers, high technology, international public relations firms, international trading and distributions, and other businesses serving clients outside of USVI.

[49]Pub. L. No. 108-357, 118 Stat. 1418 (Oct. 22, 2004).

program's tax exemptions, which will likely reduce the tax incentives for U.S. businesses operating in USVI.[50]

Tourism Trends and Other Factors

Security concerns and natural disasters have affected USVI's tourism industry in the past 5 years. The total number of visitors to USVI declined after the terrorist attacks of September 11, 2001, on the United States, although in 2004 a record number of tourists—2.6 million—visited the islands, according to the USVI Bureau of Economic Research. Three-quarters of these visitors in 2004 were cruise passengers and one-quarter were overnight visitors. According to an OIA official, cruise ship visitors are increasingly affected by problems associated with crime, especially in St. Croix. Finally, the danger of hurricanes threatens USVI's tourist industry each year, imposing significant costs.[51]

Programs to Promote Economic Development in the Insular Areas

In the last few years, DOI has organized a number of initiatives, such as conferences in the United States and business opportunity missions to the four insular areas, to attract American businesses to these insular areas.[52] The main goal of these efforts is to facilitate interaction and the exchange of information between U.S. firms and top government and business officials from the insular areas, and to spur new investment in a variety of industries. OIA recognizes that the natural economic partners of the Pacific insular areas are neighboring Asian and Pacific countries. However, OIA does not have a foreign affairs component that could actively promote economic relations between the insular areas and foreign countries in the region. Further, OIA believes it needs to promote partnership with U.S.-based firms before foreign ones.

In 2003, a 1-day Secretary's Investment Development Conference in Washington, D.C. attracted approximately 500 participants, while the second 2-day Secretary's Conference on Business Opportunities in the

[50]The U.S. Congress passed AJCA partly in response to reported abuses of the EDC program as a tax shelter or evasion scheme. While the aim of the act was to eliminate loopholes that some businesses had exploited, USVI authorities are concerned that AJCA is also driving away legitimate companies, undermining their effort to attract U.S. firms providing international services.

[51]DOI reports that the combined economic costs to USVI of Hurricanes Hugo in 1989 and Marilyn in 1995 ranged from $3 to $4 billion. FEMA and the U.S. Small Business Administration are reported to have provided grants and loans of more than $200 million.

[52]DOI organized one trade mission to Guam, Palau, and CNMI in 2005; one to American Samoa and one to USVI in 2006.

Islands in 2004 drew over 1,200 participants to Los Angeles. The 2004 conference had 248 attendees from the four insular areas. About half of the participants from USVI, Guam, and American Samoa came from government. More than 80 percent of CNMI's participants were from government. The largest number of participants from the U.S. mainland came from California and Hawaii with a large majority from the private sector, but 26 other states and the District of Columbia were also represented. Individuals from the People's Republic of China, the Philippines, and Australia took part as well.[53] In addition to the conferences, OIA organized three trade missions in the past year.[54] Between 11 and 14 U.S. companies, both small and large, participated in each of these missions.

OIA notes that many mission participants from the mainland did return to the insular areas for follow-up visits. According to OIA, several projects and business deals resulted from contacts made at conferences and missions. For example, OIA indicates that a California-based company is developing a nurse-training facility in CNMI and an entrepreneur from southern California started a software company in American Samoa. Innovative projects such as setting up a production/mass mailing facility in CNMI aimed at the Japanese market are reported to be underway. Although the list does not include new large business enterprises with significant employment impact, it appears that OIA's initiatives have brought new firms and jobs to the insular areas, albeit on a modest scale. While some of these business activities may have taken place anyway, the OIA conferences and missions seem to have helped create linkages and joint projects between the business communities in the mainland and in the insular areas. Some of the new firms may just be displacing local ones or are interested in selling products and services rather than investing; however, others are likely to benefit the insular areas' economies by building local capacity and increasing competition and productivity if investments are realized. Many business deals are apparently still in the planning stages, with companies expressing interest, holding talks, and doing preliminary work.

[53]The data come from preregistered participants. A third Conference on Business Opportunities in the Islands took place on November 13-14, 2006 in Hawaii.

[54]Other agencies, such as the Department of Commerce, the Overseas Private Investment Corporation, and the Small Business Administration provided managerial and organizational support for these missions.

Whether and to what extent OIA's conferences and missions have contributed to stronger economies in the insular areas is difficult to discern because OIA does not carry out formal impact evaluations of its conferences and missions. It does obtain some feedback through informal surveys conducted with participants. But OIA would benefit from an in-depth analysis of how effective its initiatives are in attracting investment to the islands. Further, OIA could, by learning the extent to which U.S. firms are partnering with foreign investors already operating in the insular areas, discover further opportunities for partnership. For example, many Asian-owned businesses are currently contributing entrepreneurial skills and capital: many garment factories in CNMI and one of the two canneries in American Samoa are Asian-owned. Much of the insular areas' economic development may be dependent on relationships with Asian companies, yet OIA does not actively seek to reach firms outside of the U.S. mainland.

Weakened Fiscal Condition in Three Insular Areas

With the exception of American Samoa, the fiscal condition of the insular area governments steadily weakened from fiscal year 2001 through fiscal year 2004, the most recent year for which audited financial statements were available for all four insular areas. In CNMI and Guam, the fund balance of total governmental funds declined as government spending rose faster than revenues. CNMI's net assets at fiscal year-end declined for fiscal years 2001-2004. The USVI government maintained positive balances of total government funds and reduced its negative balance of net assets by increased borrowing during the period. American Samoa showed an increase in government funds until fiscal year 2004, due to 2 years of strong surpluses of revenues over expenditures, stemming from an insurance settlement of claims from Hurricane Val, which hit the insular area in 1991. In fiscal year 2004, the increases in government funds reversed, although it is not yet known if this is a new trend. American Samoa's net assets increased during the entire 4 fiscal years.

American Samoa

For fiscal years 2001 through 2003, American Samoa's fund balance of total governmental funds increased steadily from a deficit of $23.1 million at the beginning of fiscal year 2001 to a positive $43.2 million at the end of fiscal year 2003 before dropping to $37.8 million in fiscal year 2004. From 2001 to 2003, total annual revenues rose by over $15 million, while annual spending fell by almost $12 million, contributing to significant surpluses for fiscal years 2002 and 2003. However, included in the revenues for 2002 and 2003 were proceeds attributable to an insurance settlement of claims from Hurricane Val. Without the receipt of these insurance proceeds, American Samoa's spending would have exceeded its revenues for those years. In fiscal year 2004, the increases in government funds apparently reversed, although it is not yet known if this is a new trend. For fiscal year 2004, revenue fell $9 million while spending increased $22 million.

As shown in table 4, net assets almost tripled to $211 million during fiscal years 2001 through 2004. In fiscal year 2002, American Samoa's government revenues, including the U.S. federal government's contributions, were higher as a share of GDP, 38 percent, than the revenues of any of the other three insular areas. The U.S. federal government also contributed a higher proportion of these revenues—60 percent in fiscal year 2004.

Table 4: Fiscal Condition by Year—American Samoa

	American Samoa			
Data	**2001**	**2002**	**2003**	**2004**
Population	57,529	57,716	57,844	57,902
Own source revenue	92,595,156	116,164,151	100,406,184	74,916,915
Federal contributions	89,621,049	95,366,789	97,530,861	113,960,653
Total revenues	$182,216,205	$211,530,940	$197,937,045	188,877,568
Total expenditures	182,410,239	180,541,130	170,748,872	192,421,535
Revenues less expenditures [surplus/(deficit)]	(194,034)	30,989,810	27,188,173	(3,543,967)
Total net other financing[a]	**4,953,273**	**734,881**	**2,196,503**	**(2,371,449)**
Special adjustment			(1,381,333)[b]	505,552[b]
Governmental funds beginning of year balanced	(23,141,403)	(16,491,517)[c]	15,233,174	43,236,519
Governmental funds end of year balance	(18,382,164)	15,233,174	43,236,520	37,826,655
Net assets, end of year[e]	74,580,312	141,209,273	200,835,235	211,696,176
Change in net assets	—	66,628,961	59,625,962	10,860,941
Calculations				
Federal contributions as a percent of revenues	49.2	45.1	49.3	60.3
Government revenue per capita	$3,167	$3,665	$3,422	$3,262
Government expenditures per capita	3,171	3,128	2,952	$3,323
Government revenue as percent of GDP[f]	—	.38	—	—
Government expenditures as percent of GDP	—	.32	—	—

Source: GAO analysis of Single Audit Reports covering Fiscal Years 2001, 2002, 2003, and 2004; The estimate of GDP, in the amount of $558,755,669, came from *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in American Samoa*, U.S. Census Bureau, Nov. 29, 2005.

[a]Other financing includes loan proceeds and transfers in and out from other funds.

[b]Adjustments made to reflect changes in reserve for inventory.

[c]The end of year fund balance for the prior fiscal year may not agree with the beginning of year fund balance for the succeeding fiscal year due to amounts being restated in subsequent financial statements. We could not readily identify explanations for these restatements because comparative information was not always available or disclosures were not made in subsequent financial statements.

[d]Governmental funds finance most of the basic services provided by the government.

[e]Net assets are capital assets and other assets, such as cash and receivables, less liabilities.

[f]GDP estimates are not available for 2001, 2003, and 2004.

The financial data in table 4 were extracted from American Samoa's audited financial statements, which received qualified opinions from the outside auditors. Therefore, these figures are subject to the limitations cited by the auditors in their opinions and to the material internal control weaknesses identified. These limitations and other accountability issues are discussed in a separate section of this report. Also, restatements of the financial statements may occur, so the numbers shown in table 4 may be different in subsequently issued single audit reports.

CNMI

CNMI's total government funds balance declined from a positive $3.5 million at the beginning of 2001 to a deficit of $49.2 million by the end of 2004 as total government spending rose more rapidly than revenues, which, as shown in table 5, caused a decline in the government's total net assets over the period. CNMI is distinct among the four insular areas in that it has been stable in terms of revenue per capita, although spending per capita has fluctuated. Like USVI, it receives a significantly lower proportion of its revenues from the federal government than do American Samoa or Guam.

Table 5: Fiscal Condition by Year—CNMI

Data	Commonwealth of the Northern Mariana Islands 2001	2002	2003	2004
Population	71,868	74,003	76,129	78,252
Own source revenue	227,709,651	215,650,986	225,412,808	235,754,891
Federal contributions	49,348,134	71,964,627	57,560,034	63,006,595
Total revenues	$277,057,785	$287,615,613	$282,972,842	$298,761,486
Total expenditures	258,177,431	314,985,333	303,986,379	352,488,419
Revenues less expenditures [surplus/(deficit)]	18,880,354	(27,369,720)	(21,013,537)	(53,726,933)
Total net other financing[a]	6,511,003	3,510,667	0	39,493,350
Governmental funds beginning year balance[c]	3,540,878	19,609,305[b]	(4,249,748)	(35,011,807)[b]
Governmental funds end of year balance	17,219,852	(4,249,748)	(25,263,285)	(49,245,390)
Net assets, end of year[d]	40,575,181	30,760,955[e]	15,596,170	(18,656,437)
Change in net assets	—	(9,814,226)	(15,164,785)	(34,252,607)
Calculations				
Federal contributions as a percent of revenues	17.8	25.0	20.3	21.1
Government revenue per capita	$3,855	$3,887	$3,717	$3,818
Government expenditures per capita	3,592	4,256	3,993	4.505
Government revenue as percent of GDP[f]	—	.30	—	—
Government expenditures as percent of GDP	—	.33	—	—

Source: GAO analysis of Single Audit Reports covering Fiscal Years 2001, 2002, 2003, and 2004; The estimate of GDP, in the amount of $946,854,877, came from *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in the Commonwealth of the Northern Mariana Islands*, U.S. Census Bureau, Feb. 11, 2005.

[a]Other financing includes transfers in and out from other funds.

[b]The end of year fund balance for the prior fiscal year may not agree with the beginning of year fund balance for the succeeding fiscal year due to amounts being restated in subsequent financial statements. We could not readily identify explanations for these restatements because comparative information was not always available or disclosures were not made in subsequent financial statements.

[c]Governmental funds finance most of the basic services provided by the government.

[d]Net assets are capital assets and other assets, such as cash and receivables, less liabilities.

[e]Amount reported is the restated amount from 2003 Single Audit Report, corrected because of excluded and misstated amounts.

[f]GDP estimates are not available for 2001, 2003, and 2004.

The financial data in table 5 were taken from the audited financial statements, which received qualified opinions from the outside auditors. Therefore, these figures are subject to the limitations cited by the auditors in their opinions and to the material internal control weaknesses identified. These limitations and other accountability issues are discussed in a separate section of this report. Also, restatements of the financial statements may occur, so the numbers shown in table 5 may be different in subsequently issued single audit reports.

Guam

Guam's total government funds balance declined from a positive of $74.4 million at the beginning of 2001 to a deficit of $198.7 million by the end of 2004 as total government spending rose more rapidly than revenues. Guam's reported net assets at fiscal year-end also fell from the amount shown in fiscal year 2001, as shown in table 6. (The substantial drop in net assets for fiscal year 2002 reflected a correction of previously misstated amounts.) During fiscal year 2004, net assets increased, after decreases in fiscal years 2002 and 2003. The federal government has contributed a smaller proportion of Guam's total revenues than it has for American Samoa, but larger proportions than for CNMI and USVI.

Table 6: Fiscal Condition by Year—Guam

	Guam			
Data	**2001**	**2002**	**2003**	**2004**
Population	158,330	161,057	163,593	166,090
Own source revenue	478,700,351	331,879,876	441,437,973	438,980,593
Federal contributions	138,623,945	156,342,400	216,567,613	219,041,228
Total revenues	$617,324,296	$488,222,276	$658,005,586	$658,021,821
Total expenditures	571,537,586	604,745,053	703,708,399	685,336,581
Revenues less expenditures [surplus/(deficit)]	45,786,710	(116,522,777)	(45,702,813)	(27,314,760)
Total net other financing[a]	(42,753,202)	(12,792,574)	(1,736,294)	(3,066,133)
Special adjustment			(50,000,000)[b]	23,887,350b
Governmental funds beginning of year balance[d]	74,424,223	78,493,488[c]	(94,284,682)[c]	(192,180,886)
Governmental funds end of year balance	77,457,731	(50,821,863)	(191,723,789)	(198,674,429)
Net assets, end of year[e]	386,002,829	137,005,745[f]	39,397,026	88,491,287
Change in net assets	—	(248,997,084)	(97,608,719)	49,094,261
Calculations				
Federal contributions as a percent of revenues	22.5	32.0	32.9	33.3
Government revenue per capita	$3,899	$3,031	$4,022	$3,962
Government expenditures per capita	3,610	3,755	4,302	4,126
Government revenue as percent of GDP[g]	—	.14	—	—
Government expenditures as percent of GDP	—	.18	—	—

Source: GAO analysis of Single Audit Reports covering Fiscal Years 2001, 2002, 2003, and 2004; The estimate of GDP, in the amount of $3,427,882,005, came from *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in Guam*, U.S. Census Bureau, March 10, 2005.

[a]Other financing includes transfers in and out from other funds.

[b]Special adjustments made for fiscal year 2003 to reflect earned income tax credit refunds and overprovisioning for tax refunds and gain from tax drawback settlement in fiscal year 2004.

[c]The end of year fund balance for the prior fiscal year may not agree with the beginning of year fund balance for the succeeding fiscal year due to amounts being restated in subsequent financial statements. We could not readily identify explanations for these restatements because comparative information was not always available or disclosures were not made in subsequent financial statements.

[d]Governmental funds finance most of the basic services provided by the government.

[e]Net assets are capital assets and other assets, such as cash and receivables, less liabilities.

[f]Amount reported is the restated amount from 2003 Single Audit Report, corrected because of excluded and misstated amounts.

[g]GDP estimates are not available for 2001, 2003, and 2004.

The financial data in table 6 were taken from the audited financial statements, which received qualified opinions from the outside auditors. Therefore, these figures are subject to the limitations cited by the auditors in their opinions and to the material internal control weaknesses identified. These limitations and other accountability issues are discussed in a separate section of this report. Also, restatements of the financial statements may occur, so the numbers shown in table 6 may be different in subsequently issued single audit reports. For example, the figures shown for net assets as of the end of fiscal year 2004 and the change in net assets were restated in comparative information provided for fiscal year 2004 in Guam's fiscal year 2005 single audit report.[55]

USVI

USVI's balance of total government funds remained positive throughout the period and grew from $215.5 million at the beginning of 2001 to $463.7 million at the end of 2004. However, this growth was made possible only through increased government borrowing. Spending grew more rapidly than revenues during this period and exceeded revenues by $99.1 million in 2004. Although USVI's negative net assets figures appear to have improved over the period, the trend is due to the recording of assets not previously recorded. At the end of fiscal year 2004, USVI still had a significant negative value for net government assets, as shown in table 7.

[55]The amount for net assets as of the end of fiscal year 2004 was reported in the fiscal year 2004 single audit report as $47,193,817, and the change in net assets figure was $7,796,791.

Table 7: Fiscal Condition by Year—USVI

Data	USVI 2001	2002	2003	2004
Population	108,749	108,810	108,814	108,775
Own source revenue	628,466,000	608,535,000	653,573,000	738,388,000
Federal contributions	146,137,000	151,322,000	163,859,000	160,671,000
Total revenues	$774,603,000	$759,857,000	$817,432,000	899,059,000
Total expenditures	673,254,000	865,733,000	870,807,000	998,122,000
Revenues less expenditures [surplus/(deficit)]	101,349,000	(105,876,000)	(53,375,000)	(99,063,000)
Total net other financing[a]	(63,579,000)	22,267,000	120,982,000	271,245,000
Governmental funds beginning year balance[c]	215,547,000	307,532,000[b]	223,923,000	291,530,000
Governmental funds end of year balance	253,317,000	223,923,000	291,530,000	463,712,000
Net assets, end of year[d]	(394,436,000)	(431,586,000)	(300,083,000)	(272,303,000)
Change in net assets	—	(37,150,000)	131,503,000	27,780,000
Calculations				
Federal contributions as a percent of revenues	18.9	19.9	20.0	17.9
Government revenue per capita	$7,123	$6,983	$7,512	$8,265
Government expenditures per capita	6,191	7.956	8,003	9,176
Government revenue as percent of GDP[e]	—	.27	—	—
Government expenditures as percent of GDP	—	.31	—	—

Source: GAO analysis of Single Audit Reports covering Fiscal Years 2001, 2002, 2003, and 2004; The estimate of GDP, in the amount of $2,809,187,000, came from *Final Trip Report on Benchmark Estimates of 2002 Gross Domestic Product in the U.S. Virgin Islands*, U.S. Census Bureau, June 1, 2005.

[a]Other financing includes: bond anticipation note issued, bonds issued, premium on bonds issued, and transfers in and out from other funds.

[b]The end of year fund balance for the prior fiscal year may not agree with the beginning of year fund balance for the succeeding fiscal year due to amounts being restated in subsequent financial statements. We could not readily identify explanations for these restatements because comparative information was not always available or disclosures were not made in subsequent financial statements.

[c]Governmental funds finance most of the basic services provided by the government.

[d]Net assets are capital assets and other assets, such as cash and receivables, less liabilities.

[e]GDP estimates are not available for 2001, 2003, and 2004.

The financial data in table 7 were taken from the audited financial statements, which received qualified opinions from the outside auditors. Therefore, these figures are subject to the limitations cited by the auditors in their opinions and to the material internal control weaknesses identified. These limitations and other accountability issues are discussed in a separate section of this report. Also, restatements of the financial statements may occur, so the numbers shown in table 7 may be different in subsequently issued single audit reports.

Financial Accountability Remains Weak in the U.S. Insular Areas

The governments of the four U.S. insular areas have had long-standing financial accountability problems, including the late issuance of the reports required by the Single Audit Act, inability to achieve unqualified ("clean") audit opinions on their financial statements, and numerous material weaknesses in internal controls over financial operations and compliance with laws and regulations governing federal grant awards. The findings in the single audit reports clearly point out that the insular area governments have lacked effective internal controls to provide reasonable assurance that transactions are properly recorded; assets are safeguarded from fraud, waste, abuse, and mismanagement; and federal funds are being expended in accordance with grant requirements. As a result, there has been limited accountability over the use of federal funds. Multiple agencies oversee the insular areas' efforts to improve their financial accountability and several federal agencies have designated the insular areas as high-risk under the Grants Management Common Rule.[56] Under the rule, federal grant awarding agencies may designate a grantee as high-risk if the grantee has a history of unsatisfactory performance, is not financially stable, has an inadequate management system, has not conformed to the terms and conditions of previous awards, or is otherwise not properly managing federal funds. OIA and DOI's IG, other federal inspectors general, and local auditing authorities provide oversight and assistance to the insular area governments.

[56] The Grants Management Common Rule was established in 1987 under presidential direction to adopt governmentwide terms and conditions for grants to state and local governments. Federal departments incorporate the Grants Management Common Rule in their own agency regulations. Among the many provisions in the regulations, the Grants Management Common Rule provides authority to designate a grantee as high-risk.

Single Audit Reports for Fiscal Years 2001-2004 Were Not Issued on Time

For fiscal years 1997 through 2004, the insular areas did not submit their single audit reports to the FAC by the due date, which is generally no later than 9 months after the fiscal year end.[57] As shown in table 8, American Samoa and Guam have improved on the timeliness of their audit reports since 1997. Although they were still unable to submit their single audit reports on time for fiscal year 2004, the last year of the review period for all four areas, American Samoa and Guam both submitted their fiscal year 2005 single audit reports to the FAC by the June 30, 2006, due date. The timeliness of CNMI[58] and USVI governments' single audit submissions did not improve for fiscal years 1997 through 2004. However, CNMI submitted its fiscal year 2005 single audit report to the FAC less than 1 month late. As of September 27, 2006, the USVI government had not submitted its fiscal year 2005 single audit report to the FAC.

Table 8: Single Audit Act Report Submissions, Fiscal Years 1997 through 2004

	Number of months late[a]			
Fiscal year-end	American Samoa[b]	CNMI[b]	Guam[b]	USVI
09/30/1997	71	14	13	Not applicable[c]
09/30/1998	51	2	2	13
09/30/1999	43	4	6	13
09/30/2000	31	16	8	8
09/30/2001	25	11	9	6
09/30/2002	23	13	1	12
09/30/2003	14	12	5	11
09/30/2004	8	22	1	12

Source: Single Audit Act, Federal Audit Clearinghouse, and GAO analysis.

[a]Calculated based on the submission form date. The numbers of months late were computed without regard to extensions granted to the insular area governments or the August 2002 memorandum of agreement between OIA and American Samoa.

[57]Under the Single Audit Act, the single audit reporting package is generally required to be submitted to the FAC either 30 days after the receipt of the auditor's report or 9 months after the end of the period under audit. The audited entity, upon hiring the auditor, negotiates a due date for the audit within 9 months after the close of the entity's fiscal year. The entity must have time to read the report and prepare the corrective action plan that is required to be in the reporting package.

[58]DOI granted CNMI an extension until February 28, 2006, for submitting its fiscal year 2004 single audit report.

[b]The Form Dates for submission of the fiscal year 2005 single audit reports were June 30, 2006, for American Samoa and Guam, and July 19, 2006, for CNMI.

[c]For fiscal year 1997, USVI contracted for certain agreed-upon procedures in lieu of the required single audit.

Single audits are a key control for the oversight and monitoring of the insular area governments' use of federal awards. The late submission of single audit reports means that federal government agencies have information on the insular area governments' accountability over federal funds that is not up to date and whose usefulness is therefore limited.

Audit Opinions on Financial Statements and Compliance Were Disclaimed or Qualified

Auditors are required by OMB Circular No. A-133 to provide opinions (or disclaimers of opinion, as appropriate) as to whether the (1) financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP)[59] and (2) auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major federal program.

When reporting on the fairness of the presentation of financial statements, auditors can issue an unqualified opinion, a qualified opinion, an adverse opinion, or a disclaimer of opinion. Auditors express an unqualified ("clean") opinion on financial statements when they have determined, based on sufficient review work, that the financial statements are presented fairly in all material respects, in accordance with GAAP.[60] Auditors render a qualified opinion when they identify one or more specific matters that impact the fair presentation of the financial statements. The effect of a specific matter on the auditors' qualified opinion can be significant enough to reduce the usefulness of the financial statements. Adverse opinions are expressed on financial statements when the auditors have sufficiently definitive data to conclude that the financial statements are not fairly presented in conformity with GAAP. A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. Auditors may decline to express an opinion due to

[59]Generally accepted accounting principles are the conventions, rules, and procedures that provide the norm for fair presentation of financial statements.

[60]Accounting information is material when an omission or misstatement of accounting information would, in the light of surrounding circumstances, make it probable that the judgment of a reasonable person, relying on the information, would have changed or been influenced by the omission or misstatement.

scope or data limitations when they are unable to conclude about the fairness of the financial statements in conformity with GAAP.

In accordance with OMB Circular No. A-133, auditors are required to determine and express an opinion as to whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major federal programs. Auditors are to identify the applicable compliance requirements to be tested and reported on in a single audit. OMB's Compliance Supplement lists and describes the 14 types of compliance requirements and related audit objectives and suggested audit procedures that auditors should consider in single audits conducted in accordance with OMB Circular No. A-133.[61]

Opinions on the Insular Areas' Financial Statements

The four insular area governments have been unable to achieve unqualified ("clean") audit opinions on their financial statements, receiving either disclaimers or qualified opinions on the financial statements issued for fiscal years 1997 through 2004 as shown in table 9.

Table 9: Financial Statement Audit Opinions for Fiscal Years 1997 through 2004

	Type of opinion			
Fiscal year	American Samoa	CNMI	Guam	USVI
1997	Disclaimer	Qualified	Qualified	Not applicable[a]
1998	Disclaimer	Qualified	Qualified	Qualified
1999	Disclaimer	Qualified	Qualified	Qualified
2000	Disclaimer	Qualified	Qualified	Qualified
2001	Qualified	Qualified	Qualified	Qualified
2002	Qualified	Qualified	Qualified	Qualified
2003	Qualified	Qualified	Qualified	Qualified[b] Disclaimer
2004	Qualified	Qualified	Qualified	Qualified[b] Disclaimer

Source: SF-FAC forms and single audit reports for the insular areas from the FAC database.

Note: American Samoa, CNMI, and Guam have submitted their fiscal year 2005 single audit reports and all three received qualified opinions on their financial statements.

[61]The 14 types are (1) activities allowed or unallowed; (2) allowable costs/cost principles; (3) cash management; (4) Davis-Bacon Act; (5) eligibility; (6) equipment and real property management; (7) matching, level of effort, and earmarking; (8) period of availability of federal funds; (9) procurement, suspension and debarment; (10) program income; (11) real property acquisition and relocation assistance; (12) reporting, (13) subrecipient monitoring; and (14) special tests and provisions.

[a]For fiscal year 1997, USVI contracted certain agreed-upon procedures in lieu of the required single audit.

[b]Auditors are permitted to express multiple opinions in a single audit; opinions are rendered based on opinion units. Generally, the opinion units in a government's basic financial statements include the governmental activities, business-type activities, aggregate discretely presented component units, and the major governmental and enterprise funds. For fiscal year 2003, the USVI government received unqualified opinions on its Public Financing Authority debt service fund and West Indian Company enterprise fund; qualified opinions on its governmental activities, discretely presented component units, general fund, unemployment insurance enterprise fund, and aggregate remaining fund information; and a disclaimer on its business-type activities. The opinions rendered on USVI's fiscal year 2004 financial statements were the same as in fiscal year 2003 with the addition of an unqualified opinion on the Public Financing Authority capital projects fund.

American Samoa has made progress in reducing the number of matters that caused the auditors to render qualified opinions on the financial statements, but, for fiscal year 2004, the auditors could not obtain sufficient information about the following items in the American Samoan primary government:[62] (1) the amount of funds owed to or from the other funds—pooled cash;[63] (2) the physical inventory records; and (3) the accuracy of the beginning fund balances. The auditors also could not obtain the information needed to attest to the fairness of the information presented for the discretely presented component units.[64] Specifically, the auditors could not obtain the information needed concerning (1) the cost of property, plant, and equipment in accordance with U.S. generally accepted accounting principles and the operating revenues of the American Samoa Telecommunication Authority and (2) the financial position and activity of the American Samoa Medical Center Authority – Lyndon B. Johnson Tropical Medical Center.

CNMI has also made progress in addressing the matters that resulted in the qualified opinions on its financial statements for fiscal years 2001 through 2003. However, the auditors identified the following issues in fiscal year 2004 as matters leading to the qualified audit opinion: (1) inadequacies in the accounting records regarding taxes receivable and

[62]The primary government is the state or local government. Primary governments have separately elected governing bodies and are legally separate and fiscally independent of other state and local governments.

[63]All cash not legally required to be in separate accounts is pooled to provide greater internal control over cash, and to maximize the amount available for investment, thereby increasing investment revenues.

[64]A discretely presented component unit is an organization that is not part of the primary government but for which the nature and significance of their relationship with a primary government are such that excluding the organization would cause the reporting entity's statements to be misleading or incomplete.

receivables from agencies, advances, accounts payable, tax rebates payable, other liabilities and accruals, amounts owed to component units, and the reserve for continuing appropriations and (2) inadequacies in accounting records and internal controls regarding the capital assets of the Northern Marianas College, and in accounting records and internal controls in inventory, federal agencies receivables, utility plant, accounts payable, and obligations under capital lease of the Commonwealth Utilities Corporation.

Guam has made progress in reducing the number of matters associated with the auditors' qualified opinions rendered on the government's financial statements for fiscal years 2001 through 2004. The auditors cited the following matters associated with its qualified opinion for fiscal year 2004: (1) inability to access tax-related balances, (2) lack of audited financial statements for Guam Memorial Hospital Authority, and (3) lack of audited financial statements for the Guam Visitors Bureau.

Although USVI has made progress in addressing some of the matters that were previously cited as leading to the auditors' qualified opinions, the auditors have identified new matters for fiscal year 2004. The auditor's qualified opinion on the general fund, governmental activities, and discretely presented component units was due to the following: (1) lack of accounting records for corporate income tax receivables for tax year 2002 in the general fund and governmental activities, (2) failure to record a provision for landfill closure and postclosure costs in governmental activities, and (3) inability to determine whether capital assets and land held for sale by the Virgin Islands Housing Authority (VIHA) and the Virgin Islands Housing Finance Authority (VIHFA) were fairly stated. The auditors issued a disclaimer on the USVI government's business-type activities because (1) the financial statements as of September 30, 2003, did not include a receivable for unemployment insurance contributions due to inadequate records;[65] and (2) liability for Workers' Compensation claims was not included.

Opinions on Insular Areas' Compliance with Requirements for Major Federal Programs

Auditors for the four insular areas rendered qualified opinions, disclaimers, or adverse opinions on the insular area governments' compliance with the requirements for each major federal award program.

[65]The receivable for unemployment insurance contributions as of September 30, 2003, is needed because it affects the determination of revenue and changes in net assets for the year ended September 30, 2004.

When auditors identify instances of noncompliance, they are required to report whether the noncompliance could have a direct and material effect on a major federal program.[66] The audit opinions rendered on the insular area governments' compliance with the requirements for major federal programs for the fiscal years under review are shown in table 10.

Table 10: Opinions Rendered on Compliance with Requirements for Major Federal Programs for Fiscal Years 1997 through 2004

	Type of opinion			
Fiscal year	**American Samoa**	**CNMI**	**Guam**	**USVI**
1997	Disclaimer	Qualified	Qualified	Not applicable[a]
1998	Disclaimer	Qualified	Qualified	Not provided
1999	Disclaimer	Qualified	Qualified	Qualified
2000	Disclaimer	Qualified	Qualified	Unqualified
2001	Disclaimer	Qualified	Qualified	Qualified
2002	Disclaimer	Qualified	Qualified	Qualified Adverse[b]
2003	Disclaimer	Qualified	Qualified	Qualified Adverse
2004	Disclaimer	Qualified	Qualified	Unqualified Qualified Adverse

Source: SF-FACs and single audit reports from the Federal Audit Clearinghouse database.

[a]For fiscal year 1997, USVI contracted for certain agreed-upon procedures to be done in lieu of the required single audit.

[b]For fiscal years 2002, 2003, and 2004, auditors for the USVI government issued adverse opinions on compliance with requirements for some programs,while rendering qualified opinions for the reports as a whole. An adverse opinion, in this context, means that the USVI government did not comply in all material respects with the compliance requirements described in OMB Circular No. A-133.

[66]OMB Circular No. A-133 requires auditors to report on compliance that includes an opinion (or disclaimer of opinion) as to whether the entity being audited complied with laws, regulations, and provisions of contracts or grant agreements which could have a direct and material effect on the federal program.

Number and Significance of Reported Internal Control Weaknesses Indicate Inadequate Internal Control over Financial Reporting and Inadequate Compliance with Requirements for Major Federal Programs

The large number and the significance of reported internal control weaknesses raise serious questions about the integrity and reliability of the insular area governments' financial statements and their compliance with requirements of major federal programs. The auditors, in their reports on internal control over financial reporting and on compliance with federal requirements for major federal programs, disclosed many internal control weaknesses.

Material Weaknesses and Reportable Conditions in Internal Control over Financial Reporting

The insular area governments' 29 reported internal control material weaknesses and reportable conditions for fiscal year 2004 indicate a lack of sound internal control over financial reporting needed to provide adequate assurance that transactions are properly recorded, assets are properly safeguarded, and controls are adequate to prevent or detect fraud, waste, abuse, and mismanagement. Reportable conditions over financial reporting are matters that come to an auditors' attention related to significant deficiencies in the design or operation of internal controls that could adversely affect the entity's ability to produce financial statements that fairly represent the entity's financial condition. Material weaknesses in financial reporting are reportable conditions in which the design or operation of internal controls does not reduce to a relatively low level the risk that misstatements caused by error or fraud—material in relation to the financial statements being audited—may occur and not be detected in a timely period by employees in the normal course of performing their duties. Table 11 shows the number of material weaknesses and reportable conditions for each of the four insular areas, for fiscal year 2004.

Table 11: Reported Weaknesses in Internal Control over Financial Reporting Identified in the Auditors' Reports for Fiscal Year 2004

Internal control over financial reporting	American Samoa	CNMI	Guam	USVI	Total
Material weaknesses	6	8	4	3	**21**
Reportable conditions	0	5	3	0	**8**
Total reported weaknesses	**6**	**13**	**7**	**3**	**29**

Source: Single audit reports for the four insular areas for fiscal year 2004.

The reported internal control weaknesses revealed serious deficiencies in internal controls over financial reporting. For example, auditors for the American Samoa government reported for fiscal years 2001 through 2004 that accountants and clerks doing the general accounting were not adequately trained and supervised. The auditors also reported that account reconciliations, journal entries, and other basic transactions were not adequately performed and summarized, a material weakness that casts doubt on the integrity and reliability of the financial information presented in the single audit report. Another internal control weakness reported by the auditors was that the government records had not been maintained in an organized manner due to a lack of formal procedures for the maintenance and storage of records. Due to this material internal control weakness, documentation may be misplaced, lost, or destroyed without being detected.

One of the internal control weaknesses that the auditors reported for CNMI's government for fiscal year 2004 involved liabilities recorded in the General Fund. Due to the lack of detailed subsidiary ledgers, the auditors could not determine the propriety of these account balances, and whether the negative balances in the accounts, as in prior years, also included prepaid items. The recording of prepaid items as expenditures will cause expenditures to be overstated and the related liabilities to be understated. One of the control activities[67] mentioned in GAO's *Standards for Internal Control in the Federal Government*[68] is accurate and timely recording of transactions and events. This control activity is applicable to the entire process or life cycle of a transaction or event from the initiation and authorization of a transaction through its final classification in summary records. CNMI's auditors also reported as an internal control weakness, in at least two of its single audit reports, a Commonwealth Health Center (CHC) receivable balance that represented accounts outstanding in excess of 120 days due to inadequate billing and collection procedures. According to the auditors, the effect of this weakness was a possible misstatement of CHC's receivable balances, partially mitigated by a corresponding uncollectible account balance of the same amount. The auditors recommended that the uncollectible accounts be written off, and that the

[67]Internal control activities help ensure that management's directives are carried out and should be effective and efficient in accomplishing control objectives.

[68]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

CHC implement procedures for processing all billings on a timely basis and for following up on aged accounts.

In Guam, the lack of required physical inventories of government equipment and the lack of uniform maintenance procedures to keep equipment in good condition were cited as material weaknesses by auditors for fiscal years 2003 and 2004. The auditors also stated that the government of Guam did not perform a comprehensive inventory of its capital assets, including infrastructure.[69] According to Guam's single audit report for fiscal year 2004, the government was working to tag all of its equipment with bar code property identification labels so that it would be able to conduct a physical inventory. Another internal control weakness was reported in the accounts payable-trade account: accounts payable that had aged 2 or more years remained in the accounts payable listing while more current balances were liquidated. Moreover, the auditors reported that all nine of the general ledger liability accounts tested included invalid accruals. The auditors attributed these problems—which could result in a potential misstatement of accounts payable—to poor internal control over the filing of supporting documentation of recorded transactions. Unreconciled differences in the combined cash balances for some governmental funds for fiscal year 2004 were reported by the auditors. The auditors attributed these differences to the lack of timeliness of the performance of bank reconciliations, which does not appear to have been monitored—the effect being a misstatement of cash balances. GAO's *Standards for Internal Control in the Federal Government* highlights reconciliation as a key control activity.

Auditors for USVI reported that the reconciliations of all USVI government bank accounts as of September 30, 2003 (fiscal 2003 year-end) were not completed until June 2004. The auditors stated that performing timely and accurate reconciliation of bank accounts is a key control over cash receipts and disbursements, and that the lack of timely reconciliation of all bank accounts may result in errors or irregularities in cash transactions to not be promptly detected. USVI's auditors attributed the failure to prepare timely bank reconciliations to a lack of established procedures. Auditors

[69]A detailed inventory of capital assets is needed to conform to the financial presentation required by Statement No. 34 of the Governmental Accounting Standards Board (GASB). Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, establishes new requirements for the annual financial reports of state and local governments. One of the new requirements is that state and local governments report infrastructure and depreciate their capital assets.

also reported this material weakness in the single audit report for fiscal year 2004 for USVI and stated that the reconciliations of all USVI government bank accounts as of September 30, 2004, were not completed until July and August of 2005. Auditors also found weaknesses in the government's ability to quantify and record certain key financial activity, such as a workers' compensation claims liability, due to the lack of complete and accurate financial data. During 2004, as in previous years, the government experienced delays in its year-end closing process and in the preparation of complete and accurate financial statements in accordance with GAAP. In numerous year-end closing entries that, in some instances, represented corrections to routine transactions that occurred throughout the year, auditors found their nature, timing, and extent indicative of weaknesses in controls over financial reporting.

Material Weaknesses and Reportable Conditions in Compliance with Requirements for Major Federal Programs

Auditors reported material weaknesses and reportable conditions in the insular area governments' compliance with requirements for major federal programs and the internal controls intended to ensure compliance with these requirements. In the context of compliance, reportable conditions are matters that come to an auditor's attention related to significant deficiencies in the design or operation of internal controls over compliance that could adversely affect the entity's ability to operate a major federal program within the applicable requirements of laws, regulations, contracts, and grants. Material weaknesses in this context are reportable conditions in which internal controls do not reduce to a relatively low level the risk of noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material to the major federal program being audited and undetected in a timely way by employees in the normal course of performing their duties.

Table 12: Material Weaknesses and Reportable Conditions Relating to Compliance with Requirements for Major Federal Programs for Fiscal Year 2004

Internal control over compliance with major-program requirements	American Samoa	CNMI	Guam	USVI	Totals
Material weaknesses	9	2	8	28	**47**
Reportable conditions	13	31	17	3	**64**
Total findings	**22**	**33**	**25**	**31**	**111**

Source: Single audit reports for the four insular areas for fiscal year 2004.

American Samoa

As shown in table 12, auditors reported nine material weaknesses in compliance with requirements for major federal programs for the American Samoa government for fiscal year 2004. One of these weaknesses involved a receiving report that showed that an item purchased with 2004 grant funds was not received until August 31, 2005, the end of the 2005 grant year. The effect of this delay was that the government received and expended from the 2004 grant, but did not complete the transaction and receive the goods from the vendor until 1 year later. The auditors attributed this weakness to the vendor's requirement of advance payment for this purchase and lack of follow up to determine whether the goods that had been paid for had been delivered. For fiscal year 2004, another reported internal control weakness in compliance with requirements for major federal programs involved delays in the completion of the single audit, which did not occur within 9 months of the fiscal year end, as required by the Single Audit Act. The auditors stated that the cause of the missed single audit due date was (1) a failure of the accounting system and (2) the lack of trained, qualified, and competent personnel. These two factors resulted in a delay in closing the accounting records.

CNMI

One of the two internal control weaknesses affecting compliance with major federal programs reported for CNMI's government for fiscal year 2004 was the failure to record expenditures for the Medical Assistance Program when they were incurred. In one instance, the auditor identified expenditures for billings from service providers for services rendered in previous years. The auditors attributed this weakness to the lack of policies and procedures regarding the timely recognition of expenditures at the time services are rendered. The effect of this weakness is that expenditures reported to the grantor agency, the U.S. Department of Health and Human Services (HHS), are based on the paid date and not, as required, the service date. In addition, actual expenditures incurred during the year are not properly accrued and therefore, current year expenditures and unrecorded liabilities are understated. The other internal control weakness related to the lack of adherence to established policies and procedures regarding physical inventory counts of property and equipment and the lack of reconciliation between the Division of Procurement and Supply's (P&S) master listing and the listings of several CNMI divisions and offices. For example, CNMI's Emergency Management Office (EMO) provided a list of equipment acquired with Office of Domestic Preparedness grants, but the listing did not include the serial number or other identification of the equipment or its condition. Moreover, a physical inventory was not conducted in the past 2 years by either the EMO or P&S. As a result, CNMI's government was not in compliance with federal property standards and its own property management policies and procedures.

Guam

In prior-year single audits and the fiscal year 2004 report, Guam's auditors stated that the government was in noncompliance with applicable procurement requirements. The auditor noted, in the fiscal year 2004 report, that there was insufficient documentation on file supporting the procurement for four of seven transactions tested related to a DOL grant. For two additional transactions, Guam's Chief Procurement Officer determined that the lease of space from a vendor was an unauthorized procurement because the lease agreement had expired. The method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price are to be included in the procurement records, according to applicable procurement requirements. The auditor attributed this weakness to a lack of internal control over compliance with applicable procurement requirements. Noncompliance with applicable procurement requirements was also noted for transactions related to U.S. Environmental Protection Agency and HHS grants. The auditors also reported that the government of Guam may have been noncompliant with earmarking requirements associated with an HHS block grant for maternal and child health services. According to federal law, 30 percent of the total grant payments must be used for preventive and primary care services for children, 30 percent must be used for services for children with special health care needs, and not more than 10 percent of the allotted funds can be used by a grantee for administrative expenses. The government of Guam did not provide the auditors with documents that demonstrated compliance with these requirements for its 2004 Maternal and Child Health Services Block Grant. The auditors reported that they could not determine whether the government of Guam was in compliance with these earmarking requirements due to weak internal control over recordkeeping.

USVI

Auditors reported that for fiscal years 2003 and 2004, the USVI government failed to provide accurate, current, and complete disclosure of financially assisted activities as required by U.S. Department of Agriculture (USDA) grants. In one instance, auditors found that financial reports prepared by the USVI Department of Health for the Women, Infants, and Children (WIC) Program did not reconcile with the USVI government's financial management system (FMS). The auditors identified the cause of this weakness to be due to current procedures, which do not require a reconciliation of WIC Program records with the FMS. This lack of reconciliation could result in incorrectly posted transactions going undetected and uncorrected and therefore also incorrect financial information being reported to USDA. The lack of reconciliation between the government's records and its FMS was also noted as a weakness related to a DOL grant for unemployment insurance. In its fiscal year 2004 single audit report, the auditors noted that the USVI Department of

Education did not fully comply with 12 of the 18 requirements for the second year of the compliance agreement with the U.S. Department of Education. For example, the auditors reported that the inventory management system, which was to be fully implemented by December 31, 2004, was not implemented by that date. According to the auditors, failure to fully comply with the compliance agreement by the specified deadlines was due to a lack of the necessary resources.

High-Risk Designations and Receiverships

The late submission of single audit reports combined with ongoing, significant audit findings, have been key reasons for the designation of the insular area governments as high-risk grantees by several federal agencies. Under the Grants Management Common Rule, federal awarding agencies may designate a grantee as high-risk if the grantee has a history of unsatisfactory performance, is not financially stable, has an inadequate management system, has not conformed to the terms and conditions of previous awards, or is otherwise not properly managing federal funds. Federal agencies that designate a grantee as high-risk may impose special conditions including (1) issuing funds on a reimbursement basis; (2) withholding authority to proceed to the next phase until receipt of evidence of acceptable performance within a given funding period; (3) requiring additional, more detailed financial reports; (4) requiring the grantee to obtain technical or management assistance; or (5) establishing additional prior approvals for expenditures of federal funds. Agencies, in carrying out their regulations associated with the Grants Management Common Rule, can place special conditions either at the agencywide level or at the individual program level.

American Samoa

OIA designated the government of American Samoa as a high-risk grantee in June 2005, as GAO had recommended in its report on American Samoa's accountability for key federal grants.[70] In making this designation, OIA recognized that the government of American Samoa had made significant progress in improving its financial accountability, and stated that the high-risk designation was to encourage other federal agencies to support American Samoa's fiscal reform process. OIA placed several special conditions on the American Samoan government, including the completion of single audits by the statutory deadline and having balanced budgets for 2 consecutive years—without considering nonrecurring windfalls such as insurance settlements.

[70] GAO, *American Samoa: Accountability for Key Federal Grants Needs Improvement*, GAO-05-41 (Washington, D.C.: Dec. 17, 2004).

The American Samoa government or its agencies have also been designated as high-risk by the departments or components of USDA, Education, HHS, and the U.S. Department of Transportation (DOT). USDA's Food and Nutrition Service (FNS) has also designated American Samoa as a high-risk grantee. According to a USDA official, GAO's prior recommendation that DOI designate American Samoa as a high-risk grantee influenced the FNS decision in February 2006 to designate American Samoa as a high-risk grantee for three of its programs. Some of the reasons cited by FNS officials for the high-risk designation include delinquent audits, noncompliance with laws and regulations, failure to resolve audit findings or to follow up on review findings, incurring unallowable or questionable costs, and weak systems for monitoring the programs and managing program data. In a letter to the Governor of American Samoa, FNS officials also stated that they were concerned that other serious problems might exist but had not been identified due to weaknesses and inadequate controls described in the letter. FNS officials further stated that the additional requirements associated with a high-risk designation would help to determine whether other serious but unidentified problems exist.

While the U.S. Department of Education initially designated American Samoa as a high-risk grantee in 2003 due to the lack of timely and complete single audits, American Samoa has now submitted its single audits through fiscal year 2005. The American Samoan government remains a high-risk grantee for the U.S. Department of Education due to continuing concerns about weaknesses and internal control issues identified in the single audits. One of HHS's operating divisions, the Substance Abuse and Mental Health Services Administration (SAMHSA), designated American Samoa as a high-risk grantee due to the government's delinquent single audits.[71] The insular area remains a high-risk grantee of SAMHSA, due to several older audits that were late and audit issues identified in submitted single audit reports. SAMHSA also designated American Samoa's Department of Human and Social Services as a high-risk grantee due to the lack of compliance of its financial management system with federal regulations. DOT's Federal Motor Carrier Safety Administration (FMCSA) has considered American Samoa to be a high-risk grantee for its Motor Carrier Safety Assistance Program (MCSAP) due to

[71]In a letter dated November 24, 1999, a SAMHSA grants officer stated that American Samoa would remain in the high-risk status until its delinquent audit reports had been submitted and accepted. At that time, the fiscal year 1995 financial statements had been submitted, but not the single audit reports for fiscal years 1995, 1996, 1997, and 1998.

past performance problems, although no formal designation was made in writing and no special conditions were imposed. DOT officials provided an example of a past performance problem for American Samoa: the insular area justified purchase of a vehicle for MCSAP purposes, but the vehicle was provided to the Governor's office. Instead of a formal high-risk designation, FMCSA provided additional oversight and required American Samoa to submit additional supporting documentation for all progress and final vouchers. American Samoa cooperated voluntarily by submitting the documentation and accepting the disallowed costs.

CNMI

The U.S. Department of Education designated CNMI as a high-risk grantee in 2003 because CNMI's Department of Education was unable to provide timely and complete single audits for 4 consecutive years. In September 2004, the U.S. Department of Education removed the high-risk designation based on site visits and the completion of the fiscal year 2003 single audit for CNMI with few audit findings.

Guam

Guam was designated as a high-risk grantee by the U.S. Department of Education in 2003 because Guam's Public School System was unable to provide timely and complete single audits for 5 consecutive years. As of October 27, 2006, Guam remained as a high-risk grantee for the U.S. Department of Education. Additional special conditions have been placed by U.S. Department of Education officials on its grants to Guam requiring them to demonstrate improved management stability and effective fiscal controls. DOT's FMCSA has considered Guam to be a high-risk grantee for its MCSAP due to past performance problems, although no formal designation was made in writing and no special conditions were imposed. DOT officials provided an example of a past performance problem for Guam—two vehicle inspectors paid by MSCAP funds were accepting payments for themselves in exchange for inspection decals. Instead of a formal high-risk designation, FMCSA provided additional oversight and required Guam to submit an action plan detailing corrective actions. The government of Guam cooperated voluntarily by submitting the action plan and proof that the inspectors' employment had been terminated.

The U.S. Department of Housing and Urban Development (HUD) has designated the Guam Housing and Urban Renewal Authority (GHURA) as a high risk agency because of its poor performance under both the Public Housing Assessment System (PHAS) and Section Eight Management Assessment Program (SEMAP). HUD's Real Estate Assessment Center sent staff to Guam in 2006 to perform a quality assurance review of the auditor and a report of its review is expected soon. A memorandum of agreement is being developed to set targets and strategies for improving GHUR's performance.

USVI

The U.S. Department of Education, HHS, and HUD have designated the USVI government (or its components) as a high-risk grantee. The USVI government was designated as a high-risk grantee by the U.S. Department of Education in 1999. Although USVI was already designated as a high-risk grantee, the U.S. Department of Education entered into a comprehensive 3-year compliance agreement with USVI on September 23, 2002, due to serious and recurring deficiencies in USVI's administration of the U.S. Department of Education programs. In fiscal year 2005, U.S. Department of Education officials determined that the USVI government would be unable to meet all of the terms of the compliance agreement by its expiration on September 23, 2005.[72] In a letter dated June 17, 2005, U.S. Department of Education notified the USVI government that, in accordance with the terms of the compliance agreement, it would apply special conditions to its grant awards, requiring the USVI government to procure the services of a third-party fiduciary to perform the financial management duties for all U.S. Department of Education grant awards made to USVI. As of August 25, 2006, all contract terms between the USVI government and the recommended third party fiduciary had been settled, the contract had been signed, and the fiduciary has begun work.

The Centers for Disease Control and Prevention (CDC), a component of HHS, designated USVI's Department of Health as a high-risk grantee in January 2006 due to the lack of compliance with financial management standards. According to the letter to USVI's Department of Health, one of the criteria for removing the high-risk designation is the establishment of appropriate internal controls to safeguard federal funds. The Administration of Children and Families (ACF), another component of HHS, placed USVI's Department of Human Services as a high-risk grantee in April 1997 for delinquent single audits. According to an April 9, 1997, letter, the USVI government had not submitted single audits, other than one received for the 2-year period beginning October 1, 1988, and ending September 30, 1990. Subsequent updates to the high-risk listing have referred to the USVI government's chronically late single audits.

[72]Department of Education, Office of Inspector General, *The Virgin Islands Is at Risk of Not Meeting the Goals of the September 2002 Compliance Agreement*, ED-OIG/A02-D0028 (New York Audit Region: Feb. 15, 2005).

In August 2003, HUD designated the Virgin Islands Housing Authority (VIHA)[73] as a high-risk grantee, and shortly thereafter placed VIHA into receivership. VIHA had been under examination for several years due to its failure to submit balanced budgets, a violation of HUD financial reporting requirements, and the general deterioration of management operations. VIHA's Board of Directors was unable to provide adequate oversight of housing authority programs, including the Section 8 program. VIHA also had failed to submit timely audited financial statements for fiscal years 2001 and 2002. VIHA's failure to submit timely verifiable financial information had adversely affected HUD's ability to verify that federal funds were being used properly and in accordance with program requirements and regulations. A preliminary review done by HUD indicated that VIHA was operating under a budget deficit of approximately $3.5 million. Moreover, HUD officials discovered that VIHA was improperly funding a Virgin Islands government nursing home for elderly residents in one of its public housing developments. VIHA was also cited for providing rent rebates of $3 million annually to public housing residents in violation of HUD regulations. In its audits of VIHA's fiscal year 2001 and 2002 single audits, the independent public auditor found that VIHA had serious deficiencies in financial reporting, financial analysis, and financial management systems. For example, the auditor noted that VIHA maintained incompatible accounting systems that precluded effective recording and reporting processes. Therefore, VIHA's accounting records did not reflect an accurate or complete accounting of the financial position and, in addition, VIHA was unable to track and identify expenditures of federal funds. According to HUD officials, serious fiscal irregularities and ineffective VIHA Board leadership, factors such as VIHA staff with insufficient skills, VIHA's inability to adequately manage programs, and its failure to improve and correct other operational problems, all pointed to a breakdown in the management of VIHA.

On August 1, 2003, HUD notified VIHA that it was in substantial default of Section 15 under the Annual Contributions Contract (ACC)[74] for failure to

[73]The Virgin Islands Housing Authority (VIHA) is a public housing corporation established in 1949 with the responsibility for planning, financing, constructing, maintaining, and managing public housing development within the territorial boundaries of the U.S. Virgin Islands (St. Thomas, St. John, and St. Croix).

[74]Annual contributions contracts, made between HUD and a housing authority, specify what the authority must do to receive funding from HUD during the contract year. HUD may declare a housing authority in substantial default or in breach of its annual contributions contract with HUD.

produce reliable financial statements. Violations of Section 15 (A) of the ACC were based on the numerous deficiencies noted in the authority's books and records identified by VIHA's independent auditors and late submission of financial reports. All of these actions identified VIHA as a high-risk agency. On August 20, 2003, HUD imposed an administrative receivership, assuming VIHA's decision-making authority and management by sending in a recovery team to stabilize the authority's operations. As of August 15, 2006, VIHA was still in receivership. While HUD officials told us that no special conditions have been placed on VIHA, HUD will look for the following actions to be completed before ending the receivership:

- improvement in Public Housing Assessment System (PHAS) scores for a sustained period in the areas in which the authority was failing;
- evidence that VIHA has put in place an advisory board to begin taking management control of the authority;
- evidence that key personnel have been hired, such as an executive director, chief financial officer, and managers in areas such as procurement, maintenance, construction/development, information technology, occupancy, and resident services;
- evidence that the VIHA has established policies and procedures that conform to HUD requirements, staff has been trained in these policies and procedures, and these policies and procedures are being followed;
- timely and accurate submission of required HUD reports; and
- unqualified audit opinion on both the financial statements and compliance with OMB Circular No. A-133 for major programs.

HUD is currently evaluating the conditions at VIHA and expects new PHAS scores in early 2007. All recent required HUD reports have been submitted by VIHA in a timely and accurate manner. In 2006, VIHA revised its procurement policy and, according to HUD officials, implemented the new policy successfully. VIHA has also instituted new financial internal controls and procedures to correct the financial oversight deficiencies that have been noted in the past. VIHA received an unqualified financial audit for fiscal year ending December 31, 2005. In November 2006, VIHA hired a new Chief Financial Officer with a background in housing authority finance. HUD and VIHA are considering hiring additional experienced permanent staff for the housing authority in 2007. Also, HUD and VIHA are currently evaluating additional changes to various policies and procedures in order to improve oversight and efficiency throughout the housing authority.

Efforts to Assist the Insular Areas in Improving Financial Accountability

DOI's OIA and IG, other federal inspectors general, and local auditing authorities assist or oversee the insular areas' efforts to improve their financial accountability.[75] OIA monitors the progress of completion and issuance of the single audit reports as well as providing general technical assistance funds to provide training for insular area employees and funds to enhance financial management systems and processes. DOI's IG has audit oversight responsibilities for federal funds in the insular areas.[76] In addition, the IG evaluates the effectiveness of OIA programs. Each insular area's cognizant agency[77] for the single audit monitors the submissions of the insular area government's single audit report for the insular area and considers extensions requested for submitting the report. The insular areas' cognizant agencies for fiscal years 2001-2005 were DOI for American Samoa and CNMI, HHS for Guam, and USDA for USVI. According to an OMB official, DOI will be the cognizant agency for all four insular areas for the fiscal year 2006-2010 single audits. When the single audit report is completed, the Office of Inspector General of the cognizant agency reviews the report to determine whether it meets applicable reporting standards and the requirements of OMB Circular No. A-133 for implementing the Single Audit Act. The inspectors general of other federal grant-making agencies perform audits of the insular area governments' implementation of federal programs to assess whether federal funds are used for intended purposes and effectively and efficiently. Local auditing

[75]Although the insular areas receive grants from many federal agencies, one of the grant-making agencies is designated as the cognizant agency for purposes of the Single Audit Act. The cognizant agencies have specific responsibilities under OMB Circular No. A-133. The cognizant agency is usually the agency that provides the predominant amount of funding.

[76]Pub. L. No. 97-357, 96 Stat. 1705 (Oct. 19, 1982). The 1982 Act transferred the functions, powers, and duties once vested in the government comptroller for Guam (for the islands of Guam and CNMI), Virgin Islands, and American Samoa to the Inspector General, Department of the Interior, for the purpose of establishing an organization which will maintain a satisfactory level of independent audit oversight of the respective territory government.

[77]All federal awarding agencies are responsible for ensuring that single audit reports are completed, are in accordance with OMB Circular No. A-133, and are received in a timely manner. Cognizant agencies, among other duties, have the additional responsibilities of coordinating management decisions for audit findings that affect the audit programs of more than one agency and considering auditee requests for extensions to the due dates of the reports.

authorities audit, assess, and analyze the insular area governments' activities for improving accountability, effectiveness, and efficiency of government operations. Interagency groups, such as IGIA, and other less formal groups also have worked to improve the financial accountability of the insular areas.

Interior's OIA and Federal IGs

A key part of OIA's mission is to promote sound financial management processes in the insular area governments. To accomplish this mission, OIA has increased its focus on bringing the insular area governments into compliance with the Single Audit Act. For example, OIA created an incentive for the insular areas to comply with the act by stating that an insular area cannot receive capital funding unless its government is in compliance with the act or has presented a plan, approved by OIA that is designed to bring the government into compliance by a certain date. In addition, OIA provides general technical assistance funds for training and other direct assistance, such as grants, to help the insular area governments comply with the act and to improve their financial management systems and environments.

The Graduate School of the USDA has been working with OIA for over a decade through its Pacific Islands and Virgin Islands Training Initiatives (PITI and VITI) to provide training and technical assistance.[78] In fiscal year 2004, OIA began a joint program with the Graduate School to address the long-standing problem of audit findings and resolutions that had not been addressed by the insular area governments. The USDA Graduate School also works with the Island Government Finance Officers Association (IGFOA)[79] to promote improved financial management in the insular areas. Table 13 shows OIA funding of USDA Graduate School activities.

[78]The Pacific Islands Training Initiative (PITI) was established in 1991 through an Interagency Agreement between the Graduate School, USDA's International Institute, and OIA.

[79]OIA and financial management officials from the insular areas formed IGFOA in 1999 to promote improved financial management in the insular areas. All four insular areas belong to the IGFOA and the organization holds two conferences each year—one conference is held in one of the insular areas and the other is held right after the Government Finance Officers Association's annual meeting in the United States.

Table 13: OIA Funding for Technical Assistance from the USDA Graduate School

Fiscal year	PITI/VITI (dollars in millions)
2001	$1.3
2002	1.3
2003	1.3
2004	1.3
2005	1.5
2006	1.5
2007 (projected)	1.5

Source: OIA officials.

In addition to funding the training and other services provided by the USDA Graduate School, OIA makes direct grants using its general technical assistance funds. Some of these grants are targeted at the resolution of specific financial management and reporting problems.

OIA has staff members in headquarters and field representatives in American Samoa and CNMI who make site visits to the insular areas. According to an OIA official, the office does not use a standard framework to write up the results of these site visits, although staff members do make notes while they are visiting the insular area. Establishing a routine procedure of writing up the results of site visits in a standard framework would help ensure that (1) all staff members making site visits are consistent in their focus on overall accountability objectives and (2) OIA staff has a mechanism for recording and following up on the unique situations facing each of the insular area governments.

DOI's IG performs the functions and duties that were once the responsibility of government comptrollers for the four insular areas. In this role, the IG has audit oversight responsibilities for the insular areas. It is also responsible for reviewing and following up on single audits for American Samoa and CNMI due to its role as the cognizant agency for the two insular areas for the single audits for fiscal years 2001-2005. For fiscal years 2006-2010, DOI's IG will be responsible for reviewing and following up on the single audits for all four insular areas because DOI will be the cognizant agency for all four. The IG also evaluates the effectiveness of OIA's programs and has issued three reports in 2002 and 2003 that addressed the use of federal funds in the four insular areas. One of the reports, dated March 1, 2002,[80] identified what the IG believed to be the top management challenges for the U.S. insular areas and compact states.[81] The report included assessments for each of the insular areas regarding the following four challenges: (1) overall financial management, (2) internal audit capabilities, (3) audit resolution issues, and (4) areas for improvement. In its evaluation report of oversight and follow up on audit findings and recommendations related to the insular area governments' use of federal funds provided by DOI,[82] the IG stated that the single audit report findings were not sufficiently addressed, due to a lack of federal control over the funds and DOI's lack of adequate audit follow-up procedures. Noting OIA's lack of enforcement authority over subsidies and entitlement-type funding, the IG stated that OIA should increase its oversight of these findings by encouraging the insular areas to address them and to monitor the implementation of corrective actions. In September 2003,[83] the IG issued a report about grants OIA administers for the insular areas. The IG reported that OIA had properly processed awards and distributed grant funds, but needed to improve the control process used to monitor grants.

In accordance with the Reports Consolidation Act of 2000,[84] DOI's IG also submits annual summaries of issues that it has determined to be the most significant management and performance challenges facing the department. One of the challenges the IG listed, in DOI's fiscal year 2005 performance and accountability report, related to the insular areas.[85] The IG noted in describing this challenge that these governments have long-

[80] Office of Inspector General, U.S. Department of the Interior, *Management Challenges for Insular Area Governments: An Opportunity for Improvement*, No. 2002-I-0017 (Washington, D.C.: March 2002).

[81] The compact states are the Republic of the Marshall Islands, Republic of Palau, and the Federated States of Micronesia.

[82] Office of Inspector General, U.S. Department of the Interior, *Evaluation Report, Oversight and Follow-up on Audit Findings and Recommendations*, *Pertaining to the Insular Area Governments' Use of Federal Funding*, No. 2003-I-0011 (Arlington, Va.: Feb. 28, 2003).

[83] Office of the Inspector General, U.S. Department of the Interior, *Report on Grants Administered by the Office of Insular Affairs*, No. 2003-I-0071 (Herndon, Va.: Sept. 30, 2003).

[84] Pub. L. No. 106-531, 114 Stat. 2537 (Nov. 22, 2000).

[85] These annual summaries of the top challenges facing DOI are published in the department's performance and accountability report.

standing financial and program management deficiencies. The IG has also issued many audit reports covering issues on individual insular areas. Since January 2000, it has issued 2 audit reports on American Samoa, 1 on CNMI, 8 on Guam, and 29 relating to the government of USVI.[86] The citations for these reports are in appendix III.

Inspectors general of other federal agencies that provide grants also conduct audits and evaluations on issues related to the insular areas' use of awarded funds. The U.S. Department of Education's IG has recently issued several reports—including reports on the USVI government's administration of funds under Title IV of the Higher Education Act and grant funds for the Infants and Toddlers program—as well as the previously mentioned report on the USVI government's lack of progress in meeting the terms of the compliance agreement.

Local Authorities

In addition to U.S. federal government audit organizations, each of the four insular areas has its own local auditing authorities. The USVI has its Office of Inspector General; Guam and CNMI, the Offices of the Public Auditor; and American Samoa, the Territorial Audit Office.[87] All four of these audit authorities have the authority to review their governments' use of federal grant funds. These audit authorities also determine whether government operations are efficient and effective and government assets are properly safeguarded and protected from fraud, waste, abuse, and mismanagement.

All of these local audit authorities are members of the Association of Pacific Islands Public Auditors (APIPA), formed in January 1988 through a memorandum of understanding (MOU) executed by the heads of the audit organizations of five Pacific island nations.[88] APIPA was formed to achieve

[86] These numbers exclude the IG's semiannual reports that present the results and accomplishments of the Office for the previous 6 months and may include information about the four insular areas. Also excluded are advisory reports and financial audits of the Department of the Interior.

[87] As of August 10, 2006, the Territorial Auditor position, the head of the Office, remained unfilled.

[88] The founding parties to the 1988 MOU were the Public Auditor of the Federated States of Micronesia, the Public Auditor of the Republic of Palau, the Public Auditor of the Commonwealth of the Northern Mariana Islands, the Territorial Auditor of American Samoa, and the Auditor General of the Republic of the Marshall Islands. APIPA has expanded to include Public Auditors from Pohnpei, Yap, Chuuk, Kosrae, Guam, Western Samoa, and USVI.

several objectives, including (1) the establishment of an organized body to promote efficiency and accountability in the use of public resources of emerging nations of the Pacific and (2) sponsorship of auditing and accounting training workshops. APIPA has an annual conference to provide continuing education for its members.

Interagency Coordination

While multiple entities oversee the insular areas' efforts to improve their financial accountability, in 1999 and 2003 the White House recognized the need to improve coordination of federal programs as they relate to insular areas and established the Interagency Group on Insular Areas (IGIA)[89] consisting of representatives from several federal agencies. This group is responsible for identifying issues that affect the insular areas and for making recommendations to the President and other appropriate officials regarding these issues. Executive agencies were to coordinate significant decisions or activities relating to the insular areas with the IGIA. The most recent meeting of the IGIA was in February 2006 to discuss ongoing issues, such as fiscal management, and work done during 2005 in the areas of economic and tax policy, infrastructure financing, and healthcare. We were unable to obtain information concerning the outcome of IGIA efforts. Furthermore, there appears to be limited joint monitoring or coordination of financial assistance programs and grants management across the many federal grant-making agencies as evident from discussions held with agency officials we contacted. With increased coordination, the federal agencies could collectively share key information, such as high-risk designations, and work with the insular area governments to substantially improve their financial accountability.

[89]The IGIA, established in 1999 and reestablished in 2003, is charged with working with the Secretary of the Interior to identify insular area issues and to make recommendations to the President concerning federal government policies and programs. Federal agencies are to coordinate significant decisions and activities affecting the insular areas with the IGIA.

Insular Areas' Corrective Action Plans

Under the Single Audit Act and OMB Circular No. A-133, auditees, when the audit is completed, are to prepare corrective action plans to address each audit finding in the current year's single audit report. Corrective actions are defined in OMB Circular No. A-133 as action taken by the auditee that (1) corrects identified deficiencies, (2) produces recommended improvements, or (3) demonstrates that audit findings are invalid or do not warrant action by the auditee.[90] The corrective action plan should provide the names of the contact persons responsible for corrective actions, the corrective actions planned, and the anticipated completion date.

American Samoa

In its corrective action plan for fiscal year 2004, American Samoa government managers acknowledged the auditor's finding that there were significant failures in the operation of the internal control structure related to general accounting and grants administration. Management commented in its corrective action plan that 7 years had passed since the implementation of the new computer system and the hiring of new staff. According to the corrective action plan, new internal control policies and procedures have been implemented. In this same corrective action plan, American Samoa government managers stated that they disagree with the finding that government records have not been maintained in an organized manner due to the lack of formal procedures regarding the maintenance and storage of records. According to the plan, the American Samoan government has made progress in the Grants Division by assigning grants analysts to specific departments to work with the grants program administrator to ensure that expenditures are allowable under the program.

CNMI

In its corrective action plan for fiscal year 2004, CNMI officials responded to the auditor's finding that due to the lack of detailed subsidiary ledgers, the auditors could not determine the propriety of two liability account balances and whether the negative balances in the accounts, as in prior years, also included prepaid items. CNMI government officials stated that the negative balances may not have been properly closed for prepaid items. According to the corrective action plan, balances are being reviewed and adjusted as needed and new procedures for receiving procurements were implemented, and reconciliation procedures will be

[90] If the auditee does not agree with the audit findings or believes corrective actions are not required, the corrective action plan in the single audit should include an explanation and specific reasons of why the plan is not required.

developed. In its corrective action plan for the Commonwealth Health Center's (CHC) receivable balance with accounts outstanding in excess of 120 days, management stated that they agreed with the findings, but management also asserted that it had made major progress in correcting the problems. According to management, the cause of the problem is a combination of the inefficiency of the present computer billing system, an inadequate number of staff in the Billing and Collection Office, nonpayment of bills by the Government Health Insurance program, and the inclusion of Medicaid expenditures beyond the annual cap as receivables.

Guam

In its corrective action plan for fiscal year 2004, government of Guam officials responded to the auditor's finding of the lack of the required physical inventories of equipment by reporting that GASB No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, was being adopted using a two-stage approach. The first stage is to record all capital assets such as buildings and infrastructure. The second stage is to compile all fixed asset records. For the findings related to noncompliance with procurement requirements, the government of Guam stated that GSA will continue to improve the processes and to uphold the integrity of the procurement activities of the government.

USVI

In response to the auditors' repeated findings about single audit compliance, the USVI government stated that it is committed to completing and submitting its single audit reports within 9 months after the end of the fiscal year in accordance with federal laws and regulations. However, the government plans to request and obtain a written extension from its cognizant agency if the audit cannot be completed within the 9-month deadline. For fiscal years 2003 and 2004, the auditor recommended that the USVI Department of Finance develop procedures to accelerate the bank reconciliation process and establish procedures that include the review and approval of the reconciliations by a member of management. The government responded that it will hire employees to assist with the reconciliation process, and it will change its policies and procedures for recording and handling deposits. At the 2006 IGFOA Conference held in May 2006, USVI government officials reported that with the implementation of a new Enterprise Resource Planning System, they expect timely reporting, reconciliations, information to decision makers, and completion of single audits, as well as a reduction or elimination of audit findings.

Conclusions

American Samoa, CNMI, Guam, and USVI face daunting economic, fiscal, and financial accountability challenges. The viability of their economies depends on a few key industries. While Guam will benefit from DOD's decision to reassign troops from Japan to Guam, changes in treaties, tax laws, and other external events have or will likely negatively affect the other insular areas' key industries. OIA has a number of initiatives underway to promote economic development in the insular areas. OIA's efforts in helping create linkages between the business communities in the U.S. states and the insular areas are key to helping meet some of these challenges. Nevertheless, the islands would benefit from formal periodic OIA evaluation of its conferences and business-opportunity missions, including assessments of the cost and benefit of its activities and the extent to which these efforts are creating partnerships with the economies of other nations.

A healthy private sector can improve the insular areas' fiscal condition by increasing local tax revenues. The fiscal condition of three of the four insular areas generally worsened during fiscal years 2001 to 2004, with the fourth—American Samoa—showing a more stable trend than the other insular areas.

Efforts to meet formidable fiscal challenges and build strong economies in the insular areas are hindered by delayed and incomplete financial reporting that does not provide officials with the timely and complete information they need for effective decision making. Questions about the reliability and completeness of the reporting have prevented auditors from issuing unqualified, or "clean," opinions on the island governments' financial statements. Auditors also identified many weaknesses likely to have a material, detrimental effect on the insular area governments' accountability over federal funds in their reviews of internal controls over financial reporting and compliance with major federal grant requirements.

OIA officials monitor the insular area governments' progress in submitting single audit reports, and OIA provides funding to improve financial management. Other agencies that provide funding for the insular areas provide their own oversight, such as their monitoring of entities with high-risk designations. Yet, progress has been slow and inconsistent, leaving the insular areas in current economic, fiscal, and financial difficulty. The benefit to the insular areas of past and current assistance is unclear, as is the way toward prosperity and fiscal stability. Federal agencies and the insular area governments have sponsored and participated in conferences, training sessions, and other programs to improve accountability, but knowing what has and hasn't been effective and drawing the right lessons from this experience is hampered by a lack of formal evaluation and data collection, the diffusion of responsibility with little coordination between agencies, and no central access to information. The conscientious yet disparate efforts of many federal agencies now individually engaged in improving the insular areas' economic development, fiscal stability, and financial accountability could make more efficient use of government and human resources. In a planned and well-coordinated effort, and with feedback mechanisms for continuing improvement of that effort, federal agencies can help the insular areas achieve the economic, fiscal, and financial conditions expected by nationals and citizens of a developed nation.

Recommendations for Executive Action

We recommend that the Secretary of the Interior direct the Deputy Assistant Secretary for Insular Affairs to:

- Increase coordination activities with officials from other federal grant-making agencies on issues of common concern relating to the insular area governments, such as late single audit reports, high-risk designations, and deficiencies in financial management systems and practices.
- Conduct formal periodic evaluation of OIA's conferences and business opportunities missions, assessing their impact on creating private sector jobs and increasing insular area income.
- Develop a framework for OIA employees to use in conducting site visits to help ensure objectives are achieved, to assure that relevant information is shared with the responsible officials, and to allow more efficient and effective monitoring of issues.
- Develop and implement procedures for formal evaluations of progress made by the insular areas to resolve accountability findings and set a time frame for achieving clean audit opinions.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from DOI. In commenting on a draft of this report, DOI officials agreed with our conclusions and recommendations, stating that our recommendations are consistent with OIA's top priorities and ongoing activities. DOI's specific comments on each recommendation are summarized below.

DOI officials agreed with our recommendation to increase coordination with officials from other federal grant-making agencies on issues of common concern. While DOI officials noted that it currently has processes to promote coordination with other federal agencies, additional coordination efforts are underway. Specifically, DOI officials stated that in fiscal year 2005, OIA began preparations for a conference to be held in June 2007 that will bring together officials from the federal grantor agencies and the insular areas, to coordinate efforts to address issues related to material findings identified in single audit reports and other financial management issues, including high-risk designations. We encourage OIA to utilize the planned conference to address accountability issues of common concern and use the results of the conference as a basis for regularly scheduled ongoing monitoring and followup on these issues.

DOI officials commented that they agree with our recommendation that OIA conduct periodic evaluation of its conferences and business opportunities missions because such evaluation of all federal activities is worthwhile. DOI officials added that while these conferences and missions are the primary activities through which OIA pursues its top priority for the insular areas, the costs associated with these activities are only a fraction of a percent of OIA's budget. Nevertheless, OIA supports evaluating these activities.

DOI officials agreed with our recommendation that a framework be developed for OIA employees to use in conducting site visits to ensure objectives are achieved, assure that relevant information is shared with responsible officials, and to allow more effective monitoring of issues. In its comments, DOI officials referred to a form in its *Financial Assistance Manual*, that was modified during fiscal year 2006, to better ensure that the required grant and project information is included in the project file after each site visit. While inclusion of this information for individual grants or projects should be valuable, our recommendation envisions developing a broader framework that would include information beyond that dealing with individual OIA grants or projects to include information about each of the insular areas' financial accountability environments. The information to be collected in this broader framework would include the status of required single audit reports, the progress of actions to resolve reported internal control weaknesses, and current needs for technical assistance, capacity building, and staff level expertise. This information should also be integrated into a comprehensive monitoring process.

DOI officials also agreed with our recommendation that OIA develop and implement procedures for formal evaluations of progress made by the insular areas to resolve accountability findings and set a time frame for achieving clean audit opinions. In its comments, DOI officials noted that it has a formal process for monitoring and tracking the insular areas' resolution of audit findings in place. DOI officials also indicated that they will consider establishing a timetable for achieving unqualified ("clean") audit opinions after the insular areas have had sufficient time to fully implement corrective actions to resolve material findings identified in the fiscal year 2004 and 2005 single audits. While these actions directed at improved monitoring and resolution of audit findings are a step in the right direction, they do not specifically address the broader accountability issues highlighted in our draft report. In this regard, the inability of the insular areas to achieve unqualified audit opinions over a number of years indicates the need for more attention and formal evaluation of progress toward to resolving accountability problems as called for by our recommendation in this area.

In addition to providing copies of this report to your office, we will send copies of this report to other appropriate committees. We will also provide copies of this report to interested Congressional Committees and to the Secretary of the Interior as well as to the governors and delegates of the insular areas. We will also make copies available to other interested parties upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding this report, please contact Jeanette Franzel, Director, Financial Management and Assurance at (202)512-9471 or Franzelj@gao.gov, or David Gootnick, Director, International Affairs and Trade at (202)512-4128 or gootnickd@gao.gov.

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff that made major contributions to this report are listed in appendix V.

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Director
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Appendix I: Matters Leading to Qualified Audit Opinions

Table 14: American Samoa—Matters Leading to Qualified Audit Opinions on the Financial Statements for Fiscal Years 2001 through 2004

	Fiscal year			
Description of matter	**2001**	**2002**	**2003**	**2004**
Unable to verify the accuracy of the due to/from other funds—pooled cash due to the lack of reliance on the internal control system.	X	X	X	X
Unable to verify the amount due from other governments and advances from grantors of the Special Revenue Fund due to the condition of the insular area's records.	X			
Unable to confirm the $182,320 due from American Samoa Medical Center Authority—Lyndon B. Johnson Tropical Medical Center (Medical Center) since another auditor disclaimed their opinion on the Medical Center.	X			
Unable to verify the accuracy of the physical inventory records.	X	X	X	X
Unable to ensure the physical presence and cost of recorded fixed assets and the records were incomplete.	X			
Unable to obtain sufficient audit evidence to determine if bank overdrafts represented held checks (accounts payable) or actual overdrafts. No adjustments had been made to accounts payable.	X			
Unable to obtain and test detailed schedules of the immigration deposits.	X	X	X	X
Unable to obtain from the Territory's Attorney General an adequate discussion, evaluation, or estimation of pending or threatened litigation.	X		X	
Unable to obtain from the Attorney General any information on settlement negotiations with its former workers' compensation carrier.	X	X	X	
Sufficient auditing procedures could not be performed on the compensated balances recorded as of September 30, 2001.	X			
In accordance with GASB 33, the insular area didn't restate the beginning fund balance of the general fund for amounts that would have been deferred as of September 30, 2000.	X			
Unable to be satisfied as to the amounts due from other governments and advances from grantors of the Special Revenue Fund as of September 30, 2001, due to the conditions of the American Samoa Community College records.	X			
Unable to satisfy the validity of the amounts due from taxpayers due to the state of the insular area's records.		X		

Description of matter	Fiscal year 2001	2002	2003	2004
Accuracy of the beginning fund balance due to noted evidence of a failure of identified controls in preventing or detecting misstatements of accounting information and a lack of appropriate management oversight and review and approval of transactions.		X	X	
The insular area did not record a liability for workers' compensation claims that occurred prior to 9/30/2003.			X	
Auditors disclaimed an opinion on the American Samoa Telecommunication Authority because the entity did not maintain accurate inventory records and was unable to reconcile the general ledger to the physical inventory, cost of PP&E was no longer available, and the account receivable subsidiary records include sufficient discrepancies causing the system to be unreliable.	X	X		
In the opinion of the American Samoa Telecommunication Authority's auditor, PP&E not recorded at cost to conform with U.S. GAAP and the lack of evidence available to test the beginning of the year accounts receivable balance caused the auditors to be unable to form an opinion on the amount of operating revenues.			X	X
Auditors disclaimed an opinion on the American Samoa Medical Center Authority—Lyndon B. Johnson Tropical Medical Center because the entity could not locate documentation supporting accounting records and auditors were unable to satisfy themselves regarding inventory quantities.	X	X		
The financial statements of the Medical Center were not audited.			X	X

Sources: American Samoa Single Audit Reports for fiscal years 2001 through 2004.

Table 15: CNMI—Matters Leading to Qualified Audit Opinions on the Financial Statements for Fiscal Years 2001 through 2004

	Fiscal years			
Description of matter	**2001**	**2002**	**2003**	**2004**
Inability to obtain response from CNMI's Attorney General regarding litigation, claims, and assessments.	X		X	
Inability to determine the propriety of fixed assets and fund equity of the General Fixed Assets Account Group.	X			
Omission of the Northern Marianas College from the university and college fund type—Higher Education Fund.	X			
Omission of the Public School System from the component unit—School District.	X			
Omission of the Commonwealth Government Employees Credit Union from the component unit—Governmental Fund.	X			
Lack of recognition of certain tax revenues as nonexchange transactions.	X			
The propriety of receivables from federal agencies for the Fiduciary Fund Type—Agency Fund; and other receivables and accounts payable of the Northern Mariana Islands Government Health and Life Insurance Trust Fund. Unable to express an opinion on the General Long-Term Debt Account Group.	X			
Omission of the Commonwealth Utilities Corporation from the component units—Proprietary Funds.	X	X		
Inability to determine the propriety of receivables from federal and other agencies, advances, other liabilities and accruals, and reserve for continuing appropriations and their effect on the determination of revenues and expenditures for all governmental fund types.	X	X	X	X
Inability to determine if the due to component units was fairly stated for all government funds due to inadequacies in the accounting records.		X	X	X
Inadequacies in the accounting records regarding accounts payable.			X	X
Inability to determine the propriety of inventory and capital assets of the Northern Marianas College.		X		
Inability to determine the propriety of taxes receivable.		X	X	X
Inability to determine the propriety of inventory, due from grantor agencies, utility plant and obligations under capital lease of the Commonwealth Utilities Corporation.			X	
Inadequacies in the accounting records regarding tax rebates payable.				X

Description of matter	Fiscal years 2001	2002	2003	2004
Inadequacies in the accounting records regarding capital assets of the Northern Marianas College and inventory, federal agencies receivables, utility plant, accounts payable, and obligations under capital lease of the Commonwealth Utilities Corporation.				X

Sources: CNMI Single Audit Reports for fiscal years 2001 through 2004.

Table 16: Guam—Matters Leading to the Qualified Audit Opinions on the Financial Statements for Fiscal Years 2001 through 2004

	Fiscal years			
Description of matter	**2001**	**2002**	**2003**	**2004**
Inability to access tax-related records or perform procedures as to the effectiveness of the systems tax-related balances.	X	X	X	X
Incomplete inclusion of the Guam Department of Education within the general fund due to nonavailability of information from the Department.	X	X		
Incomplete presentation of the General Fixed Assets Account Group or incomplete presentation of capital assets.	X	X		
Accounting records inadequate to support capital assets amounts, net of accumulated depreciation.			X	
Incomplete presentation of the General Long-Term Debt Account Group.	X			
Lack of audited financial statements for the Tourist Attraction Fund, Territorial Highway Fund, the Port Authority of Guam, and the Guam Waterworks Authority.	X	X		
Lack of audited financial statements for or omission of the Guam Telephone Authority.	X	X		
Lack of audited financial statements for or omission of the Guam Memorial Hospital Authority.	X	X	X	X
Omission of the Pension Trust Fund or lack of audited financial statements for the Government of Guam Retirement Fund.	X	X	X	
Omission of the Guam Council on the Arts and Humanities Agency, a Special Revenue Fund.	X			
Lack of audited financial statements for or omission of the Guam Community College.	X	X	X	
Lack of audited financial statements for or omission of the Guam Visitors Bureau.	X	X	X	X
Omission of the Guam Rental Corporation.		X		
Lack of audited financial statements for or omission of the Guam Housing Corporation.		X	X	
Lack of audited financial statements for the Guam Economic Development and Commerce Authority.			X	
Inability to determine propriety of the General Fund continuing appropriations balance.	X	X		
Inability to determine propriety of the inventory balance for the State Agency Surplus, an Internal Service Fund—Proprietary Fund Type.	X			

Description of matter	Fiscal years 2001	2002	2003	2004
Receivables recorded in the Solid Waste Management Fund and in the Federal Grant Assistance Fund were unsubstantiated.		X		
Absence of an accrual for the closure and postclosure costs of a solid waste landfill.		X	X	
Inability to determine the propriety of capital assets and related amounts for accumulated depreciation and depreciation expense.			X	

Sources: Guam Single Audit Reports for fiscal years 2001 through 2004.

Table 17: USVI—Matters Leading to the Qualified Audit Opinions on the Financial Statements for Fiscal Years 2001 through 2004

	Fiscal years			
Description of matter	**2001**	**2002**	**2003**	**2004**
Not recording a provision for landfill closure and postclosure costs in governmental activities or general long-term debt account group or the effect of the exclusion of a provision on beginning net assets.	X	X	X	X
Unable to obtain sufficient evidence that land held for sale (amounting to about $25 million) was fairly stated.	X	X	X	
Virgin Islands Lottery had not been audited for business-type activities.		X		
Omission of financial data of the Roy L. Schneider Hospital in the public benefit corporations column.	X			
Unable to determine the amount of cash on deposit with, and due from, the U.S. Virgin Islands Department of Finance as of September 30, 2001.	X			
Auditors of the Juan F. Luis Hospital were unable to satisfy themselves about management's contention that the preautonomy accounts payable not recorded as a liability as of September 30, 2001, were the responsibility of the government.	X			
Omission of the general fixed assets account group.	X			
Not maintaining accounting records for income tax receivables stated at $87 million.		X		
Auditor of the VI Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital) was unable to satisfy themselves as to the propriety of certain transactions recorded in the statement of net assets.		X		
Auditor of the VI Housing Authority (VIHA) and VI Housing Finance Authority (VIHFA) financial statements, a discretely presented component unit, was unable to obtain sufficient evidence as to the propriety of the revenue and expenses reported by VIHA, or to determine whether capital assets were fairly stated.		X	X	
VIHA did not report an equity interest in a joint venture because it had not been able to determine its carrying value.			X	
Unable to determine the extent to which the unemployment insurance fund (a major fund) may have been affected by the exclusion of a receivable for unemployment insurance contributions due to inadequate records.		X	X	X
Not maintaining accounting records for corporate income tax receivables related to tax year 2002 in the general fund and governmental activities.			X	

Description of matter	Fiscal years 2001	2002	2003	2004
Unable to determine the extent to which the revenue, change in fund balance/net assets of the general fund and the governmental activities may have been affected by the exclusion of a receivable for corporate income taxes pertaining to tax year 2002 in the beginning net assets due to inadequate records.				X
Government Employees' Retirement System (GERS), a fiduciary component unit (pension trust fund), is not recording contributions pursuant to the Early Retirement Act of 1994, had asset valuation issues, and adjustments that may have been necessary to reflect certain balances with the USVI government's Department of Finance.			X	X
Unable to determine the effects of adjustments that might have been necessary if the other auditors had obtained sufficient audit evidence as to whether capital assets and land held for sale were fairly stated in the financial statements of VIHA and VIHFA, respectively.				X
Omission of a liability for workers' compensation claims from the basic financial statements.				X

Sources: USVI Single Audit Reports for fiscal years 2001 through 2004.

Appendix II: Internal Control Weaknesses and Compliance with Requirements Applicable to Major Federal Programs

American Samoa

The American Samoan government has seen decreases in the number of material weaknesses and reportable conditions that auditors reported for internal control over financial reporting. The following table shows the numbers of material weaknesses and reportable conditions reported for internal control over reporting and compliance with requirements applicable to each major federal program, for fiscal years 2001-2004.

Table 18: American Samoa—Reported Weaknesses Identified in the Auditors' Reports for Fiscal Years 2001 through 2004

	Internal control over financial reporting in accordance with government auditing standards (report on financial statements)			Compliance with requirements applicable to each major federal program and on internal control over compliance with OMB Circular No. A-133 (report on federal award)		
Fiscal year	Material weaknesses[a]	Reportable conditions	Total number of findings	Material weaknesses[b]	Reportable conditions[c]	Total number of findings
2001	8	0	8	11	6	17
2002	6	0	6	13	9	22
2003	6	0	6	14	10	24
2004	6	0	6	9	13	22

Sources: American Samoa Single Audit Reports for Fiscal Years 2001 through 2004.

Note: The numbers of total findings can be equated with the total number of reportable conditions. To compute the numbers of reportable conditions that were not material weaknesses, we subtracted the number of material weaknesses from the total findings.

[a]Material weaknesses in internal control over financial reporting are reportable conditions in which the design or operation of internal controls does not reduce to a relatively low level the risk that misstatements caused by error or fraud—material in relation to the financial statements being audited—may occur and not be detected in a timely period by employees in the normal course of performing their duties.

[b]Material weaknesses in this context are reportable conditions in which internal controls do not reduce to a relatively low level the risk of noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material to the major federal program being audited and undetected in a timely way by employees in the normal course of performing their duties.

[c]Reportable conditions in this context are matters that come to an auditor's attention related to significant deficiencies in the design or operation of internal controls over compliance that could adversely affect the entity's ability to operate a major federal program within the applicable requirements of laws, regulations, contracts, and grants.

CNMI

In examining the internal controls the government of CNMI uses to provide reasonable assurance that it is properly recording financial transactions and safeguarding public funds, the auditors found 10 or more problems significant enough to warrant reporting. Most of these problems were material weaknesses in internal control over financial reporting. As shown in table 19, the auditors also reported numerous problems in compliance with the requirements for major federal programs.

Table 19: CNMI—Reported Weaknesses Identified in the Auditors' Reports for Fiscal Years 2001 through 2004

	Internal Control over financial reporting in accordance with government auditing standards (report on financial statements)			Compliance with requirements applicable to each major federal program and internal control over compliance with OMB Circular No. A-133 (report on federal awards)		
Fiscal year	Material weaknesses	Reportable conditions	Total	Material weaknesses	Reportable conditions	Total
2001	10	0	10	4	13	17
2002	9	1	10	2	14	16
2003	10	2	12	1	15	16
2004	8	5	13	2	31	33

Sources: CNMI Single Audit Reports for Fiscal Years 2001 through 2004.

Note: The numbers of total findings can be equated with the total number of reportable conditions. To compute the numbers of reportable conditions that were not material weaknesses, we subtracted the number of material weaknesses from the total findings.

Guam

The numerous material weaknesses reported by Guam's auditors reveal the lack of sound internal controls needed to ensure that (1) transactions are properly recorded, (2) assets are adequately safeguarded, and (3) federal funds are administered in accordance with the applicable requirements of laws, regulations, contracts, and grants. Table 20 shows the total number of findings from the financial statement audit as reported by the auditors on compliance with (1) internal controls over financial reporting and (2) with requirements applicable to each major federal program.

Table 20: Guam—Reported Weaknesses Identified in the Auditor's Reports for Fiscal Years 2001 through 2004

	Internal control over financial reporting in accordance with government auditing standards (report on financial statements)			Compliance with requirements applicable to each major federal program and on internal control over compliance with OMB Circular No. A-133 (report on federal awards)		
Fiscal year	Material weaknesses	Reportable conditions	Total number of findings	Material Weaknesses	Reportable conditions	Total number of findings
2001	21	59	80	23	43	66
2002	41	56	97	30	14	44
2003	8	11	19	7	16	23
2004	4	3	7	8	17	25

Sources: Guam Single Audit Reports for Fiscal Years 2001 through 2004.

Note: The number of total findings can be equated with the total number of reportable conditions. To compute the numbers of reportable conditions that were not material weaknesses, we subtracted the number of material weaknesses from the total findings.

USVI

USVI audit findings (material weaknesses and reportable conditions) for both internal controls over financial reporting and compliance with requirements for major federal programs ranged from a total of 31 to 61 for fiscal years 2001 through 2003, as shown in table 21.

Table 21: USVI—Reported Weaknesses Identified in the Auditors' Reports for Fiscal Years 2001 through 2004

	Internal control over financial reporting in accordance with government auditing standards (report on financial statements)			Compliance with requirements applicable to each major federal program and on internal control over compliance with OMB Circular No. A-133 (report on federal awards)		
Fiscal year	Material weaknesses	Reportable conditions	Total number of findings	Material weaknesses	Reportable conditions	Total number of findings
2001	2	0	2	41	20	61
2002	2	0	2	38	9	47
2003	3	0	3	43	10	53
2004	3	0	3	28	3	31

Sources: USVI Single Audit Reports for Fiscal Years 2001 through 2004.

Note: The numbers of total findings can be equated with the total number of reportable conditions. To compute the numbers of reportable conditions that were not material weaknesses, we subtracted the number of material weaknesses from the total findings.

Appendix III: DOI Inspector General Reports on Four Insular Areas for Calendar Years 2000—2005

American Samoa

Audit Report, Assessment and Collection of Taxes, American Samoa Government. No. 2002-I-0003. Guam: November 15, 2001.

Audit Report, U.S. Fish and Wildlife Service Federal Assistance Grants Administered by the American Samoa Government, Department of Marine and Wildlife Resources, from October 1, 2001, through September 30, 2003. No. R-GR-FWS-0013-2004. Reston, Va.: March 31, 2005.

CNMI

Audit Report, Saipan Harbor Improvement Project, Commonwealth Ports Authority, Commonwealth of the Northern Mariana Islands. No. 2003-I-0073. Washington, D.C.: September 30, 2003.

Guam

Audit Report, U.S. Department of Defense Contract Funds, Department of Education, Government of Guam. No. 00-I-172. Washington, D.C.: January 10, 2000.

Survey Report, Guam U.S. Passport Office, Government of Guam. No. 00-I-332. Washington, D.C.: April 14, 2000.

Audit Report, Loan Programs, Guam Economic Development Authority, Government of Guam. No. 01-I-417. Guam: September 21, 2001.

Audit Report, Qualifying Certificate Program, Guam Economic Development Authority, Government of Guam. No. 01-I-419. Guam: September 30, 2001.

Audit Report, Bond Services, Lease Operations and Trust Fund Activities, Guam Economic Development Authority, Government of Guam. No. 2002-I-0016. Guam: March 28, 2002.

Audit Report, Management of Federal Grants, Department of Mental Health and Substance Abuse, Government of Guam. No. 2002-I-0036. Guam: August 19, 2002.

Audit Report, Guam Waterworks Authority, Government of Guam. No. 2003-I-0072. Washington, D.C.: September 30, 2003.

Audit Report, U.S. Fish and Wildlife Service Federal Assistance Grants Administered by the Government of Guam, Department of Agriculture, Division of Aquatic and Wildlife Resources from October 1, 1999, to September 30, 2000. No. R-GR-FWS-0029-2004. Reston, Va.: March 4, 2004.

USVI

Audit Report, Internal Controls over Cashier Operations, Government of the Virgin Islands. No. 00-I-166. Washington, D.C.: January 3, 2000.

Audit Report, Administration of Federal Grants, University of the Virgin Islands. No. 00-I-216. Washington, D.C.: February 16, 2000.

Audit Report, Head Start Program Grants, Department of Human Services, Government of the Virgin Islands. No. 00-I-499. Washington, D.C.: June 14, 2000.

Audit Report, Low Income Housing Program Grants, Virgin Islands Housing Authority. No. 00-I-625. Washington, D.C.: August 24, 2000.

Audit Report, Environmental Protection Agency Grants, Department of Public Works, Government of the Virgin Islands. No. 00-I-696. Washington, D.C.: September 2000.

Audit Report, Administrative Functions, Legislature of the Virgin Islands. No. 01-I-107. Washington, D.C.: December 29, 2000.

Audit Report, Administration and Collection of Excise Taxes, Bureau of Internal Revenue, Government of the Virgin Islands. No. 01-I-291. Washington, D.C.: March 30, 2001.

Audit Report, Billing and Collection Functions, Virgin Islands Port Authority, Government of the Virgin Islands. No. 01-I-303. Washington, D.C.: March 30, 2001.

Audit Report, Virgin Islands Lottery, Government of the Virgin Islands. No. 01-I-290. Washington, D.C.: May 11, 2001.

Audit Report, Payroll Operations, Department of Education, Government of the Virgin Islands. No. 01-I-330. Washington, D.C.: May 14, 2001.

Audit Report, Virgin Islands Fire Service, Government of the Virgin Islands. No. 2002-I-0001. (Virgin Islands: October 30, 2001).

Audit Report, Job Training Partnership Act Programs, Department of Labor, Government of the Virgin Islands. No. 2002-I-0002. (Virgin Islands: November 7, 2001).

Audit Report, Virgin Islands Housing Finance Authority, Government of the Virgin Islands. No. 2002-I-0009. Virgin Islands: December 31, 2001.

Audit Report, Administrative Functions, Virgin Islands Police Department, Government of the Virgin Islands. No. 2002-I-0010. Virgin Islands: February 13, 2002.

Audit Report, Federal Highway Grants, Department of Public Works, Government of the Virgin Islands. No. 2002-I-0042. Virgin Islands: August 16, 2002.

Audit Report, Grants for the Construction of Health Care Facilities, Department of Health, Government of the Virgin Islands. No. 2002-I-0043. Virgin Islands: September 20, 2002.

Audit Report, Professional Service Contracts, Government of the Virgin Islands. No. 2002-I-0046. Virgin Islands: September 30, 2002.

Audit Report, Public Finance Authority, Government of the Virgin Islands. No. 2003-I-0002. Washington, D.C.: November 22, 2002.

Audit Report, Compliance with the Memorandum of Understanding Between the Governor of the Virgin Islands and the Secretary of the Interior. No. 2003-I-0003. Virgin Islands: November 27, 2002.

Audit Report, Grant for Solid Waste and Wastewater Disposal Projects, Department of Public Works, Government of the Virgin Islands. No. 2003-I-0012. Herndon, Va.: March 31, 2003.

Audit Report, Grant for Hazard Mitigation Projects, Virgin Islands Police Department, Government of the Virgin Islands. No. 2003-I-0031. Herndon, Va.: March 31, 2003.

Audit Report, Grant for Hurricane Recovery Projects, Government of the Virgin Islands. No. 2003-I-0032. Herndon, Va.: March 31, 2003.

Audit Report, Follow-up of Recommendations Relating to Internal Revenue Taxes, Bureau of Internal Revenue, Government of the Virgin Islands. No. 2003-I-0059. Herndon, Va.: August 29, 2003.

Audit Report, *Emergency Services Surcharge Collections by Innovative Telephone Corporation on Behalf of the Government of the Virgin Islands*. No. 2003-I-0067. Herndon, Va.: September 26, 2003.

Audit Report, *Use of Official Credit Cards*, *Government of the Virgin Islands*. No. V-IN-VIS-0104-2003. Herndon, Va.: August 27, 2004.

Audit Report, *Financial Arrangements Between the Government of the Virgin Islands and Financial Institutions*. No. V-IN-VIS-0069-2004. Herndon, Va.: September 30, 2004.

Audit Report, *Procurement Practices*, *Virgin Islands Port Authority*, *Government of the Virgin Islands*. No. V-IN-VIS-0001-2004. Washington, D.C.: March 28, 2005.

Audit Report, *Grants for Waste Disposal Projects*, *Department of Public Works*, *Government of the Virgin Islands*. No. V-IN-VIS-0072-2004. Washington, D.C.: May 11, 2005.

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Appendix IV: Comments from the Department of the Interior

United States Department of the Interior

OFFICE OF THE ASSISTANT SECRETARY
POLICY, MANAGEMENT AND BUDGET
Washington, DC 20240

TAKE PRIDE IN AMERICA

DEC 0 5 2006

Norma Samuel
Assistant Director
Financial Management and Assurance
United States Government Accountability Office
Washington, D.C. 20548

Dear Ms. Samuel:

Thank you for the opportunity to review and comment on the U.S. Office of Government Accountability (GAO) Draft Report No. GAO-07-119, dated November 2006, entitled "U.S. Insular Areas: Economic, Fiscal, and Financial Accountability Challenges" (Draft Report). The Department of the Interior (Department) agrees with the four recommendations presented in the Report and is pleased that the GAO recommendations validate the ongoing activities of the Department's Office of Insular Affairs (OIA), which carries out the Secretary of the Interior's responsibilities with respect to the U.S. territories and freely associated states.

We find the GAO's review of the U.S. territories of American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam and the U.S. Virgin Islands (USVI) to be mostly accurate and well balanced. The focus of the Draft Report lines up well with OIA's top two priority areas for the insular areas: private sector economic development and accountability. As the Draft Report makes clear, progress is not easily achieved in either of these two priority areas.

Private sector economic development is OIA's top priority because of the insular areas' economic challenges and urgent public needs in health, education, infrastructure, environmental protection, financial management, and several other areas.

Transforming the insular areas from public-sector-dominated economies to healthy, diverse, private-sector-led economies is an enormous task. Many of the reasons for this are identified in the Draft Report. This transformation cannot succeed unless it is adopted as a top priority by the insular area governments themselves. OIA can, however, provide a crucial leadership role and can provide important technical assistance to help the insular areas improve their business climates, identify areas of potential for private sector investment, and market insular areas to potential investors. This is what OIA has been doing.

OIA's other major priority for the insular areas has been to improve accountability for Federal financial assistance. For many years there was no source of comprehensive financial information for each of the insular areas, as each was several years delinquent in completing required annual single audits. Since Fiscal Year (FY) 2004, OIA has implemented processes and provided funding for projects to help the insular areas to produce more timely and accurate financial information. OIA's comprehensive approach includes: funding for training conferences and workshops to increase local capacity; funding for financial experts and consultants to work in the islands; assigning OIA staff to provide critical technical advice and aggressively monitor and evaluate the fiscal management and reporting activities of insular area governments; communicating with other Federal agencies regarding systemic issues related to the insular areas' administration of Federal grant programs; and developing rating processes to allocate OIA grant funds based upon the progress of the insular areas in improving financial management and accountability for Federal funds. To date, this comprehensive approach has contributed to the completion of 17 audits by the insular areas covered by the Draft Report. All of the insular areas have made progress in developing and implementing corrective actions to resolve material audit findings and clear audit opinion qualifications. Three of the four insular areas covered in the Draft Report—American Samoa, the CNMI and Guam—are current on their single audits and are developing systems to allow them to continue to complete audits in a timely manner. The remaining insular area, the USVI, is one audit delinquent. However, the Department is not the cognizant agency for audits for the USVI and, therefore, OIA's ability to assist the USVI to improve the timeliness and accuracy of its single audits is limited.

In addition to the single audits, OIA receives other financial information from the insular areas in the form of quarterly financial reports, financial reviews (*e.g.,* Performeter Reports), OIA grant administrative reports (Financial Cash Status Reports, Narrative Status Reports, cost documents) and audit reports completed by the Department's Office of the Inspector General, GAO and insular area audit offices. Also, OIA staff meets with insular area officials at workshops held every May, June and December, and OIA staff performs on-site reviews. Since FY 2003, the workshops have centered on compliance with Federal audit requirements and the improvement of the insular areas' administration of Federal grant programs.

As noted in the Draft Report, the insular areas face serious challenges with limited resources. As the insular areas complete the task of catching up on their delinquent single audits, they will be able to target more resources to resolving material deficiencies.

This in turn will help to resolve audit opinion qualifications and put the insular areas on the path to "clean" opinions.

OIA's accountability efforts are of course not limited to the insular areas covered in the Draft Report; they also extend to the insular areas that are affiliated with, but not part of, the U.S. In this regard, we would note that Palau has submitted clean single audits in a timely fashion for the past three fiscal years, and that the most recent single audit for the State of Pohnpei, FSM, was timely, clean, and with no questioned costs.

The Department will continue its comprehensive approach and will implement other innovative ideas, as resources permit, to assist the insular areas to continue to improve financial management and accountability.

<u>GAO Recommendations:</u>

We concur with the recommendations to the Secretary of the Interior for actions by the Deputy Assistant Secretary for Insular Affairs and are pleased that the GAO recommendations mirror actions already implemented by the Department. The recommendations are discussed below:

1) Increase coordination activities with officials from other federal grant-making agencies on issues of common concern relating to the insular area governments, such as late single audit reports, high-risk designations, and deficiencies in financial management systems and practices.

The Department agrees with this recommendation, but notes that OIA already utilizes a number of processes to promote this type of coordination with other Federal agencies. The Draft Report mentions the Interagency Group on Insular Areas (IGIA), which brings together representatives of nearly 30 Federal agencies for the purpose of coordinating policy with respect to the insular areas covered by the Draft Report. In August 2004, OIA convened a working group of Federal grantor agencies that award material amounts of Federal funding to the insular areas. Within both of these groups OIA addresses material issues affecting the insular areas and Federal grant programs. In addition, in FY 2005 OIA began preparations for a conference that will bring together Federal grantor agencies and insular area officials to address (a) issues related to material findings identified in single audit reports and (b) other financial management issues, including declarations of high-risk. The conference is scheduled for June 2007 in coordination with the semiannual OIA workshop held for insular area officials responsible for finance, budget and procurement.

2) Conduct formal periodic evaluation of OIA's conferences and business opportunities missions, assessing their impact on creating private sector jobs and increasing insular area income.

The Department agrees with this recommendation because periodic evaluation of all Federal activities is a good thing. We would note, however, that the conferences and missions are the primary activities through which OIA pursues its top priority for the insular areas, yet they account for only a fraction of a percent of OIA's budget. The participants in the conferences and mission pay their own expenses. Given the successes that have already come out of these efforts, and those that are currently in process, these activities are among the most cost-effective that OIA engages in. We support evaluating these activities so that we can make them even more effective.

We would note that a number of indirect benefits flow from the conferences and missions. For example, all of the insular areas have a strong incentive to make a good impression at the conferences and missions. This motivates the insular areas to polish their self-marketing efforts, and to consider business climate reforms that might improve their attractiveness to outside investors. When OIA promotes the conferences and missions, it engages in extensive outreach to private sector companies. This enables a large number of businesses to learn about the competitive advantages offered by some or all of the insular areas. We are aware of companies that have pursued important opportunities in the insular areas solely on the basis of our pre-conference or pre-mission marketing efforts.

The conferences themselves, of course, give the insular areas an invaluable opportunity to market themselves before a wide audience of potential investors at minimal cost. The missions are also quite cost-effective for the insular areas, because they bring to the islands groups of businesspeople who have demonstrated significant interest in opportunities there.

We would also note that we agree with GAO's suggestion that more effort should be made to promote non-U.S. investment in the insular areas. OIA participated in outreach efforts to potential investors in Tokyo in 2003 and in Auckland, New Zealand this year, and funded American Samoa's participation in trade shows in New Zealand and Hong Kong this year. We agree that more of these efforts are needed.

3) Develop a framework for OIA employees to use in conducting site visits to help ensure objectives are achieved, to assure that relevant information is shared with the responsible officials, and to allow more efficient and effective monitoring of issues.

The Department agrees with this recommendation, and notes that OIA's Financial Assistance Manual, as revised in FY 2003, provides a form to be used to structure and summarize on-site visits. The form was modified during FY 2006, and OIA staff is ensuring that the required information is included in the project file after each site-visit that pertains to a material issue.

4) Develop and implement procedures for formal evaluations of progress made by the insular areas to resolve accountability findings and set a time frame for achieving clean audit opinions.

The Department agrees with this recommendation. In addition to the ongoing activities discussed above, we note that in FY 2004, OIA developed a formal process for monitoring and tracking the insular areas' resolution of audit findings. The process was developed as part of the Corrective Action Plans that were reviewed and accepted by the Department's Office of Financial Management. In addition, the information is used in OIA's process for allocating grant funding for both the Capital Improvement Program and the Technical Assistance grant program.

The insular areas' progress on resolving material issues will also contribute to the resolution of audit opinion qualifications. OIA intends to consider a timetable for achieving "clean" audit opinions after the insular areas have had adequate time to fully implement corrective actions to resolve material findings identified in the single audits of FY 2004 and 2005.

Thank you again for the opportunity to comment on the Draft Report. If you have any questions concerning the response, please contact David B. Cohen, Deputy Assistant Secretary of the Interior- Insular Affairs, or Nikolao Pula, Director of the Office of Insular Affairs, at (202) 208-4736.

Sincerely,

R. Thomas Weimer

R. Thomas Weimer
Assistant Secretary

Appendix V: GAO Contacts and Staff Acknowledgments

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The following individuals made important contributions to this report: Norma Samuel, Emil Friberg, Jr., James Wozny, Maxine Hattery, Gina Ross, Sandra Silzer, Seyda Wentworth, and Elwood White.

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