



GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

May 25, 2007

Congressional Committees

Subject: *Compacts of Free Association: Micronesia's and the Marshall Islands' Use of Sector Grants*

Supplementing our December 2006 report entitled *Compacts of Free Association: Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability*,¹ this report provides information on the uses of economic assistance provided under the amended U.S. compacts with the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) from 2004 through 2006.

From 1987 through 2003,² the United States provided \$2.1 billion in economic assistance to the FSM³ and the RMI through a Compact of Free Association. In 2003, the U.S. government approved amended compacts with the FSM and the RMI,⁴ providing a combined total of \$3.6 billion for the two countries in 2004 through 2023.⁵ The amended compacts identify the 20 years of grant assistance as intended to assist the FSM and RMI governments in promoting the economic advancement and budgetary self-reliance of their people. Under the amended compacts, U.S. grant funding decreases annually,⁶ paired with increasing contributions to trust funds for the FSM and the RMI; earnings from the trust funds are intended to provide a source of revenue when the grants expire in 2023. In addition, the annual grant funding is

¹ GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability*, GAO-07-163 (Washington, D.C.: Dec. 15, 2006).

² In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

³ The FSM comprises four states: Chuuk, Kosrae, Pohnpei, and Yap.

⁴ Whereas the original compact was a single agreement among the U.S., FSM, and RMI governments, the amended compacts (approved in Pub. L. No. 108-188, Dec. 17, 2003) are separate agreements between the United States and each of the two countries.

⁵ The \$3.6 billion in assistance includes (1) compact grants; (2) trust fund contributions; (3) Kwajalein impact funding; (4) estimated values of compact-authorized federal services, such as weather, aviation, and postal services over the 20-year period; and (5) inflation adjustments. Services related to disaster relief have been excluded.

⁶ The decrement in grant funding is deposited into the FSM's and the RMI's trust funds. The RMI's annual decrement of \$500,000 began in 2004, and the FSM's annual decrement of \$800,000 began in 2007.

partially adjusted for inflation.⁷ The amended compacts require the countries to target funding to six development sectors—education, health, the environment, public sector capacity building, private sector development, and infrastructure, with priority given to education and health. The amended compacts also provide for a supplemental education grant (SEG) for both countries.⁸ The Department of the Interior's (Interior) Office of Insular Affairs (OIA) is responsible for administering and monitoring the grants.

The amended compacts' subsidiary fiscal procedures agreements⁹ (FPA) require the FSM and RMI governments to monitor the day-to-day operations of sector grants and activities, submit periodic performance reports and financial statements, and ensure annual financial and compliance audits. In addition, the compacts and fiscal procedures agreements require the U.S. and FSM Joint Economic Management Committee (JEMCO) and the U.S. and RMI Joint Economic Management and Financial Accountability Committee (JEMFAC) to

- meet at least once annually to evaluate the progress of the FSM and the RMI, respectively, in achieving the objectives specified in their development plans;¹⁰
- approve grant allocations;
- review required annual reports;
- identify problems encountered; and
- recommend ways to increase the effectiveness of compact grant assistance.¹¹

Moreover, the FSM and the RMI are required to conduct annual audits within the meaning of the Single Audit Act, as amended.¹²

⁷ The amended compacts provide for a partial annual inflation adjustment of grant funding. Under the compacts' implementing legislation, the funding may be fully adjusted for inflation after 2014 under certain U.S. inflation conditions.

⁸ The amended compacts' implementing legislation authorized appropriations, beginning in 2005, to the Secretary of Education to supplement the compact grants for the education sector. Under the fiscal procedures agreements, SEG funds are to be used to support "direct educational services at the local school level focused on school readiness, early childhood education, primary and secondary education, vocational training, adult and family literacy, and the smooth transition of students from high school to postsecondary educational pursuits or rewarding career endeavors." JEMCO and JEMFAC are responsible for approving the SEG grants annually.

⁹ These agreements contain detailed requirements concerning implementation of the amended compacts' funding and accountability provisions. The U.S. fiscal procedures agreements with the FSM and the RMI are formally known as the "Agreement Concerning Procedures for the Implementation of United States Economic Assistance Provided in the Compact of Free Association, as amended, Between the Government of the United States of America and the Government of the Federated States of Micronesia" and the "Agreement Concerning Procedures for the Implementation of United States Economic Assistance Provided in the Compact, as amended, of Free Association Between the Government of the United States of America and the Government of the Republic of the Marshall Islands."

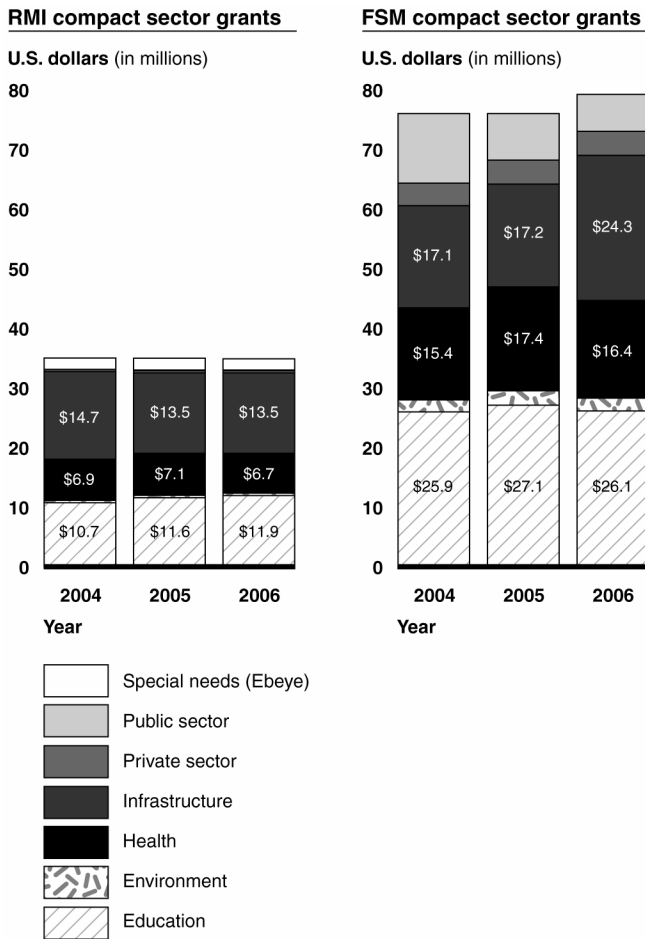
¹⁰ The FSM's development plan is called the Strategic Development Plan. The RMI's development plan consists of three documents: Vision 2018, Meto 2000, and its Medium Term Budget and Investment Framework. In addition, the annual portfolio submissions include strategic goals and indicators for each of the sectors. We refer collectively to all of these RMI documents as the RMI's development plan.

¹¹ GAO, *Compacts of Free Association: Implementation of New Funding and Accountability Requirements Is Well Under Way, but Planning Challenges Remain*, GAO-05-633 (Washington, D.C., July 11, 2005).

¹² The Single Audit Act, as amended, is codified in Chapter 75 of Title 31 of the *United States Code*.

In our December 2006 report, we examined the FSM's and RMI's use of the compact funds, their efforts to assess progress toward their stated development and sector goals, and their monitoring of sector grants and accountability for the use of compact funds in 2004 through 2006.¹³ The report also examined Interior's administrative oversight of the assistance provided under the compacts. Regarding the FSM's and RMI's use of the compact grants, our December 2006 report observed that the countries' governments allocated the largest amounts for education, infrastructure, and health, prioritizing health and education as required (see fig. 1).

Figure 1: FSM and RMI Grant Allocations, Fiscal Years 2004 through 2006



Source: GAO analysis of FSM and RMI 2004 through 2006 sector grant award agreements.

Our December 2006 report also noted that several factors affected the grants' use.¹⁴ In the FSM, disagreement among the national and state governments regarding project implementation and fund management delayed infrastructure projects, and the government's inability to secure land leases hindered project implementation in Chuuk state. In the RMI, political disagreements between the government and

¹³ The amended compacts' implementing legislation instructs GAO to report, for the 3 years following the legislation's enactment and every 5 years thereafter, on the FSM's and the RMI's use, and on the effectiveness of U.S. financial, program, and technical assistance as well as the effectiveness of administrative oversight by the United States.

¹⁴ The report included appendixes detailing the countries' allocations in each sector and the terms, contained in fiscal procedures agreements, controlling the use of the grants.

Kwajalein Atoll landowners over the management of compact fund distribution delayed the release of funds allocated for special needs on the island of Ebeye,¹⁵ and disagreements over land use prevented infrastructure projects in the Majuro and Kwajalein Atolls. Further, the report noted that neither country had planned its allocation and use of funds for long-term sustainability in view of the planned annual decrements and the partial inflation adjustments of grant funding. Finally, the report observed that the FSM's distributions of its grant allocations among the national and state governments and the development sectors responded to a formula established in FSM law rather than to the states' varying populations and needs. To improve the countries' administration, and planning for the use of the grants, we recommended that the Secretary of the Interior direct the Deputy Assistant Secretary for Insular Affairs, as Chairman of JEMCO and JEMFAC, to work with the FSM and RMI governments to develop spending and investment plans that take into account the annual decrement in grant funding and the partial inflation adjustment. We also recommended that the Deputy Assistant Secretary for Insular Affairs should work with the FSM national and state governments to evaluate the impact of the FSM's current allocation formula on the government's ability to meet national goals and deliver services.

To supplement our December 2006 report, enclosures II through VII of this correspondence provide additional information on the FSM's and RMI's use of compact funds for, respectively, each of the six development sectors in 2004 through 2006. Enclosure I contains a description of the scope and methodology of this review. Each enclosure addresses the sector grant goals; the grant funding and uses of the funding allocated for the sector; and the challenges that have affected, or may affect, the use of the grant. A summary of the grants and their purposes follows.

- *Education.* The FSM and RMI priorities for education sector grants under the amended compacts are to advance a quality basic education system. However, both countries face numerous challenges to improving their education sectors such as lack of qualified teachers, teacher and student absenteeism, and poor or inadequate classroom facilities. In addition, because a disagreement between U.S. agencies and the FSM and the RMI governments over some of the proposed uses of the SEG, these grants did not become available until late in 2005 and 2006.
- *Infrastructure.* Both the FSM and the RMI have prioritized use of the infrastructure grant for education- and health-related projects, in accordance with their respective fiscal procedures agreement. However, as of November 2006, only the RMI had used infrastructure funds to build several projects. The FSM had not yet built any projects and has more than \$58 million in available funds, although it had made some progress in initiating projects. In the FSM, progress was hampered by undefined procurement processes and building standards, disagreement within the FSM about project management, unresolved land issues, inadequate long-term planning, lack of funding for maintenance, and lack of technical capacity. Similarly, in the RMI, unresolved

¹⁵ Numerous RMI residents were displaced within Kwajalein Atoll, the RMI's second most populated atoll, to provide space for U.S. missile testing. Many of these residents now reside on Ebeye Island.

land issues and a lack of planning, technical capacity, stakeholder buy-in, and maintenance also present challenges.

- *Health.* The FSM and RMI priorities for health sector grants under the amended compacts to improve the delivery of health care services. In both the FSM and the RMI, the health sector received the third largest sector grant. In the FSM, even with the focus on primary health care, only 10 percent of the states' health care budgets targeted this goal. Additionally, there has been little progress made to improve the quality of care provided in hospitals in the four FSM states. In the RMI, funding has not followed strategic goals, and the RMI faces numerous challenges to health care service improvements including lack of technical capacity, increased prevalence of lifestyle disease, and unsustainable spending.
- *Public sector capacity building.* Under the amended compacts, public sector capacity building (PSCB) grants are intended to support the efforts of the FSM's and the RMI's internal capacity to build effective, accountable, and transparent governments. According to grant conditions, PSCB funds can be used to hire experts to advise the FSM and RMI governments; train personnel; and develop, purchase, or upgrade various government systems. With OIA's agreement, the FSM allocated over 88 percent of its PSCB funds to support the ongoing operations of the national and state governments, activities not supported by the compact, rather than to build new skills and expertise. The RMI accepted PSCB funds only in the past 2 years, to support the operations of its Public Auditor's Office. Despite both countries' extensive need of greater government capacity, PSCB has not been a priority in either country and it is difficult to determine what if any progress has occurred in this sector in either country.
- *Private sector development.* FSM and the RMI private sector development grants are made available in part to attract foreign investment and increase indigenous business activity. Both countries allocated funds to their various offices, such as visitor bureaus, land offices, and development entities, in support of their goals. However, private sector development in both countries has been hampered by such factors as their remote geographic location, inadequate infrastructure, and poor business environments.
- *Environment.* Environmental goals in the FSM and RMI include engaging in environmental infrastructure planning, design, construction, and operation. Grants for the two countries' environment sectors were allocated to several offices to support activities such as environmental protection, marine conservation, solid waste management, and public education. However, several challenges have limited the achievement of both countries' goals, including lack of enforcement and a lack of trained professionals.

We provided a draft of this report to the Departments of Education, Health and Human Services, the Interior, and State. We also provided a draft of the report to the Federated States of Micronesia and the Republic of the Marshall Islands. We received technical comments from the Department of Education which we incorporated as appropriate. The Departments of State and Health and Human

Services had no comments. The Department of the Interior provided a letter indicating the report was clear and informative, and indicated it continues to implement the recommendations from our earlier report GAO-07-163 entitled *Compacts of Free Association: Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability* (see enclosure VIII). The FSM's letter acknowledged, that our findings, in this report and GAO-07-163, provided useful and constructive criticism, and that they are committed to continued improvement (see enclosure IX). The RMI, in its general comments, raised concerns that we used reports from fiscal years 2004 and 2005 as the basis for making assessments on program management, and that they had made changes, revisions, and refocused their efforts since fiscal year 2005, which our report did not take into account. Our field work was conducted in March 2006. At that time, only project reporting for the first quarter of fiscal year 2006 was available. We therefore chose not to include those reports in our scope. However, we will review the improved reporting during our next mandated review. The RMI also reiterated its position that the grants under the compact should be subject to full inflation in order to maintain service levels. The RMI also raised concerns about the SEG and how the legislation has been interpreted. Additionally, the RMI raised concerns about statements and opinions which we generally attributed to RMI officials in the education sector. To address these concerns, we have identified the position of the person making the statements in the text, such as the Minister of Education. We have modified this report to respond to these comments and other matters raised by the RMI (see enclosure XI).

We are sending copies of this report to interested congressional committees. We will also make copies available to others on request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. If you have any questions, please contact me at (202) 512-3149 or gootnickd@gao.gov. Key contributors to this report are listed in enclosure VIII.



David Gootnick, Director
International Affairs and Trade

List of Committees

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

The Honorable Joseph R. Biden, Jr.
Chairman
The Honorable Richard G. Lugar
Ranking Minority Member
Committee on Foreign Relations
United States Senate

The Honorable Nick J. Rahall, II
Chairman
The Honorable Don Young
Ranking Minority Member
Committee on Natural Resources
House of Representatives

The Honorable Tom Lantos
Chairman
The Honorable Ileana Ros-Lehtinen
Ranking Minority Member
Committee on Foreign Affairs
House of Representatives

Enclosure I Scope and Methodology

To identify the goals of the amended compacts, we reviewed the Compacts of Free Association and their subsidiary agreements between the United States and the two countries. To learn of the countries' uses of the compact funds, we reviewed the Federated States of Micronesia's (FSM) and the Republic of the Marshall Islands (RMI) planning and budget documents; the U.S., FSM, and RMI annual compact reports for 2004 and 2005; and briefing documents prepared by Interior's Office of Insular Affairs (OIA) in preparation for the annual bilateral meetings with the two countries.

To determine the allocation of grant funding by sector, we reviewed all 2004, 2005, and 2006 grant agreements with both countries, obtained from OIA, including special terms and conditions included in these agreements. To compute education spending per student, we used FSM and RMI grant data and student population statistics. To calculate the variability in health spending per capita across the four FSM states, we used FSM grant data and population statistics. We did not calculate health spending per capita for the RMI due to a lack of data. We determined that these data were sufficiently reliable for the purposes of our report.

To identify challenges that impact the use of compact funds, we discussed planning efforts with U.S., FSM, and RMI government officials and identified, through our own analysis, issues that affected planning, such as the FSM's use of its distribution formula. We reviewed relevant documents, such as FSM and RMI legislation, and we also reviewed documentation that the countries provided to the U.S. government. In March 2006, we traveled to the FSM (Chuuk, Kosrae, Pohnpei, and Yap). In addition, in Chuuk we visited the Islands of Fanapangas, Fefan, Polle, Toll, Tonoas, Duot, Uman, Ut, and Weno. We also traveled to the RMI, visiting Arno, Kwajalein, and Majuro Atolls. Our field work covered the locations with the largest population, although we also reviewed nearby sites serving rural communities. In both countries, we visited primary and secondary schools, colleges, hospitals, dispensaries, community health centers, farms, fisheries, post offices, weather stations, telecommunications offices, and airport facilities. Specifically, in the RMI we visited 7 of 75 primary and 3 of 5 secondary public schools. In the FSM, we visited 18 out of 198 primary and 8 of 21 secondary public schools across the four states. We visited both of the RMI's hospitals, in Majuro, and a health dispensary on Arno. In the FSM, we visited each state's hospital as well as 16 dispensaries. In the Chuuk lagoon islands, we also visited dispensaries and schools. We did not select sites using probability sampling techniques and therefore cannot generalize to all possible sites. We discussed compact implementation with the FSM national and state governments, including the FSM's Office of Compact Management, and with the RMI government, including the RMI's Chief Secretary.

We conducted our review from October 2005 through December 2006 in accordance with generally accepted government auditing standards. Information contained in this report was gathered primarily during our March 2006 field work, with some information updated through interviews with OIA staff or correspondence with FSM and RMI officials through November 2006.

Enclosure II Education

The Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) goals for education sector grants under the amended compacts are to support and improve the educational system of the countries with an emphasis on advancing a quality, basic education system. The JEMCO approved allocations for the FSM education sector amounting to \$79 million, or 34 percent of compact funds; and the JEMFAC approved allocations for the RMI education sector amounting to \$34.2 million, or 33 percent of compact funds in 2004 through 2006.¹⁶ Both countries also received Supplemental Education Grant (SEG) funding,¹⁷ beginning in 2005, to support additional direct educational services. However, both countries face numerous challenges to improving their education sectors. In addition, because of multiple factors, including disagreement between U.S. agencies and the FSM and the RMI governments over some of the proposed uses of the SEG, funding for the SEG was almost 1 year late for both 2005 and 2006.

¹⁶ In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

¹⁷ Funding for the SEG is appropriated to the U.S. Department of Education (ED) account and transferred to an Interior account for disbursement, with Interior responsible for ensuring that the use, administration, and monitoring of SEG funds are in accordance with a memorandum of agreement among ED, the Department of Labor, Health and Human Services, and Interior, as well as with the fiscal procedures agreements. JEMCO and JEMFAC are responsible for approving the SEG grants annually. The SEGs are awarded in place of grants formerly awarded to the FSM and RMI under Part A of title I of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 6311 et seq.); title I of the Workforce Investment Act of 1998 (29 U.S.C. 2801 et seq.), other than subtitle C of that Act (29 U.S.C. 2881 et seq.)(Job Corps); title II of the Workforce Investment Act of 1998 (20 U.S.C. 9201 et seq.; commonly known as the Adult Education and Family Literacy Act); title I of the Carl D. Perkins Vocational and Technical Education Act of 1998 (20 U.S.C. 2321 et seq.); the Head Start Act (42 U.S.C. 9831 et seq.); and subpart 3 of Part A, and part C, of title IV of the Higher Education Act of 1965 (20 U.S.C. 1070b et seq., 42U.S.C. 2751 et seq.), according to Pub. L. 108-188.

Education Sector Grant Priorities and Terms

The goals for FSM's and RMI's education sector grants under the amended compact and subsidiary fiscal procedures agreements are to

- improve the educational system of the countries, including primary, secondary, and post secondary education; and
- develop the countries' human and material resources necessary to perform these services.

Emphasis is to be placed on advancing a quality basic education system by

- increasing the achievement levels of students in the primary and secondary education system based on performance standards and assessments appropriate for the countries;
- providing secondary and vocational training;
- improving management and accountability within the educational system;
- raising the level of staff quality, including teacher training; and
- improving the relevance of education to the needs of the economy.

According to the fiscal procedures agreements, the SEG grant is to be used in part to support additional direct educational services at the local school level, with emphasis on school readiness, early childhood education, primary and secondary education, vocational training, adult and family literacy, and the transition from high school to postsecondary education or career endeavors. SEG is not to be used for school construction, remodeling, general operational costs, or teacher salaries, except those salaries needed to carry out programs or activities supported by the SEG.

In addition to being subject to the requirements in the amended compacts and fiscal procedures agreements, the FSM and RMI are subject to grant conditions imposed by the JEMCO and JEMFAC, respectively, and by OIA. (For sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII.)

FSM Education Sector

Compact sector grants for the FSM education sector in 2004 through 2006 supported the operation of primary and secondary schools in addition to other education functions and activities. The 2005-2006 SEG primarily supported early childhood

education in Chuuk and Pohnpei and education improvement programs in Yap and Kosrae. Although Chuuk receives the largest share of education funding, it has the lowest funding level on a per student basis. The FSM education sector faces many challenges in improving the quality of education.

Funding for the FSM Education Sector

In 2004 through 2006, JEMCO approved allocations totaling about \$79 million to the FSM national and state governments for the education sector: approximately \$26 million (34 percent of all compact funds) in 2004; about \$27 million (36 percent of all compact funds) in 2005; and about \$26.1 million (33 percent of all compact funds) in 2006. The largest allocations of compact funding each year went to Chuuk, the most populous state; the smallest allocations went to Kosrae, the least populous state (see table 1).

Table 1: FSM Education Sector Grant Allocation, by FSM Government, Fiscal Years 2004 through 2006

Grant recipient	2004	2005	2006
National government	\$4,324,122	\$4,511,317	\$4,159,081
Chuuk	8,140,265	8,804,369	9,432,618
Kosrae	1,883,853	2,070,432	2,412,498
Pohnpei	7,373,651	7,469,772	6,978,447
Yap	4,243,681	4,249,157	3,149,415
Total	\$25,965,572	\$27,105,047	\$26,132,059

Source: Compact grant award letters.

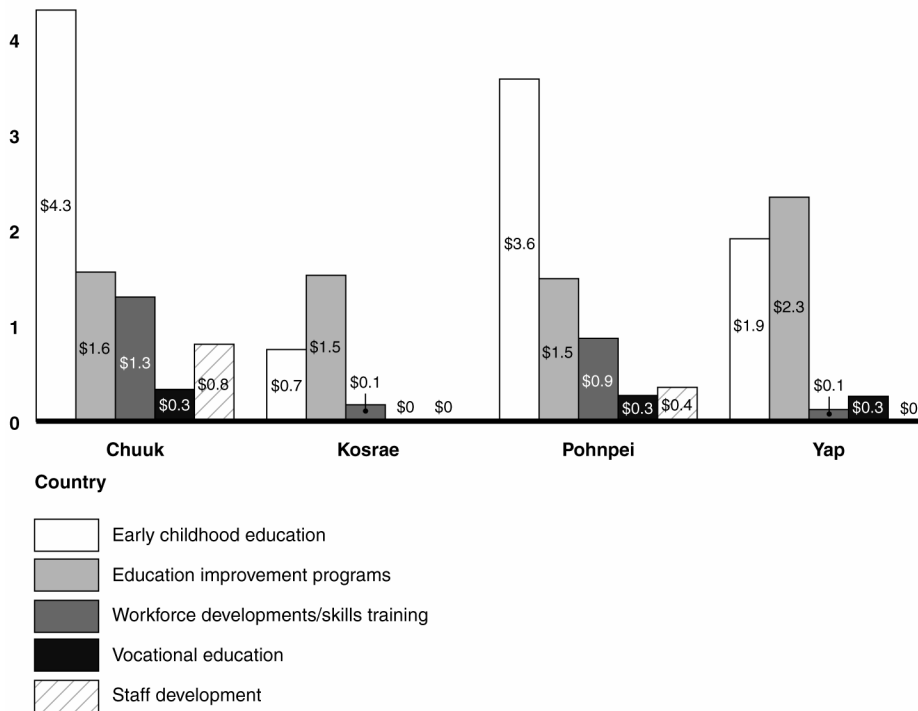
The compact grant supported the operation of primary and secondary schools in addition to other education functions and activities. At the state level, compact grants mainly supported the operation of primary and secondary schools. Compact grants also paid for postsecondary scholarships and provided partial support to some private schools. Among national institutions supported by grant funding, the College of Micronesia–Federated States of Micronesia (COM-FSM) received \$3 million in 2004, \$3.9 million in 2005, and \$3.8 million in 2006.

In addition to receiving compact sector funding, the FSM education sector received SEG from the United States—\$12.1 million for 2005 and almost \$12.1 for 2006. In Chuuk and Pohnpei, 2005 and 2006 SEG primarily supported early childhood education, while in Yap and Kosrae, the largest portion of the SEG went to education improvement programs. The SEG also supported vocational training, skills training, and staff development. In addition, the national government received some SEG funding for monitoring, coordination, technical assistance, scholarships, and research. The College of Micronesia received SEG funds for financial aid for students and for teacher training. Figure 2 shows SEG funding to the FSM states for 2005 and 2006.

Figure 2: FSM State SEG Funding by Activity, Fiscal Years 2005 through 2006

U.S. dollars (in millions)

5



Sources: FSM 2005 and 2006 supplemental education grant award agreements.

Combined annual U.S. assistance from the education sector compact funds and the SEG averaged approximately \$990 per student in primary and secondary schools. However, the level of funding per student varied widely by state: Chuuk received about \$730 per student in U.S. assistance, while Yap received about \$2,050 per student. Partly as a result of this discrepancy, Chuuk has a much higher student-to-teacher ratio (19:1) than Yap (8:1).¹⁸

¹⁸ According to the FSM, each state's distinct geographic features also affect the student-to-teacher ratio; for example, outer island schools tend to be smaller in size and have a lower student teacher ratio. The funding disparity does not appear to have affected the reported quality of education. For example, the percentage of students who were deemed not proficient in math was the same in Yap and in Chuuk in 2005, and the percentage of teachers lacking at least an associate degree is similar in the two states.

Table 2: Compact and SEG Public School Available Funding Per Student (K-12) by FSM Government, Fiscal Year 2005

	Chuuk	Kosrae	Pohnpei	Yap	National government	FSM
Compact	\$8,686,164	\$2,070,432	\$7,067,309	\$4,203,177	\$475,200	\$22,502,282
SEG	4,216,090	1,305,546	3,352,563	2,393,183	548,932	11,816,314
Total	\$12,902,254	\$3,375,978	\$10,419,872	\$6,596,360	\$1,024,132	\$34,318,596
Student number	17580	2532	11277	3212	n/a	34,601
Funding per student	\$734	\$1,333	\$924	\$2,054	n/a	\$992

Source: Funding data are drawn from 2005 compact and SEG budgets and award letters. Student numbers are drawn from the FSM submission of 20 education indicators in 2005 to JEMCO.

Notes: To calculate the compact and SEG funding for public primary and secondary schools, we excluded the funding for nonpublic schools, postsecondary schools, and some COM funding. Specifically we excluded

- \$118,205 to nonpublic schools in Chuuk;
- \$350,000 to postsecondary scholarships and \$52,463 to public libraries in Pohnpei;
- \$23,890 to St. Mary School and \$22,090 to the Seventh-Day Adventist School in Yap; and
- \$3,856,067 to the College of Micronesia operation funds, \$267,046 to the college for financial aid, and \$180,050 to the FSM Fisheries and Maritime Institute.

These amounts do not include other U.S. federal program assistance for education in the FSM.

Challenges in the FSM Education Sector

The challenges facing the FSM education sector include a lack of qualified teachers, a high level of teacher and student absenteeism, and poor conditions at facilities.

- *Lack of qualified teachers.* The large number of unqualified teachers at all education levels in the FSM is a serious impediment to improving the quality of education in the country; addressing this challenge will require a long-term effort. According to the FSM’s 2006 submission to the JEMCO, nearly 40 percent of the teachers nationally have no postsecondary qualifications. The situation is particularly critical in Yap and Chuuk, where more than half of teachers do not possess a degree from a postsecondary institution. In 2004, the national government began requiring that all teachers be certified¹⁹ and making the possession of an associate’s degree one of the certification criteria. To help teachers achieve the required degrees, the FSM obtained a grant from the U.S. Department of Education (ED); however, the grant expires in 2007, and teacher training is far from complete. The FSM reported that as of August 2006, after 4 years of teacher training grants, 27 teachers (12 from Chuuk, 4 from Kosrae, 8 from Pohnpei, and 3 from Yap) had attained associate degrees with the assistance of the grants. However, more than 900 FSM teachers had no degrees and lacked certification.

¹⁹ To obtain the certification, teachers are required to pass a national test, have at least an associate (2-year) degree, and demonstrate to classroom observers core teaching competencies.

- *Absenteeism.* Officials at many of the schools we visited reported absenteeism is a problem for both teachers and students. For example, a high school we visited in Pohnpei reported a 20 percent absentee rate for teachers in February 2006. In the event of a teacher's absence, the schools attempt to combine classes rather than send students home. There is also a lack of accountability in the system regarding teachers' performance, according to Kosrae's Department of Education Director. In response, Kosrae tried to shift teachers from holding civil service positions to biannual contracts in order to make it easier to terminate nonperformers. The effort was met with resistance from the teachers, but Kosrae's Education Department nonetheless hoped to put all teachers on contract.
- *Poor conditions.* Deteriorating conditions at school facilities challenge efforts to strengthen FSM education. When we visited Kosrae High School, we found the bathrooms in deplorable condition and we were told that the female students avoided using them. In the Southern Nomoneas High School on Chuuk Lagoon Island, a damaged roof caused classes to be cancelled when it rained, because students sat on the floors of the classrooms in the absence of chairs and desks (see fig. 2). Chuuk schools were also negatively affected by an unreliable power supply due to the poor condition of the power system on Weno Island. As we reported in December 2006, the FSM had not undertaken any school facility repair projects using the infrastructure sector grant funds.²⁰ However, education sector grant carry-over funds from 2004 were authorized by JEMCO to be used to repair schools and to purchase desks and chairs; only in Chuuk was this funding used.

²⁰ GAO-07-163.

Figure 3: Poor Conditions of Classroom Facilities in the FSM



Southern Nomoneas High School, Tonoas, Chuuk Lagoon, FSM

Source: GAO.

RMI Education Sector

Compact sector grants for the RMI education sector in 2004 through 2006 supported the operation of primary and secondary schools in addition to other education functions and activities, such as the College of Marshall Islands. The 2005 and 2006 SEG funding supported early childhood education, paid for textbooks and supplies at primary and secondary schools, and supported the National Vocational Training Institute, an alternative to the main-stream high schools. The RMI education sector faces many challenges in improving the quality of education.

Funding for the RMI Education Sector

In 2004 through 2006, JEMFAC approved grants for the RMI's education sector that presented the second largest share of compact funding: in 2004, \$10.7 million (31 percent of compact funds); in 2005, \$11.6 million (33 percent of compact funds); in 2006, \$11.9 million (34 percent of compact funds) (see table 3). The compact grant supported the Ministry of Education's (MOE) operations. It also supported other education functions and activities, such as the College of the Marshall Islands and the National Scholarship Board.²¹

²¹ The RMI education system comprises five agencies: (1) the Ministry of Education, (2) the College of the Marshall Islands, (3) the Scholarship Grant and Loan Board, (4) the National Training Council, and (5) the Atoll Feeding Program.

Table 3: Compact Funding for the RMI Education Sector, by Agency, Fiscal Years 2004 through 2006

Grant Recipient	2004	2005	2006
Ministry of Education	\$8,362,932	\$9,597,911	10,174,046
National Scholarship Board	700,000	900,000	760,037
College of the Marshall Islands	2,036,626	700,000	1,000,000
National Training Council	186,000	0	0
Total^a	\$11,285,558	\$11,197,911	\$11,934,083

Source: The RMI Education Budget Portfolio, 2004 through 2006.

Note: The amounts shown represent compact funding budgeted by the RMI for each agency and differ slightly from the final awards for 2004 and 2005.

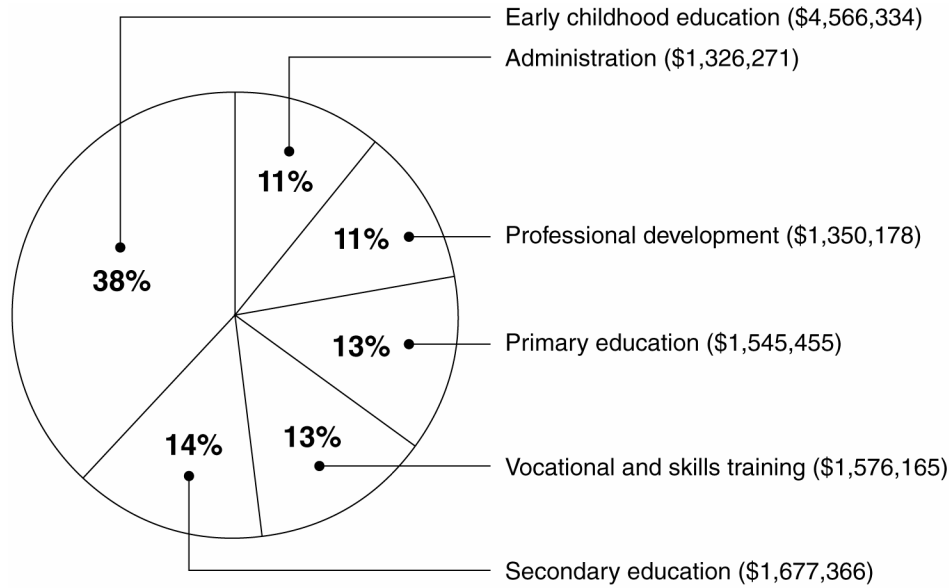
^aThe total includes Kwajalein (Ebeye) Special Needs funding of \$1.1 million in 2004 and \$1.6 million in 2005 as part of the education grant. The 2006 funding included Ebeye Special Needs funding: \$1 million for the education sector and \$100,000 for the scholarship board.

In addition to receiving compact sector funding, the RMI education sector received SEG funding: \$6.1 million for 2005, and approximately \$5.9 million for 2006 from the United States. The SEG was used primarily to support early childhood education, as well as functions at other education levels, such as primary and secondary schools (see fig. 4). The SEG was also used to support a wide range of additional activities, including purchasing textbooks and supplies, hiring World Teach/Dartmouth teachers and substitute teachers,²² and funding the National Training Council and the National Vocational Training Institute, which is an alternative to mainstream high school. We calculate that in 2005, compact funding and the SEG provided, on average, approximately \$1,300 a year for each of the RMI's public school students (kindergarten through 12th grade).²³

²² To enable regular teachers to attend training, the RMI used SEG funding to support World Teach and Dartmouth volunteer teachers (\$217,936 in 2005) and to hire substitute teachers (\$132,000).

²³ This amount includes SEG funding but does not include other U.S. federal programs. We also excluded from this calculation, compact funding for the College of the Marshall Islands and the National Scholarship Board as well as SEG funding for the National Training Council, the National Scholarship Board, and adult education from this calculation. Because the budget does not give information on the amount of U.S. assistance to private schools, this number may overstate the level of funding to public school students.

Figure 4: RMI Distribution of Supplemental Education Grant, Fiscal Years 2005 through 2006



Sources: RMI 2005 and 2006 supplemental education grant award agreements.
 Note: Amounts shown represent combined 2005 and 2006 SEG.

Challenges in the RMI Education Sector

Challenges facing the RMI education sector include a lack of qualified teachers, teacher and student absenteeism, high dropout rates, the accreditation problems at the College of Marshall Islands, and poor classroom facilities. Some of these challenges, such as lack of qualified teachers, are significant and will take a long time to address.

- Lack of qualified teachers.* Lack of qualified teachers presents an obstacle to progress in the education sector. The RMI Ministry of Education is conducting several ongoing efforts to improve teacher quality, including the Teacher Quality Education program, with the goal of ensuring that all teachers have associate’s degrees by 2008. However, a ministry official in charge of professional development stated that this time frame may be unrealistic because some teachers will have to take remedial courses, on a part time basis, before they can enroll in courses for a degree. One teacher told us that although he had taken summer classes towards his degree for the past 3 years, earning the degree may require another 10 years of summer classes. A further problem with the teacher training program is that some teachers do not attend classes although they are paid to do so, according to one official from the Asian Development Bank. The ministry official in charge of professional development told us that the ministry had recently initiated a policy of docking teachers’ pay if they did not enroll in or attend classes.
- Absenteeism.* At the schools we visited, officials told us that absenteeism was a serious problem for both students and teachers. Personnel actions are rarely taken when teachers do not appear for work, according to an official at the

MOE. The difficulty in taking action stems, in part, from the RMI's public service employment practices, according to the Minister of Education. Because teachers in the RMI are hired by the Public Service Commission, to initiate a personnel action, the ministry must document the case and turn it over to the commission for adjudication. The ministry does not have the authority to impose penalties, and the commission often does not take the personnel actions suggested by the ministry, according to ministry officials.

- *High dropout rates.* According to the RMI Ministry of Education, the dropout rate in 2005 was 23 percent at the primary school level (grades 1-8) and 38 percent for boys and 37 percent for girls at the secondary school level (grades 9-12). The ministry estimated that less than 25 percent²⁴ of the students now enrolled in first grade will complete high school.
- *Accreditation problems.* The College of the Marshall Islands has experienced accreditation problems since 2003. According to the President of the college, the accreditation committee indicated that the college's physical infrastructure was one of the most serious obstacles to accreditation and that the committee would require evidence that the facilities would be substantially upgraded before it would change the college's "show cause" status.²⁵ Through a memorandum of understanding signed by the RMI President and the cabinet and agreed to by OIA, from 2006 through 2010, the college will receive \$5 million per year from the infrastructure grant. However, this initiative will significantly reduce the funding available under the infrastructure sector grant to build and renovate primary and secondary schools.
- *Inadequate classroom facilities.* Despite the use of compact infrastructure funds to build new classrooms at six schools, many RMI schools remain in poor condition. For example, classrooms at the Marshall Islands High School are unsafe because ceilings have collapsed (see fig. 5), while schools on Ebeye have no reliable electricity because of rolling blackouts on the island. Access to secondary education is also limited by the lack of available classroom space; students take an entrance test to enter public secondary schools because of limited capacity at the schools.²⁶ We calculated, based on data from

²⁴ According to the RMI's response to our draft report, the 25 percent figure was out dated. The new estimate is 50 percent of the students enrolling in first grade will complete high school. The 25 percent figure, however, was reported in the Ministry of Education's Portfolio document for 2005-2006.

²⁵ According to the *Western Association of Schools and Colleges Accreditation Handbook*, an order to "Show Cause" is a decision by the Commission to terminate the accreditation of the institution within a maximum period of 1 year of the date of the order, unless the institution can show cause why this action should not take effect. Such an order is typically issued when an institution, having been placed on warning or probation for 1 year, has been found not to have made sufficient progress to come into compliance with Commission standards. The institution has the burden of proof to demonstrate why its candidacy or accreditation should not be terminated. The institution must demonstrate that it has responded satisfactorily to Commission concerns, that it has come into compliance with all Commission standards, and will likely be able to sustain its compliance.

²⁶ According to the RMI, in response to our draft report, the RMI noted that progress has been made on new construction at the Marshall Islands High School, and classes are moving into the new buildings.

the 1999 RMI census, that less than 60 percent of the school-age population was actually enrolled in 9-12.²⁷ The principal of Ebeye High School told us the school would not have enough classrooms for the new school year and that they were converting an old warehouse into classroom space.

Figure 5: Poor Classroom Facilities in the RMI



Marshall Islands High School, Majuro, RMI
Source: GAO.

²⁷ On the basis of the 1999 Census, the RMI had a population of approximately 6,000 who would reach secondary school age (grade 9 to grade 12) by 2005. The enrollment in the RMI public and private secondary schools combined for the 2005-2006 school year was 3,414.

FSM and RMI Supplemental Education Grants

For 2005 and 2006, SEGs were awarded near the end of the fiscal year, whereas compact sector grants were awarded at the start of each fiscal year. Although the SEG was approved in December 2003, the implementation of SEG has been slowed by several factors, including (1) the length of time it took the Departments of the Interior (DOI), Education (ED), Health and Human Services (HHS), and Labor (DOL) to develop a memorandum of agreement on a framework for the use and monitoring of the SEG; (2) the FSM's and RMI's late submissions of SEG plans, combined with a lengthy approval process involving the four U.S. agencies; and (3) disagreements among the parties about the appropriate use of SEG grant funds. The FSM and the RMI have expressed concern because the grant has not received an adjustment for inflation, as was established for compact grants, and because it was subject to a rescission in 2005 and 2006.

- *Lengthy agreement process.* After the amended compact was enacted, Interior, ED, HHS, and DOL—the four U.S. agencies involved with the federal programs incorporated into SEG—took 19 months to develop a memorandum of agreement (MOA) providing a framework for the use and monitoring of the SEG.²⁸ The MOA specifies that ED and HHS are required to review the countries' SEG plans and provide feedback to Interior. The process is dependent on the annual appropriation from the U.S. Congress. ED seeks funding in its appropriation and transfers the funds to Interior, and after the plans are approved, Interior disburses the funds. According to an HHS official, problems with coordination and planning for the transition of funding from the various federal programs to the SEG complicated the agreement process. However, officials from ED pointed out that the length of time it took to develop the memorandum was due to the complexity of the task, which marked a “complete paradigm shift” in the way funds were provided to the FSM and RMI, including transferring oversight from the U.S. agencies to the FSM and RMI governments. Owing partly to the fact that the memorandum of agreement was not concluded until July 2005, 10 months into the fiscal year, the 2005 SEG was not awarded to the FSM and RMI until October and August 2005, respectively. As a result of the delay, both countries used their own revenue to fund early childhood education during the transition period and were later reimbursed.
- *Late submission and lengthy review of SEG plans.* The required reviews and revisions of the SEG plans also slowed SEG funding. In 2005, the FSM and RMI submitted their plans near the beginning of the fiscal year. Partly owing to extensive revisions, the funding was not awarded until nearly 1 year later. In 2006, the FSM and the RMI did not submit their plans until well into the fiscal year. An OIA official stated that the agencies had verbally agreed to a 30-day review period; however, in SEG's first 2 years of implementation, the reviews took longer than 30 days.

²⁸ The agreement was required by the amended compacts' enabling legislation P.L. 108-188.

- *Disagreement over SEG uses.* Disagreements between the U.S. government and the FSM and RMI governments about the planned uses of the SEG contributed to slowing the SEG's implementation. Because a U.S. review found the planned use of funds inappropriate, the U.S. government required revisions to the plans. For example, according to the U.S. ED, because the FSM's and the RMI's SEG plans for 2006 contained many uses not allowed under the fiscal procedures agreement accompanying the compacts, ED and DOI questioned several of the FSM's and RMI's proposed SEG activities.²⁹ The RMI has expressed its disagreement and frustration over the U.S. interpretation of the appropriate use of SEG funding, stating that the compact does not state that SEG funds are to be used for "supplemental programs" but rather to supplement programs. For example, U.S. agencies expressed concern over the sustainability of the RMI's early childhood education (ECE) program. According to the agencies, SEG funds are not appropriated to replace the federal programs under which the RMI previously received funding and the ECE program should be supported by the education sector grant. In that way, if the SEG funds were not available in a given year, the ECE program would still be operational, albeit perhaps with reduced activities. The RMI responded that the SEG was designed to replace Head Start and that the new program meets the unique geographic and cultural needs of the RMI. The RMI insists that funding of early childhood education through the SEG will continue. According to ED officials, the two countries, particularly the FSM, did not understand what activities the SEG funding could support.

Both the FSM and the RMI have raised concerns that the U.S. appropriation for the SEG in 2006 was smaller than the amount anticipated by the countries and OIA officials. The country and OIA officials had anticipated that the 2006 SEG grant would be increased by the inflation adjustment authorized by the legislation creating the SEG. However, ED's 2006 appropriation, the source of SEG funding, was not available until December 30, 2005, and the amount appropriated for the FSM and RMI combined was \$182,190 less than the previous year's SEG grant.³⁰ The lower level of funding reflected no inflation adjustment,³¹ and a general rescission imposed on all executive branch agencies in 2006. ED officials informed us due to a tight budget environment, the department's 2006 budget only requested increases for those programs that could demonstrate effectiveness in achieving their objectives or those of the highest priority. Officials in both the FSM and the RMI voiced confusion and frustration over the delay and reduced funding. At JEMCO and JEMFAC meetings held in August 2006, some U.S. officials argued that the inflation adjustment should be viewed as a compact obligation and that the ED should ask for the inflation adjustment in its budget. The ED official present responded that because of budget constraints, including an inflation adjustment, in the department's 2006 budget was

²⁹ The FPA does not allow the SEGs to be used for school construction or remodeling, general operational costs, or teacher salaries, except for the salaries of the teaching professionals who carry out activities supported by the SEG.

³⁰ The 2005 SEG was \$18,183,360 and the 2006 SEG was \$18,001,170.

³¹ The provision authorizing the SEG in the amended compacts' implementing legislation authorizes an annual appropriation to the Secretary of Education that is adjusted for inflation (partial) through 2023. The MOA states Education "shall seek the annual appropriation of funds for the SEGs, including adjustments for inflation, as described in Section 105(f)(1)(B)(iii) of Pub. L. No. 108-188."

impracticable but that inflation adjustment might be considered for future ED budgets.

ENCLOSURE III

Infrastructure

Both the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) have prioritized education- and health-related infrastructure projects in accordance with their respective fiscal procedures agreement. However, as of November 2006, only the RMI has used infrastructure funds to build several projects. The FSM has not yet built any projects and has more than \$58 million in available funds, although it has made some progress in initiating projects. Progress is hampered by land constraints and other issues in both countries.

Infrastructure Sector Grant Priorities and Terms

The amended compacts provide for grants to assist the FSM and the RMI governments in their efforts to provide adequate public infrastructure. The highest priority for infrastructure funding is to be given to primary and secondary education capital projects and projects that directly affect health and safety, including water and wastewater projects, solid waste disposal projects, and health care facilities. Secondary priority is to be given to economic-development-related projects, such as airport and seaport improvements, roads, sea walls, and energy development.

Infrastructure grant terms include the amended compacts' requirement that 5 percent of the annual grant be set aside, with an equal contribution from the FSM and RMI, to establish an Infrastructure Maintenance Fund (IMF) in each nation. Further, the amended compacts' enabling legislation indicates that it is the sense of Congress that both countries should invest at least 30 percent of total annual sector grants in infrastructure.³² Additionally, the amended compacts' subsidiary fiscal procedures agreements require that prior to a draw down of infrastructure assistance both countries provide the U.S. government with (1) evidence of title, leasehold agreement, or other legal authority for the use of land upon which a capital improvement project is to be constructed, (2) a detailed project budget for each capital development project, and (3) a scope of work that describes the work to be performed and schedule from planning through construction. The fiscal procedures agreements also require that both countries implement infrastructure development plans (IDP).³³ In addition, the FSM and RMI are subject to grant conditions imposed by the JEMCO and JEMFAC, respectively, and by OIA. (For sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII).

FSM Infrastructure Sector

In 2004 through 2006,³⁴ the FSM received more than \$58 million in amended compact grants for infrastructure development. However, owing to delays in meeting fiscal

³² The RMI amended compact required it to allocate between 30 and 50 percent of its annual grant assistance to infrastructure.

³³ The RMI's plan is called an infrastructure development and maintenance plan (IDMP) while the FSM's is called an infrastructure development plan (IDP). In addition, while the fiscal procedures agreements for both countries require costs to be included in these plans, only the agreement with the FSM requires the IDP to include an implementation schedule.

³⁴ In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

procedures agreement requirements and grant terms and conditions, the grant was not used to build any new projects during this period. FSM's infrastructure development faces numerous challenges, such as a lack of defined procurement processes and building standards, the need to resolve infrastructure management issues, lack of stakeholder agreement, and land constraints. Further, accountability issues have been raised by the DOI Inspector General concerning the FSM's infrastructure management.

Funding for FSM Infrastructure Sector

In 2004 through 2006, JEMCO allocated more than \$58 million in compact funds, approximately 26 percent, to infrastructure development in the FSM. Approximately \$17 million was allocated in 2004,³⁵ \$17 million in 2005, and \$24 million in 2006 for public infrastructure improvements and maintenance. In addition, in 2004 through 2006, the U.S. Federal Aviation Administration (FAA) provided the FSM nearly \$24 million for airport improvement projects in the four states. Of the \$58 million allocated for infrastructure from compact funds in 2004 through 2006, the FSM had obligated \$48 million (83 percent) as of October 2006.³⁶ These funds were intended for administration, infrastructure maintenance, U.S. FAA airport improvement projects' matching fund requirements, and various infrastructure projects in all four states.

A number of infrastructure sector-related activities were initiated in the FSM in 2005 and 2006, although no compact-funded construction projects had been completed by October 2006. In May 2005, the FSM national government signed a contract with a professional architectural and engineering design firm to undertake project engineering, management, and administration of the FSM's project management unit (PMU).³⁷ The PMU's responsibilities include (1) certifying projects, or determining that the scope and budget of a project are reasonable and justifiable, and (2) ensuring that projects will be designed to a professionally acceptable standard and that the project budget properly reflects such a standard. The PMU has certified projects in all four FSM states as being consistent with the priorities listed in the FSM's IDP. As of November 2006, the PMU had certified 21 projects; of these, 14 projects, with a total estimated value of \$42 million, had been approved by OIA. (Table 4 shows the certified FSM projects.) Pending projects in the FSM include schools, wastewater treatment plants, power and water distribution systems, and road and airport improvements.

³⁵ At the time that funding was allocated in August 2004, JEMCO had not concurred with FSM's Infrastructure Development Plan. The concurrence came on March 11, 2005, during a special JEMCO meeting but only insofar as the plan involved the use of compact infrastructure sector funds for projects within the priorities established in the Fiscal Procedures Agreement.

³⁶ Unobligated funds remain available for use in subsequent years.

³⁷ As a condition for spending infrastructure funds, JEMCO required that the national government ensure that the projects be professionally managed. The FSM contracted with an architectural and engineering consulting firm based in Honolulu, Hawaii. Further, OIA required the FSM to create a centralized PMU within the national government in accordance with the FSM's IDP, which stated the need for a centralized PMU. Additionally, OIA requires the FSM to seek its approval for individual infrastructure projects.

Table 4: FSM Certified and Approved Infrastructure Projects as of June 2006

Date certified by PMU	Date approved by OIA	Project name	State
9/19/2005	11/17/2006	FSM Matching Fund Share for FAA Airport Improvement Projects	FSM
12/20/2005	1/23/2006	Lelu Elementary School	Kosrae
12/20/2005	1/23/2006	Utwe Elementary School	Kosrae
1/17/2006	2/2/2006	Tafunsak Elementary School	Kosrae
1/6/2006	2/3/2006	Weno Wastewater Collection & Treatment Facility	Chuuk
1/17/2006	2/2/2006	Pohnpei Water Drilling	Pohnpei
2/14/2006	3/13/2006	Malem/Utwe Distribution System Upgrade	Kosrae
3/8/2006	5/12/2006	Madolenihmw High School	Pohnpei
3/8/2006	5/12/2006	Kolonia Elementary School	Pohnpei
3/8/2006	5/12/2006	Early Childhood Education Center	Yap
4/11/2006	6/1/2006	Yap State Hospital Renovation	Yap
4/28/2006	6/1/2006	Weno Island Emergency Power Provision	Chuuk
4/28/2006	6/1/2006	Nanpil Hydroelectric Power Plant Rehabilitation	Pohnpei
6/1/2006	6/1/2006	Weno Road and Drainage Upgrade (Phase I)	Chuuk

Source: FSM PMU and OIA.

Note: The table does not include PMU data on estimated project costs, because none of the projects shown have been advertised for bidding.

Challenges in the FSM Infrastructure Sector

The FSM faces a number of challenges that have hindered its initiation of compact-funded infrastructure projects and that, if not corrected, may affect project implementation. These challenges consist of (1) a lack of defined procurement processes and uniform standards, (2) disagreement about project management and implementation, (3) persistence of unresolved land issues, (4) inadequate long-term planning, (5) lack of funding for maintenance, and (6) lack of technical capacity, and (7) weaknesses in accountability for infrastructure sector grant funds.

- *Undefined procurement processes and building standards.* Delays in establishing defined processes for procuring design and construction services and implementing uniform building standards has hampered FSM infrastructure construction and, according to an OIA official, may result in the procurement of less than optimal design and construction services and materials. The fiscal procedures agreement permits the FSM to use its own procedures for procurement, provided it meets the standards enumerated in the fiscal procedures agreement. However, the FSM did not pass a procurement law until June 2006, and according to an OIA official, interim procurement regulations implemented at that time had not been finalized as of November 2006. Additionally, the national government lacks a uniform building code, and as a result, each state applies disparate standards that do not conform to any international code, according to an OIA official.

- *Disagreement about project management and implementation.* Disagreement between the FSM national and state governments and within the national government about the management of infrastructure projects has also hindered project implementation. According to state officials, the national government has not defined the states' role in administering infrastructure projects. Further, according to an OIA official, FSM state officials refuse to recognize the PMU as the central infrastructure authority because they do not want to lose control of their own infrastructure projects. One state official indicated that the FSM states were not consulted during the selection of the PMU managing firm, and the governor of one state refused to even meet with the PMU manager. In addition, state officials expressed displeasure over the national government's delay in implementing infrastructure projects, attributing it to centralized decision making.
- *Unresolved land issues.* The FSM faces long-term challenges obtaining the clear title or long-term leasehold agreement required by the fiscal procedures agreement. Land in Chuuk is predominantly owned by a family or clan, and tradition requires the approval of all senior members of the clan before land can be sold. In Weno, Chuuk's state capital, only about 1 percent of the land is owned by the government, and much of that is in dispute, according to a 1998 study by a land consultancy and valuation firm funded by the Asian Development Bank.³⁸ In addition, problems with land valuation in Chuuk have further complicated matters. The same study found that sales of comparable land in Weno ranged from \$5 per square meter to \$1,704 per square meter, although the study recognized that the higher prices may have been influenced by the availability of compact funds.³⁹ Moreover, conflicts over land ownership have affected the ability of the Chuuk state government to provide adequate health and education services. For example, we visited a high school on the island of Tonoas in the Chuuk lagoon where classroom buildings had been closed by the landowner because the Chuuk state government had not paid the rent.⁴⁰ (See fig. 6.)

³⁸ Neil K. Darroch, *Land Consultancy & Valuation – Government Leased Land Chuuk State*, a special report requested by the Asian Development Bank on behalf of the FSM, August 1998.

³⁹ JEMCO first addressed this issue in 2004, resolving that no use of compact funds for payments toward preexisting land purchase arrangements or leases would be allowed. JEMCO further expressed its concern regarding issues related to the purchase or lease of land including problems with determining fair market value, obtaining clear title, and avoiding real or apparent conflicts of interest. However, the FSM fiscal procedures agreement does not prohibit the purchase of real property with amended compact funds and, in fact, establishes terms for its titling, use, and disposition. OIA indicated in May 2006 that if fair land values are established and land-ownership issues are clarified, compact funds may be considered for land purchase in the FSM.

⁴⁰ This issue was raised at the March 2006 mid-term JEMCO meeting, where an FSM JEMCO member indicated that the school closure situation had been resolved by using the "renovated" dormitories as temporary classrooms until the land dispute is mediated. JEMCO members accepted this explanation. However, we observed no evidence of "renovation" of the dormitories as indicated by the FSM official.

Figure 6: Southern Nomoneas High School, Tonoas Island, Chuuk State



Southern Nomoneas High School, Tonoas, Chuuk Lagoon, FSM

Source: GAO.

- *Inadequate long-term planning.* The FSM has not adequately planned for its long-term infrastructure needs, according to OIA. In 2002, the FSM contracted with a U.S. firm to develop a 15-year infrastructure plan, which estimated that meeting FSM's total infrastructure needs would require over \$2 billion dollars. According to an OIA official, the plan employed a "cookie-cutter" approach to development, met with no concurrence from the FSM states, and was not adopted by the FSM Congress. Nonetheless, the national government's IDP contains portions of this plan. Moreover, the IDP, which includes synopses of 11 different infrastructure sectors, contains long lists of projects and estimated costs but does not provide explanations or support for the individual projects or prioritize them as JEMCO requires. According to an OIA official, the FSM's IDP is not based on any type of assessment of the needs of specific areas in the FSM, and no such assessment has been performed.

In addition, as of November 2006, the FSM had not undertaken a cost-benefit analysis to reconcile conflicting approaches to infrastructure design. Some FSM officials have expressed concern that the PMU's design standards are too high and costly and that this may ultimately limit the number of projects they can build. For example, according to an OIA official, the PMU estimated that a standard-design school building would cost \$1.2 million, whereas the Pohnpei government had constructed school buildings of a similar size for \$275,000. However, the OIA official added that the Pohnpei-designed school buildings did not meet any type of recognized standards, lacking sufficient bathrooms, fire exits, and

wheelchair access, and that the PMU design represented a higher material and construction standard. OIA also noted that the Pohnpei school building was a shell, with no fencing, sewer systems, walkways, furniture, fixtures, or equipment, while the PMU design is intended to be a turn-key project.⁴¹

- *Lack of maintenance funding.* Although OIA set aside 5 percent of the infrastructure sector allocations in 2004 through 2006 for an FSM infrastructure maintenance fund, per the amended compact, the FSM had not provided the required matching amount as of November 2006.
- *Lack of technical capacity.* The FSM lacked the technical capacity locally to manage its own PMU. According to OIA, the FSM national Department of Transportation, Communication, and Infrastructure, which houses the PMU, does not have the capacity to monitor and oversee the PMU consulting firm's activities. The FSM has taken a step to acquire this capacity by employing an experienced contracting officer's representative in November 2006.⁴² However, it is not certain that the FSM national government will have the technical capacity locally to ensure quality control should the contracting officer's representative cease employment.
- *Weaknesses in accountability.* Interior's IG and the U.S. Army Corps of Engineers identified several accountability problems related to the FSM's implementation of its infrastructure sector grant. In its July 2006 review,⁴³ the IG concluded that its findings raised concerns about the FSM's ability to manage the compact infrastructure grant effectively. Specifically, the IG found that the FSM national government (1) failed to properly plan for the timely construction of needed health and education infrastructure projects, (2) entered into a less than beneficial contract for the establishment of an FSM national PMU, and (3) implemented project management regulations containing a conflict of interest. The IG suggested the suspension of all infrastructure sector funding to the FSM and termination of the FSM's contract with the PMU managing firm. In addition, OIA requested the Army Corps of Engineers to review the FSM's contract with the PMU managing firm. The Corps' November 2005 review identified items in the contract that were not in the FSM government's best interest, including an open-ended scope of work and apparent conflict of interest in the compensation structure.

⁴¹ "Turn-key" means that projects completed will be fully furnished, fully equipped with fixtures and equipment, and ready to move in upon completion.

⁴² A contracting officer's representative serves as a liaison between the government and the contractor to monitor the contractor's performance.

⁴³ Department of Interior, Office of Inspector General, *Memorandum: Compact Infrastructure Grant Poor Planning and Questionable Contracting (FSM)* (Washington, D.C.: July 31, 2006).

RMI Infrastructure Sector

The RMI's infrastructure sector has received the largest amount of total available RMI compact sector funding since the beginning of the amended compact, and the government has met amended compact and fiscal procedures agreement requirements for prioritizing infrastructure spending on education and health projects. Between 2004 and July 2006, nine new construction projects and 17 maintenance projects in the RMI were completed or, as of October 2006, were near completion. However, the RMI faces some challenges in moving forward with future infrastructure projects, including land constraints and a lack of planning, technical capacity, stakeholder buy-in, and maintenance. Further, accountability issues exist in the RMI's management structure.

Funding for the RMI Infrastructure Sector

In 2004 through 2006, JEMFAC allocated \$41.7 million to infrastructure development in the RMI. The allocations averaged 40 percent of the total sector grant for the past 3 years, consistent with the amended compact requirement that between 30 percent and 50 percent of U.S. annual compact grant assistance be directed toward infrastructure development. In addition, of the total amount allocated to the RMI for infrastructure since 2004, JEMFAC allocated \$2 million for infrastructure development on Kwajalein Atoll, consistent with the amended compact requirement. In addition, in 2004 through 2006, the FAA provided \$26.1 million to the RMI for airport improvement projects.⁴⁴ As of July 2006, the RMI had obligated approximately \$15.5 million (37 percent) of its infrastructure sector grant allocation, for new construction and maintenance projects, since 2004. The RMI has focused 77 percent of infrastructure development and maintenance funding over the past 3 years on primary and secondary education.

A number of infrastructure-related activities were initiated or completed in the RMI in 2004 through 2006. The RMI, with the assistance of a professional engineering and architectural consulting firm, developed a 20-year infrastructure development maintenance plan (IDMP), listing prioritized projects, by conducting an extensive assessment of the RMI education and health infrastructure. In 2004, the RMI hired the same consulting firm to manage its Project Management Unit⁴⁵ and to design and oversee individual infrastructure projects. As of November 2006, nine new construction projects and 17 maintenance projects in the RMI had been completed or were ongoing (table 5 lists these projects). During our visit to Majuro in March 2006, we found that there was evidence of a leasehold agreement⁴⁶ for the projects under way at the time, in accordance with fiscal procedures agreement requirements.⁴⁷

⁴⁴ The FAA grants are intended to provide 95 percent of project funding, with a 5 percent local contribution requirement. The RMI has used compact funds, with OIA's approval, to meet this matching requirement.

⁴⁵ The RMI contracted with a New Zealand-based architectural and engineering consulting firm. This was also the same firm that prepared the RMI's IDMP.

⁴⁶ The RMI government has no public land and instead must lease all land used for public purposes.

⁴⁷ The standard lease agreement for Majuro and Ebeye is for 25-years, with an option to renew for an additional 25 years.

Table 5: Status of RMI Infrastructure Projects as of August 2006

New construction projects			
Project name (project phase or year)	Contract value	Description	Percentage completed
Rita Elementary School (phase I)	\$1,028,255	Two 4-classroom blocks	100%
Laura High School (phase I)	567,673	One 4-classroom block	100
Laura High School (phase II, stage I)	145,234	Preparation for the second half of conversions of former garment factory	99
Marshall Islands High School (phase I)	1,180,316	One 8-classroom block	99
Northern Islands High School (phase I)	872,277	Administration building and dormitory	99
Jaluit High School (phase I)	2,752,000	Two 8-classroom blocks and a dormitory	90
Rita Elementary School (phase II)	1,400,294	Two additional classroom blocks	47
Marshall Islands High School (phase II)	4,396,047	Three 8-classroom blocks and one 4-classroom block	17
Rairok Elementary School (phase I)	512,853	Building structure and roofing repairs	12
Total new construction	\$12,854,949		
Maintenance projects			
Ailuk Elementary School	\$59,000	Education maintenance project	100%
Ebeye Hospital (year 1)	307,502	Mechanical, electrical, and air conditioning maintenance and architectural repairs	100
Education III	220,185	Elementary school maintenance on Jaluit and Arno atolls	100
Health Center I	198,354	Health center maintenance on Southern atolls and Arno (8 centers in total)	100
Health Center II	203,587	Health center maintenance on the eastern atolls	100
Laura Elementary School	157,815	8 classrooms and library	100
Majuro Hospital	179,925	Painting, flooring, wall repairs, seating, isolation ward toilets, doors, and shelving repairs	100
Majuro Hospital Emergency repairs	180,000	Rebuilding of corridors, morgue, laundry, and storage rooms	100

Majuro Middle School toilets	28,586	Toilet repairs and renovations	100
Marshall Islands High School gymnasium	65,594	Floor and wall repairs, and toilet construction	100
Marshall Islands High School painting and fence repairs	99,679	Painting of two buildings and fencing of staff quarters	100
Marshall Islands High School toilets	22,622	Toilet repairs and renovations	100
Jaluit High School kitchen	77,885	Kitchen finishes repairs, new cooking equipment, and dining room flooring	100
Education I	130,796	Elementary school maintenance on Majuro	100
Education IV (phase I)	168,388	MIHS classroom ceilings renovations and electrical work	93
Education IV (phase III)	179,400	MIHS classroom renovations: windows, floors, and painting	56
Ebeye Hospital (year 2)	307,572	Mechanical, electrical, and air conditioning maintenance and architectural repairs	42
Total maintenance	\$2,596,987		
Total new construction and maintenance	\$15,451,936		

Source: RMI Infrastructure Development and Maintenance Program Quarterly Performance Monitoring Report for the third quarter of 2006.

The PMU has taken steps to ensure cost efficiency. To reduce design costs, the PMU developed a standard design for all new school buildings (see fig. 7). The PMU's design also contains features to reduce the cost of long-term maintenance. For example, the design minimized the use of steel reinforcements, which eventually rust in the corrosive ocean environment, by using fiberglass bars instead (see fig. 8). The cost per square foot of new construction ranged between \$175 to \$218.⁴⁸ In addition, the PMU has rehabilitated existing structures, such as an abandoned garment factory and grocery store, to house classroom facilities. According to an OIA official, RMI's PMU contractor is doing a good job and, at 15 percent for overhead and profit, is appropriately compensated for the quality of services and design.

⁴⁸ Total costs also include the cost of furniture, fixtures, equipment and service connections, landscaping, paths, entrances, and fences.

Figure 7: Newly Constructed School in the RMI



Rita Elementary School, Majuro, RMI

Source: GAO.

Figure 8: Corroded Rebar



Laura Elementary School, Majuro, RMI

Source: GAO.

Challenges in the RMI Infrastructure Sector

Several challenges have limited the RMI's implementation of infrastructure projects or could affect its future efforts. These challenges include a lack of competition for construction contracts, an absence of stakeholder cooperation, unresolved land

constraints, lack of assessment of funding decisions, inadequate facilities maintenance, and lack of technical capacity.

- *Lack of competition.* A very limited number of construction firms in the RMI have the resources to meet bonding and scope of work requirements for the infrastructure projects, resulting in a lack of competition for infrastructure construction contracts. Further, in August 2004, the DOI Inspector General found that PMU advertising practices at the time lacked sufficient breadth to ensure maximum open and free competition. According to an OIA official, few firms outside the RMI have responded to its requests for bids because projects have been marketed individually. According to the PMU manager, grouping projects to increase the size of the total contract would likely attract the bids of more regional and international firms.
- *Absence of stakeholder engagement.* Implementation of infrastructure projects in the RMI has been limited by client ministries' lack of engagement in the projects. According to the PMU manager, the Ministry of Education has not conducted the long-term planning for school infrastructure required by the PMU. Further, according to an RMI official, the Ministry of Education has not worked diligently to resolve constraints, such as land issues affecting education-related infrastructure projects. Another RMI official reported that the Ministry of Public Works remained disengaged from infrastructure projects even though the PMU is housed in the Ministry of Public Work's office. Further, the PMU manager told us that he had difficulty obtaining support and concurrence from upper management of the RMI government, which often created delays in the initiation or completion of projects.
- *Unresolved land use issues.* Land use issues have hampered the construction of infrastructure projects in the RMI and will likely continue to do so.⁴⁹ The projects that have been completed or are near completion were built on land for which the government of the RMI had long-term leasehold interest, and the design of these initial projects was influenced by the availability of land with secured leases. For example, because of boundary disputes with landowners at Rita Elementary School, new school buildings had to be constructed inside the existing school yard; at Laura High School, new facilities had to be constructed on another site some distance from the original facilities, effectively splitting the campus in two locations and, according to the principal, resulting in suboptimal school management. Other projects have been delayed by difficulty in securing long-term leases for land with disputed titles. For example, as a result of ongoing land disputes between the RMI government and the landowners, the PMU developed three different designs for Uliga Elementary School in Majuro. As of November 2006, this issue remained unresolved, requiring the school to continue running split sessions to accommodate all students. In addition, the construction of Kwajalein Atoll

⁴⁹ Land disputes are a common problem in the RMI because of traditional land ownership practices and the limited amount of land—only about 70 square miles. In the RMI, the paramount chiefs (*iroij*) possess certain rights over each land parcel that is held in tandem with the rights of the land manager (*alab*) and the people living on the land (*drijerbal*). Any leasehold agreement requires the signatures of all three groups of stakeholders, according to a nonprofit research organization based in the FSM.

High School has been delayed because of the inability of the RMI government to secure a lease on a site large enough to accommodate new facilities to meet needs. Although the RMI government could exercise eminent domain to secure land for public infrastructure use, a high-ranking RMI official told us that the government was not considering using this option.

- *Lack of assessment.* The RMI has not assessed the effects of certain infrastructure funding decisions on current and future projects or the sustainability of current expenditure levels. The RMI, with OIA's consent, dedicated \$25 million in future infrastructure sector grants (\$5 million dollars a year for the next 5 years) to the College of the Marshall Islands for facility improvements, to avoid accreditation penalties from the Western Association of Schools and Colleges. According to OIA, the RMI has not assessed how this funding shift will affect primary and secondary education priority projects in the RMI. In addition, according to OIA, the RMI government has not assessed the sustainability of its current rate of infrastructure expenditures. Further, the RMI government has not assessed the trade-offs of the PMU's current designs that increase longevity and reduce maintenance by using expensive, brand-name products—as compared to designs that would construct more buildings with less costly materials.⁵⁰ The PMU emphasized that its products are of high quality and built to last. However, according to a Ministry of Health official, the PMU contractor's current design for health dispensary facilities was far too costly and the dispensaries could be built for half the expense.
- *Inadequate maintenance.* Inattention to, and insufficient funding for, infrastructure maintenance and security could limit the sustainability of the projects that the RMI completes. Although the government has established a separate account and contributed the requisite matching 5 percent from local revenues to establish the infrastructure fund, as required by the fiscal procedures agreement, it is not ensuring adequate maintenance. For example, we visited schools in the RMI that had been renovated in 2004 and 2005 with amended compact infrastructure sector funds where sections of ceilings were missing and bathrooms were in disrepair or vandalized. Moreover, officials from OIA and RMI indicated that the amount set aside for the maintenance fund—5 percent from the United States and 5 percent from the RMI—is not sufficient for the maintenance needed. In addition, although the PMU managing firm has developed 20-year maintenance plans for each of the new infrastructure projects, the RMI has not used the maintenance fund for these new projects. According to OIA, RMI officials agree on the advisability of a maintenance contract for each infrastructure project but have not allocated funding for this purpose.
- *Lack of technical capacity.* Unless it replaces its current PMU manager (with professionals) after the contract with the firm expires, the RMI may lack the technical capacity to manage the PMU. The contract for the consulting firm that manages the RMI's PMU expired in October 2006 but was extended until

⁵⁰ Contracts and bid documents allowed builders to substitute products of equivalent or higher quality from other sources, including U.S. materials. However, for some products there are no alternatives.

September 2007 to complete ongoing projects. As of November 2006, the RMI government decided that newly initiated projects would be managed on a case by case basis. However, according to OIA, the RMI currently does not have sufficient technical capacity to manage the PMU, although the PMU contractor provided training to selected Ministry of Public Works staff as part of its contract requirement.

- *Accountability weaknesses.* Several accountability problems regarding its PMU—inadequate oversight, impaired independence, and noncompetitive procurement—may have affected the RMI government’s implementation of infrastructure projects.
 - *Inadequate oversight.* According to RMI officials and the PMU manager, the RMI conducted little oversight of the PMU. Except for the RMI Contract Review Board, which is responsible for managing the bidding process for each infrastructure project, no mechanisms exist to oversee the PMU managing firm’s work or ensure that the PMU has adequate support to complete its work.
 - *Impaired independence.* The PMU’s independence was impaired by the absence of a “firewall” between project management and design engineering, both of which were conducted by the PMU managing firm. According to an OIA official, this created the potential for a disincentive to identify problems in design.
 - *Noncompetitive procurement.* In a review of the RMI’s progress in implementing amended compact requirements, the DOI IG found that the RMI government did not meet fiscal procedures agreement procurement requirements when it hired the PMU contractor. The agreement allows for noncompetitive, sole-source procurement under certain circumstances.⁵¹ The DOI IG determined that none of these circumstances existed to justify the RMI government’s decision to award the contract for PMU management on a sole-sourced, noncompetitive basis. OIA concurred with this finding and agreed to monitor the RMI’s compliance with fiscal procedures agreement procurement requirements.

⁵¹ The fiscal procedures agreement allows for noncompetitive, sole-source procurement when the award of a contract is infeasible under either procedures for small purchase, sealed bids, or competitive proposals and when one of the following circumstances applies: (1) the item is available only from a single source, (2) a public exigency or emergency will not permit a delay resulting from competitive solicitation, and (3) competition is determined to be inadequate after the solicitation of a number of sources.

Enclosure IV Health

The Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) priorities for health sector grants under the amended compacts are to improve the delivery of health care services, and both countries are subject to several grant conditions. The FSM health sector received the third largest FSM sector grant, and limited progress has been made to improve secondary health care. The RMI health sector also received the third largest amount of RMI sector grant funding, although funding has not always followed the goals laid out in the country's development plans, and the RMI faces numerous challenges to health care service improvements.

Health Sector Grant Priorities and Terms

The goals for the FSM's and RMI's health sector grants under the amended compact are to support and improve the delivery of preventative, curative, and environmental care and develop the human, financial, and material resources necessary to provide these services. The fiscal procedures agreements for both countries emphasize the establishment of sustainable funding mechanisms for (1) operating community-based systems with emphasis on prevention, primary care, mental health, and substance abuse prevention and (2) operating hospitals to provide secondary care at appropriate levels and reduce medical referrals abroad.

In addition to being subject to the requirements in the amended compacts and the fiscal procedures agreements, the FSM and the RMI are subject to grant terms imposed by the JEMCO and JEMFAC, respectively, and by OIA. (For sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII). Some grant conditions that appeared in the annual health sector grants for both countries include

- streamlining and refining performance measures, baseline data, and annual performance targets;
- conducting comprehensive evaluations of primary health care systems; and
- using carryover funding for technical assistance in performance budgeting and measurement and for health-related infrastructure expenditures such as facility upgrades, renovation and repair, and fixed equipment and other capital assets.

Furthermore, because of deficiencies found in the Chuuk state health dispensary program in the FSM, such as a lack of drugs, medical supplies, and equipment, and weak supervisory controls, JEMCO required the FSM national government and Chuuk state to develop a plan with specific actions and deadlines to address those deficiencies.

FSM Health Sector

In 2004 through 2006,⁵² the FSM's health sector received the third largest FSM compact sector grant allocation, averaging 21 percent of the country's total compact funding since 2004. However, allocations varied considerably across the five FSM governments. Limited progress was made in improving health care services provided at each of the four FSM state hospitals, an activity the FSM identified in its development plan as a priority, owing to a variety of challenges. Although primary health care is identified as a priority in the FSM's development plan, the states' health care budgets did not reflect this priority. Notably, Chuuk's health care system was in the poorest condition and had the greatest need for resources.

Funding for the FSM Health Sector

In 2004 through 2006, JEMCO approved health sector allocations of more than \$49 million (21 percent) of the FSM's total compact funding (see table 6).⁵³

Table 6: FSM Health Sector Grant Allocations, Fiscal Years 2004-2006

Grant recipient	2004	2005	2006
FSM National Government	\$553,613	\$763,235	\$764,383
Chuuk	4,691,707	5,595,636	6,292,745
Kosrae	1,326,663	1,674,212	1,763,553
Pohnpei	5,989,461	6,200,560	4,898,393
Yap	2,881,672	3,197,090	2,675,865
Total	\$15,443,116	\$17,430,733	\$16,394,939

Source: FSM health sector grant agreements, 2004 through 2006.

FSM health sector grant obligations primarily supported ongoing operations. Compact funding was used for salary adjustments for some categories of health professionals and minor repairs. In addition, hospitals used compact funding to purchase supply inventories, alleviating chronic shortages of drugs and other supplies, and to hire staff to expand in-and out-patient service capacity.

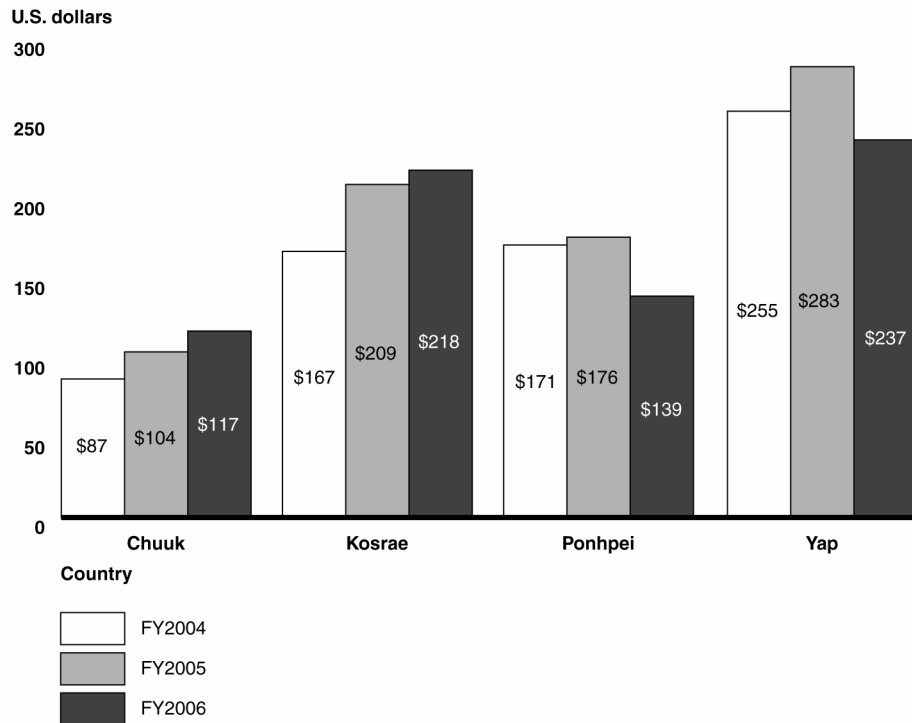
The FSM distributed compact health sector funds unequally on a per capita basis among the four states, resulting in variability in the quality of care provided in the states (see GAO-07-163 for further analysis). Per capita allocations for health reflected the disparity of compact funding allocation among the states (see fig. 9) with Chuuk being lower than the other states. By 2006 the gaps between state funds per capita was reduced as Chuuk expanded its health sector grant and Pohnpei and Yap reduced their grants. Still, in 2006 Chuuk received 40 percent of compact health sector funding available to the four FSM states but had approximately 50 percent of the population. In addition, Yap still received more than twice as much compact

⁵²In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

⁵³In addition, HHS federal grants, including Maternal and Child Health, Immunization, and Family Planning augmented compact funding to support prevention and other public health services. (See GAO-07-16, app. II for U.S. federal programs provided in the FSM.) Other revenue sources included a basic social services loan from the Asian Development Bank, targeted foreign assistance, health insurance reimbursement, and nominal service fees.

health sector funding per person than Chuuk. Moreover, on the basis of our visits to FSM state hospitals and primary care facilities, Chuuk state's health care system was in the poorest condition and had the greatest need for resources. In addition, the FSM national government received 5 percent of the FSM's total health sector allocations, for health planning, donor coordination, and providing technical and training assistance for the FSM's health care sector.

Figure 9: FSM Per Capita Distribution of Health Sector Funds, Fiscal Years 2004 through 2006



Sources: GAO analysis of FSM 2005 Economic Review data and health sector grant award agreements for 2004 through 2006.

Challenges in the FSM Health Sector

Challenges that have limited, or may limit, the FSM's ability to reach its compact goals include inadequate resources at state hospitals and limited primary health care. Further, Chuuk represents the most significant primary health care challenge.

Limited Resources at State Hospitals

We found that limited progress has been made to improve the quality of care provided in hospitals in the four FSM states since the amended compact took effect. In March 2006, we visited the state-run hospitals in Chuuk, Kosrae, Pohnpei, and Yap and found inadequate or nonexistent maintenance in FSM hospitals and limited availability of drugs and supplies.⁵⁴ According to the FSM's development plan, in

⁵⁴ These findings were similar to our observations from 2000 (GAO-NSIAD-00-216).

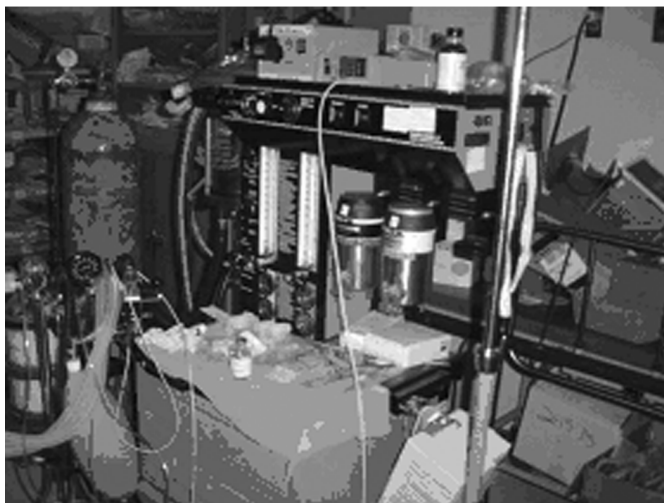
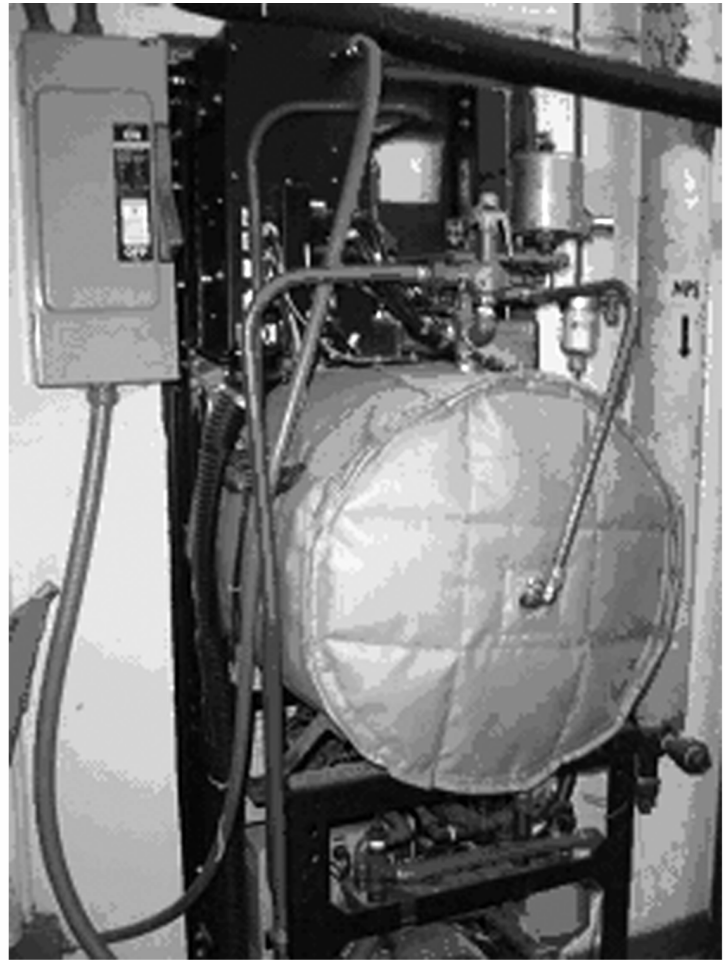
order “to provide efficient, best-practice secondary and tertiary care, it is necessary that the state hospitals

- be well designed and maintained;
- have medical, nursing, professional laboratory and x-ray technicians and support staff who are appropriately trained in procedures and guidelines to enable quality control; and
- include a working, equipped laboratory, functional x-ray equipment, and a full-service pharmacy.”

Three of the four hospitals we visited were in need of maintenance. In the Chuuk state hospital, we found broken windows, dirty toilets, and broken equipment throughout the facility (see fig. 10 for photos). In addition, in 2005 the DOI Inspector General found that the Chuuk state hospital had unsanitary waste disposal practices, including the presence of biomedical waste such as used syringes located a few feet from the hospital’s kitchen window.⁵⁵ In Kosrae and Pohnpei, we found a general lack of maintenance, though considerably better than in Chuuk. In the Pohnpei state hospital, there were ceiling tiles and floor tiles missing, while in the Kosrae state hospital, the corners of the floors were visibly corroded. We found the Yap state hospital to be the best maintained of the four FSM state hospitals.

⁵⁵ When we visited the Chuuk state hospital in March 2006, we found that the Chuuk Department of Health had rectified this situation.

Figure 10: Broken Equipment at Chuuk State Hospital, FSM



Chuuk State Hospital, Chuuk, FSM

Source: GAO.

Moreover, the FSM state hospitals lacked some or all of the following: (1) sufficient personnel; (2) well-equipped laboratories; (3) functional equipment; and (4) adequately stocked pharmacies. Officials at all four hospitals cited a shortage of nurses and other staff. Nursing staff in Chuuk and Yap described the frustrations of feeling underpaid and working in consistently understaffed conditions, and said these conditions greatly affected the quality of patient care. Additionally, laboratories and radiology units lacked supplies and equipment. Only Yap state hospital had a laboratory in full working order. All the FSM states' laboratories lacked supplies of reagents, necessary for conducting blood tests and other lab work. Some of the laboratory, radiology, and operating room equipment in all the hospitals was often outdated or broken. In addition, with the exception of Yap, the hospitals lacked the technical ability to maintain and repair equipment. All the FSM state hospitals had pharmacies with depleted stocks or varying amounts of expired drugs.

According to an OIA official, the quality of service and organizational enhancements over the medium and long term continue to depend on the safety and adequacy of the health sector's physical infrastructure. Facility repair, renovation, and construction are needed. As of August 2006, only Yap had prioritized health-related infrastructure projects for compact infrastructure grant use, and the hospital's renovation has been approved by OIA.

Limited Primary Health Care

Despite the FSM's strategic goal to improve primary health care services, historically only 10 percent of the health care budgets, on average, in each of the four states have targeted this goal. According to an OIA official, most funding for primary health care services in the FSM comes from HHS. Weaknesses in the primary health care system have led to increased costs and strain on hospitals. The primary health care system in the FSM states includes the dispensary/health center system and the public health personnel responsible for delivering primary, preventive, and public health services throughout the islands. A field mobile public health team from the public health division at each state Department of Health is supposed to provide public health services to municipalities and communities using the dispensaries and health assistants. These teams are to visit dispensaries on a regular schedule, but have seldom done so in the last few years because of funding constraints, poor management and supervision, and lack of supplies. The FSM reported that the secondary health care system receives approximately 70 percent of all patients that could have been handled at the primary health care level or who received improper, insufficient, or inadequate primary health care services at the dispensaries due to the lack of drugs, medical supplies, and equipment. All states except Kosrae showed evidence of cutting primary health care drugs, services, or both in order to increase support for hospital services. The resulting increase in inpatient and outpatient utilization at hospitals increased costs and overcrowding, according to the FSM's development plan.

The FSM national government and some states are taking steps to improve primary care by assessing need and establishing community health centers. Recognizing the disproportionate level of care provided at hospital-based outpatient clinics and emergency rooms, JEMCO required that the FSM conduct an assessment of its primary health care systems (for other grant conditions see GAO-07-163). The FSM carried out this assessment in 2005, resulting in the targeting of certain areas for improvement, including service delivery, procurement, and management practices. Yap Department of Health Services initiated a community-based project to bring primary health care services closer to the people. The initiative involved construction and operation of community health centers in all four districts of Yap's main island. The local community donated the land and the facility and the Department of Health Services runs the centers. Each center is staffed with a physician and a nurse who are selected by the local community. Pohnpei State has implemented a similar program, and has established a Community Health Center in Kolonia. These programs have received HHS Community Health grants.

Chuuk Health Care Challenges

The FSM faces the most significant primary health care challenges in Chuuk state. JEMCO twice applied special grant conditions to Chuuk's share of the FSM's annual health sector allocation and required Chuuk to develop a plan with specific actions and deadlines to address deficiencies, including

- many nonfunctioning dispensaries;
- severe problems in maintaining adequate drug and supply stocks;
- inconsistent drug and medical supply restocking practices and poor inventory control;
- antiquated or nonexistent medical equipment;
- weak supervisory controls;
- poor to no regulation or regular inspection of dispensary facilities, especially those in private homes; and
- continued payment of wages to health assistants who fail to fulfill their job responsibilities ("ghost employees").

The Chuuk Department of Health Services established a Dispensary Reform Plan, per JEMCO's requirement, and met the reporting deadline.⁵⁶ As of June 2006, the department had taken measures to discipline or remove from the payroll nine employees who were not fulfilling their duties, but many challenges remain to be resolved, including

- providing adequate medical supplies and drugs to functioning dispensaries;
- eliminating all nonfunctioning dispensaries from the books and consolidating dispensaries where appropriate;
- training staff;
- renovating facilities; and
- establishing appropriate supervisory mechanisms.

In Chuuk, we visited 16 dispensaries in the lagoon islands, where conditions included (1) an absent health assistant; (2) lack of medical and pharmaceutical supplies and equipment, such as working blood pressure cuffs, scales, and glucometers used for measuring blood sugar levels in diabetics; (3) lack of maintenance of facilities; and (4) lack of supervision, regulation, and monitoring. In addition, land constraints continue to affect the department's ability to provide adequate health services to communities. For example, we visited one newly constructed dispensary funded by Federal Emergency Management Agency funds on Tonoas Island in the Chuuk Lagoon that remained closed because of a dispute with the landowner over rent payments.

RMI Health Sector

⁵⁶ The deadline was May 15, 2005.

The RMI received more than \$20 million in amended compact health sector funding from 2004 through 2006, comprising approximately one-third of the country's total revenue available for health services. Compact funding has supported both basic operations and improvements in capacity at Majuro and Ebeye hospitals and the RMI's primary care network. Despite improvements, the RMI faces several challenges regarding health care service, such as a lack of qualified personnel.

Funding for the RMI Health Sector

In 2004 through 2006, JEMFAC approved allocations of more than \$20 million (21 percent) of amended compact funding, for the RMI health sector. In addition, to meet the amended compact's requirement that a portion of health sector funds go specifically for special needs on Kwajalein Atoll,⁵⁷ health services in the atoll have received an average of \$1.2 million annually in special health care funding since 2004 (see table 7). Through July 2006, the RMI had targeted an additional \$4.9 million in infrastructure sector grant funding for equipment purchases for Majuro and Ebeye hospitals, facilities maintenance, and community health center renovation.

Table 7: RMI Health Sector Grant Funding, Fiscal Years 2004 through 2006

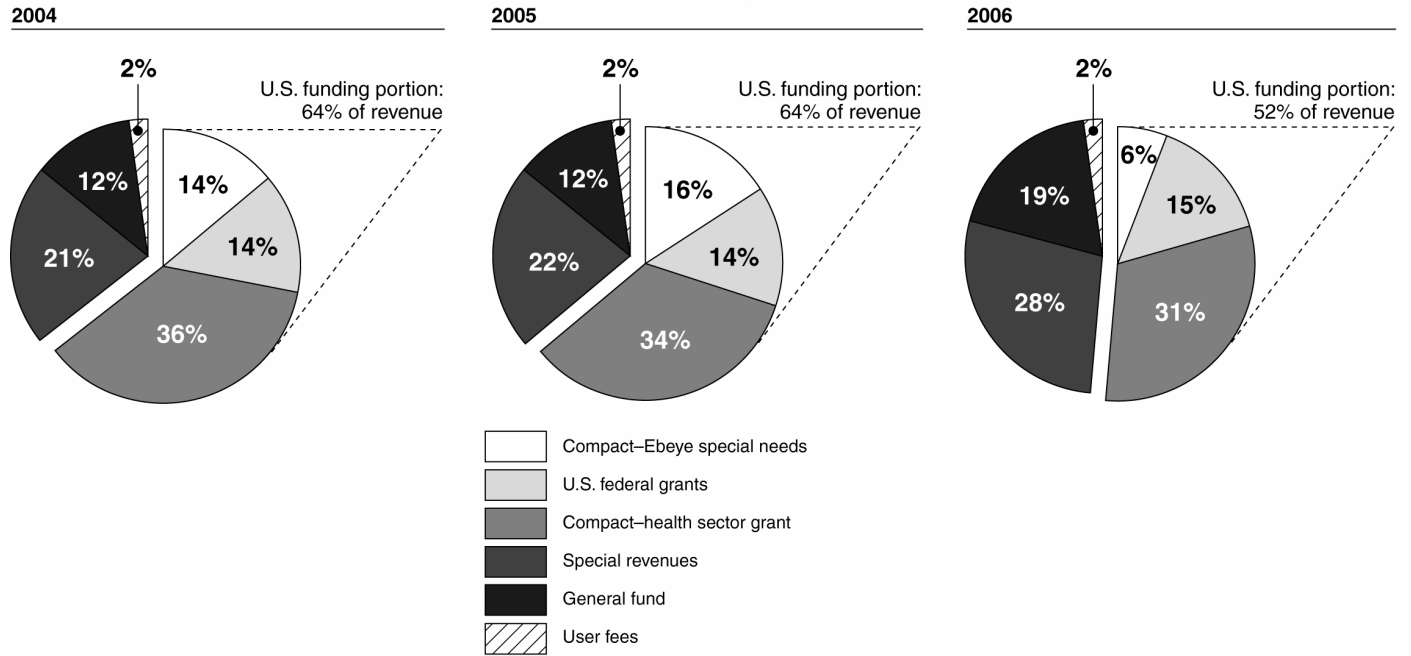
Funding	2004	2005	2006	Cumulative total
Health sector grant	\$ 5,894,448	\$5,564,197	\$5,597,181	\$17,055,826
Kwajalein Atoll health services	1,000,000	1,500,000	1,085,560	3,585,560
Annual total	\$6,894,448	\$7,064,197	\$6,682,741	\$20,641,386

Source: GAO analysis of RMI health sector grant agreements for 2004-2006.

Compact funding was augmented by HHS federal grants, including Maternal and Child Health, Immunizations, and Tuberculosis, that have supported prevention and other public health services. (See GAO-07-163, app. II, for U.S. federal programs provided in the RMI.) Amended compact and other U.S. program assistance constituted over half of the RMI's health care budget for 2004 through 2006 (see fig. 11).

⁵⁷ Kwajalein Atoll is the second most populated atoll in the RMI, where many residents were displaced within the atoll to provide space for U.S. missile testing. Many of these residents now reside on Ebeye Island.

Figure 11: Sources of RMI Health Care Funding, Fiscal Years 2004-2006



Sources: RMI Ministry of Health Portfolio Budget Statements and health sector grant award agreements for 2004 through 2006.

Since 2004, compact funds have supported the RMI Ministry of Health’s basic operations and improvements to secondary and primary health services. Compact funds have been used to maintain basic health care operations, paying salaries and recurring expenses such as utilities, rent, and supplies. Compact funds also supported needed improvements in capacity at Majuro and Ebeye hospitals, such as hiring of new key personnel including a radiologist, and the purchase of capital equipment including an ambulance, a nurse call system, new beds, and computers. With these additions, Ministry officials expected improvements in diagnostic and treatment capacity. The RMI also supported its primary care network of 54 community health centers using amended compact funding to purchase new radios for the outer island health care centers and dispensaries, to provide training to health assistants who staff the health centers, and to make facility improvements.⁵⁸

Funding for primary health care in the RMI has increased from 24 percent of the Ministry’s total budget since 2004 to 30 percent in 2006, reflecting an increased focus on providing preventative and public health services. The RMI’s development plan states that primary health care is one of the country’s top health goals. In addition, primary health care is the focus of the Ministry of Health’s strategic mission and is viewed as the principal means to improve health status. In 2004 and 2005, hospital-based outlays outpaced expenditures for public health, prevention, and outer island primary care services. The 2006 budget, however, shows the first noticeable shift of budgeting priorities toward primary care. These changes, if sustained over time, will

⁵⁸ In addition, a new Majuro hospital annex, funded by the government of Japan, was opened in January 2006. The new annex houses administration; laboratories; and public health, dental, and outpatient services. RMI and OIA officials told us that the new annex has improved health care services.

enable the Ministry to improve the delivery of primary health care services, according to OIA.

The findings of a comprehensive assessment of the dispensary system conducted by the RMI, which the JEMFAC required in 2005, noted the need to increase emphasis on primary health care. The assessment documents various problems caused by insufficient funding to the primary health care system including transportation and communication problems and shortfalls in staffing, equipment, pharmaceuticals, supplies, and facility maintenance. These problems were commonplace before the amended compact period began, and continue to exist. Only 45 of the RMI's 62 health centers and dispensaries were open in 2004. Some of these facilities were closed due to personnel shortages, while other facilities were non functional because of serious renovation and refurbishment needs. However, the Ministry of Health has since trained additional health assistants and completed some needed maintenance using infrastructure sector grant funding. In 2005, the RMI's Ministry of Health reported that there were 58 functioning health centers.

Despite improvements to the Majuro and Ebeye hospital facilities, further health care improvements are needed. According to a former HHS Representative to the Pacific Islands, the new Majuro hospital annex is "a bee hive of activity that is clean and has a working laboratory." However, even with the addition of the new annex, the existing hospital facilities need improvement. A building assessment in the RMI's IDMP indicated the existing Majuro hospital was in "very poor structural condition." Moreover, in September 2005, a fire destroyed a section of the hospital that housed the supply room. The loss was not insured. In addition to structural damage to the hospital, RMI officials estimated the loss of uninsured drugs and medical supplies at nearly \$1 million. Though emergency repairs were made to the existing facility and the U.S. government donated drugs, the damage led the RMI government to prioritize the replacement of complete wings of the hospital in its compact infrastructure grant to begin in 2007. The need for equipment and furniture purchases and additional personnel will likely stall the Ministry's ability to redirect funding to prevention and primary care in the near future.

The new Ebeye hospital, completed in 2002, opened without dedicated maintenance funds.⁵⁹ In January 2005 the RMI government signed a comprehensive maintenance contract with a U.S. firm for both hospitals, using infrastructure sector grant funding. During our visit in March 2006, the Ebeye hospital was clean and well-maintained; however, severe condensation problems with the hospital's air conditioning system created potential structural problems. Furthermore, persistent problems with Ebeye's power supply interrupted hospital services. While Ebeye hospital is equipped with emergency generators, the hospital relies on the local utility for its primary energy needs.

⁵⁹ The Department of the Interior funded the initial construction of the hospital, which began in 1994. However, because of cost overruns, that funding source was depleted considerably before the project's completion. Subsequently, the RMI government secured a loan from the Asian Development Bank to complete the project.

Challenges in the RMI Health Sector

The RMI faces a number of challenges to continued improvement in the delivery of health care services, including a lack of technical capacity, increasing prevalence of lifestyle diseases, and unsustainable spending.

- *Lack of technical capacity.* The RMI still lacks the capacity to diagnose and treat certain diseases and trauma. For example, the number of cases sent off-island for medical referral increased by 27 percent between 2004 and 2005.⁶⁰ Moreover, Ministry of Health officials reported a persistent lack of qualified medical, nursing, and ancillary staff in the RMI. Officials indicated that this persistent shortage has affected the Ministry's ability to diagnose and provide care to patients and increased its reliance on foreign labor. For example, the Ministry purchased expensive capital equipment with compact funds, such as a CT scan machine in 2005. However, the machine has not been used for almost 1 year due to the lack of technical expertise necessary to operate it, according to a Ministry official.
- *Increasing prevalence of lifestyle diseases.* Despite some improvements in health management, lifestyle diseases continue to create challenges for the RMI's health care. The incidence of diabetes, hypertension, sexually transmitted diseases such as HIV, and other conditions are on an upward trend.
- *Unsustainable spending.* The impact of annual decreases in the amount of compact grant funding available and the pace of infrastructure development on health sector funding warrant close attention. In addition, while the fiscal procedures agreement calls for the establishment of sustainable funding mechanisms, user fees comprised only 2 percent of the Ministry of Health's revenues in 2004 through 2006. User fees are charged at the government hospitals on Majuro and Ebeye and are \$5 for outpatient services per visit and \$5 for in-patient services per day including food, medicines, and other care provided to the patient. The RMI's development plan noted that user fees could be substantially increased by selective increases in charges without creating hardship to patients. According to an OIA official, if health revenues do not keep pace with operating and infrastructure costs, the Ministry's ability to improve health services and programs may falter.

⁶⁰ In the Ministry of Health's Annual Report for 2005, this increase was also attributed to the lifting of previously implemented off-island medical referral restrictions. Despite this increase, the RMI reduced its expenses from \$5.5 million in 2000 to \$1.5 million in 2005 by sending more patients to hospitals in the Philippines, where medical care costs are significantly less than the cost of medical care in the United States.

ENCLOSURE V

Public Sector Capacity Building

Under the amended compacts, public sector capacity building (PSCB) grants are intended to support the efforts of the Federated States of Micronesia (FSM's) and the Republic of the Marshall Islands (RMI's) internal capacity to build effective, accountable, and transparent governments. According to grant conditions, PSCB funds can be used to hire experts to advise the FSM and RMI governments; train personnel; and develop, purchase, or upgrade various government systems. With JEMCO's agreement, the FSM allocated over 88 percent of its PSCB funds to support the ongoing operations of the national and state governments, activities not supported by the compact, rather than to build new skills and expertise. The RMI has only accepted PSCB funds in the past 2 years, to support the operations of its Public Auditor's Office. Despite both countries' extensive need of greater government capacity, PSCB has not been a priority in either country and it is difficult to determine what if any progress has occurred in this sector in either country.

Public Sector Capacity Building Grant Priorities and Terms

According to the compact, PSCB funds are made available to support the efforts of the FSM's and the RMI's to build effective, accountable, and transparent national and local government and other public sector institutions and systems. PSCB priorities established in each compact's fiscal procedures agreements are (1) financial management, (2) improving economic planning, (3) auditing, (4) law enforcement, (5) immigration controls, (6) the judiciary, and (7) compilation and analysis of appropriate statistical indicators. In a June 2003 memorandum outlining implementation issues, OIA described permissible—that is, conforming—uses of the FSM PSCB grant, including

- hiring teams of international experts to provide economic planning advice to the government, and to help develop local expertise;
- training to upgrade the knowledge and skills of staff that perform priority functions, including training for law enforcement and fire fighting;
- purchasing or upgrading of financial management systems and various electronic systems and data-bases for law enforcement, immigration, and customs; and
- developing statistics useful for economic planning.

The memorandum indicated that the FSM PSCB grant was not intended to fund existing basic operations, including salaries for permanent positions—OIA considered these activities to not conform with the grant's purpose. Additionally, clarifying the grant's application to specified priorities, the memorandum stated that the purpose of the grant is not to cover the full operating costs needed to maintain

entities, such as law enforcement and auditing bodies in “as is” condition, but to enhance and strengthen certain critical functions.

In addition to being subject to the requirements of the amended compacts and fiscal procedures agreements, the FSM and RMI are subject to grant conditions imposed by the JEMCO and JEMFAC, respectively, and by OIA. (For sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII.)

FSM Public Sector Capacity Building

For 2004 through 2006,⁶¹ grants for FSM public sector capacity building amounted to 11 percent of total compact funds. With the permission of JEMCO, the FSM used the majority of these funds for activities that did not conform to the grants purposes and that supported the public sector. The primary challenge affecting the use of the funds is the FSM’s lack of planning to end its use of the grant for activities that do not conform to the grant’s purpose.

Funding for FSM Public Sector Capacity Building

JEMCO approved allocations of more than \$25 million for FSM public sector capacity building in 2004 through 2006 (see table 8 for grant allocations to the national and state governments).

Table 8: Public Sector Capacity Building Allocations to FSM Governments, Fiscal Years 2004 through 2006

FSM government	2004	2005	2006
National	\$4,287,697	\$ 608,028	\$0
Chuuk	2,853,813	3,001,410	2,724,099
Kosrae	1,013,866	1,113,866	1,346,976
Pohnpei	1,676,163	1,542,488	759,254
Yap	1,831,307	1,520,466	1,345,585
Total	\$11,662,846	\$7,786,238	\$6,175,914

Source: GAO analysis of FSM 2004 through 2006 public sector capacity building grant agreements.

In 2004, OIA agreed to allow the FSM to use the PSCB grant for basic government operations rather than for functions supporting the sector objectives identified in the compact and fiscal procedures agreement. According to a senior OIA official, the FSM needed to fund basic government operations to enable its use of other sector funds. In allowing nonconforming uses of the grant, OIA required the FSM national and state governments to reduce, over a 5-year period, the amounts allocated for nonconforming purposes and to provide a schedule of their planned reductions. As

⁶¹In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

table 9 shows, the FSM national and state governments' scheduled reductions of allocations of the PSCB for nonconforming purposes exceed the reductions required by OIA.

Table 9: Reductions Scheduled by FSM Governments and Required by OIA for Nonconforming Use of Public Sector Capacity Building Grant, Fiscal Years 2005 through 2009

(Dollars in millions)

	2005	2006	2007	2008	2009
Scheduled reductions					
FSM national government	\$6.31	\$5.89	\$4.23	\$2.12	\$0
Chuuk	2.74	2.65	1.77	0.88	0
Kosrae	0.91	0.91	0.91	0.46	0
Pohnpei	1.31	0.99	0.66	0.33	0
Yap	1.35	1.35	0.90	0.45	0
Total scheduled reductions	\$12.62	\$11.79	\$8.47	\$4.24	\$0
Total required reductions	\$8.49	\$6.37	\$4.25	\$2.12	\$0

Source: FSM Strategic Development Plan, 2004 through 2023.

According to OIA, in 2004 through 2006, the FSM allocated approximately 88 percent of the PSCB funds for nonconforming purposes, such as supporting ongoing operations of the national and state offices of public safety and finance and the states' attorneys general, rather than for conforming purposes such as training local officials in financial management and hiring outside experts on economic planning. The other 12 percent of PSCB funds—approximately \$3 million—was allocated to support the basic operations of FSM states' public auditors' offices and for accounting contracts in 2004 through 2006. Although the funds were allocated for salaries in these offices⁶² rather than, for example, for training, OIA considered the use of funds by these offices to be appropriate.

Although the FSM obligated most of the allocated PSCB funds for nonconforming purposes, a small amount—about \$2 million—of the allocation for 2004 and 2005 was not obligated (see table 10). JEMCO directed that the FSM use the unobligated funds to support the PSCB grant's goals. Accordingly, the FSM obligated these funds for activities such as hiring accounting advisors for some states and their component units and advisors for budget and procurement offices; building capacity in performance reporting; and undertaking an economic monitoring and capacity building project.

⁶² The FSM's national audit office did not use PSCB funds to pay salaries, according to OIA.

Table 10: FSM Unobligated Public Sector Capacity Building Funds, Fiscal Years 2004 and 2005

FSM	2004	2005
National	\$293,771	\$112,666
Chuuk	221,819	106,371
Kosrae	16,129	46,155
Pohnpei	200,476	120,204
Yap	604,739	303,004
Total	\$1,336,934	\$688,400

Source: Office of Insular Affairs.

The FSM also received approximately \$3.9 million in technical assistance from DOI in 2004 and 2005,⁶³ some of which it used for activities that conform to the PSCB grant’s goals. For example, the FSM received technical assistance funds to conduct public auditor training and develop its financial reporting activities.

Challenges in FSM Public Sector Capacity Building

The FSM’s efforts to build public sector capacity are challenged by a lack of planning for the replacement of grant funding with local monies to support activities deemed nonconforming by OIA.

According to OIA, the FSM national and state governments have not yet developed plans for replacing the funding currently used to support “nonconforming activities” with local revenues instead of the public sector capacity-building grant. In reviewing the states’ budgets it is clear that offices such as the Attorney General, Treasury, and Administration and Finance will all be affected. For example, in 2006, 100 percent of Chuuk’s public safety operations, including the police and fire departments, and more than 95 percent of Kosrae’s Attorney General’s Department, including its divisions of law and public safety, were funded with public sector capacity building grant funds.

RMI Public Sector Capacity Building

The RMI received a total of \$207,000 in 2005 and 2006 for public sector capacity building. Since 2005, the RMI has used the public sector capacity building grant funds to support one office, using technical assistance grants to support other capacity building needs.

Funding for RMI Public Sector Capacity Building

In 2005 and 2006, JEMFAC allocated approximately \$103,514 annually for RMI public sector capacity building; the RMI did not request or receive any public sector capacity building funds in 2004. The RMI’s Chief Secretary informed us in March

⁶³ Funding for technical assistance includes Operations and Maintenance Improvement Grant funds.

2006 that beginning in 2007, the RMI would not request any funds for public sector capacity building.

The RMI used the allocated funds to support the RMI Auditor General's office. The government also sought and received approximately \$3.2 million in OIA technical assistance grants,⁶⁴ some of which supported public sector capacity building activities. For example, the RMI was awarded more than \$500,000 in technical assistance to help develop performance-based budgeting and \$160,000 to hire a financial management information systems project manager in 2004 and 2005. The RMI also received a grant totaling \$111,400 for training public auditors.

Challenges in RMI Public Sector Capacity Building

Public sector capacity challenges remain in the RMI, although the government did not seek the PSCB grant for 2007. Examples of the challenges faced include, as we noted in our December 2006 report,⁶⁵ the RMI government's limited monitoring of sector grants, in part because of a lack of capacity in the Chief Secretary's office and in most ministries that receive compact funds. According to the RMI's Chief Secretary, the government does not have a plan to address the challenges the RMI faces in public sector capacity building.

In response to our draft report, the RMI government indicated that it has many other sources of funding to support public sector capacity building that reduce the need to allocate compact funding to this sector. Even with these other sources of funding, including bilateral donors and regional and multilateral organizations, the RMI still believes that capacity building funds should be available from the U.S. government outside the annual sector grant allocations. However, the compact identifies public sector capacity building as one of the sectors in which the annual grant assistance should be used. While other sources of funding may be available to assist the RMI with public sector capacity building, as noted above, funding from these other sources is not assured.

⁶⁴ Funding for technical assistance includes Operations and Maintenance Improvement Grant funds.

⁶⁵ GAO-07-163.

ENCLOSURE VI

Private Sector Development

Under the amended compacts with the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI), private sector development grants are made available in part to attract foreign investment and increase indigenous business activity. Both countries allocated funds to their various offices such as visitor bureaus, land offices, and development entities. However, various factors hamper private sector development in both countries, including their remote geographic location, inadequate infrastructure, and poor business environments.

Private Sector Development Priorities and Terms

The compacts and the fiscal procedures agreements with the FSM and the RMI name numerous goals for private sector development: attracting new foreign investment, increasing indigenous business activity by vitalizing the commercial environment, ensuring fair and equitable application of the law, promoting adherence to core labor standards, and maintaining progress toward the privatization of state-owned and partially state-owned enterprises, as well as engaging in other reforms. Specifically, the fiscal procedures agreements identify the following private sector development priorities:

- advance the private development of fisheries, tourism, and agriculture;
- employ new telecommunications technologies;
- analyze and develop new systems, laws, regulations, and policies to foster private sector development; and
- facilitate investment by potential private investors and develop business and entrepreneurial skills.

The FSM's strategic development plans have broad goals, including (1) creating a sound economic policy environment to support outward-oriented private-sector-led growth; (2) improving the competitiveness of the factors of production in the FSM to promote private sector development; (3) improving the environment for direct investment and expanding entrepreneurial and business development support services; (4) reducing the direct role of government in the economy; and (5) providing efficient and cost-effective economic infrastructure to support competitive private sector development.

The RMI's development plans have broad goals such as increasing trade and investment and small business and enterprise development, as well as promoting private sector development through agriculture and tourism. These goals are articulated in RMI's annual performance plans.

In addition to being subject to the requirements of the amended compacts and fiscal procedures agreements, the FSM and RMI are subject to grant conditions imposed by

the JEMCO and JEMFAC, respectively, and by OIA (for sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII).

FSM Private Sector Development

The private sector grant to the FSM, totaling about \$12 million in 2004 through 2006,⁶⁶ supported numerous offices. A variety of challenges hamper private sector development in the FSM.

Funding for FSM Private Sector Development

JEMCO allocated \$10.2 million for FSM private sector grant development in fiscal years 2004 through 2006. Table 11 shows the allocations to the national and state governments in those years.

Table 11: FSM Private Sector Grant Allocations, Fiscal Years 2004 through 2006

FSM government	2004	2005	2006
FSM national government	\$513,091	\$0	\$0
Chuuk	1,338,874	1,403,876	1,498,616
Kosrae	795,261	988,025	606,029
Pohnpei	525,423	657,602	887,817
Yap	613,470	989,407	1,046,701
Total	\$3,786,119	\$4,038,910	\$4,039,163

Source: FSM private sector grant agreements, 2004 through 2006.

The FSM national and state governments used these funds to support 40 different offices, including visitor bureaus, land management offices, marine and agriculture departments, and economic development and foreign investment activities. OIA questioned the performance of many of these entities and indicated that in 2007, grant funding would only be allocated on a project basis.

Challenges in FSM Private Sector Development

⁶⁶ In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

As we reported in June 2006,⁶⁷ challenges facing the FSM's development of its private sector include the country's remote geographic location, inadequate infrastructure, and poor business environment. Officials at the IMF and the Asian Development Bank informed us that legislative actions implemented by the FSM to improve the business environment, including bankruptcy and mortgage laws, are insufficient to stimulate investment and improve tax income. According to these officials, these reforms must be accompanied by reforms in taxes, land ownership, foreign investment regulations, and public sector management. Although FSM has taken steps in some of these areas, its progress has been slow. For example, the FSM has agreed on the elements of tax reform but has no plan for implementation.

RMI Private Sector Development

Several offices in the RMI are supported with private sector development funds. However, the RMI government faces a variety of challenges to private sector development.

Funding for RMI Private Sector Development

JEMFAC allocated \$1.1 million of amended compact funds for RMI private sector development in 2004 through 2006: \$356,620 in 2004, \$361,943 in 2005, and \$361,943 in 2006. The RMI government used the allocated funds to support the Marshall Islands Visitors Authority, the Small Business Development Center, the Departments of Resources and Development, and the Land Registration Authority.⁶⁸ According to the RMI Chief Secretary, the RMI government will not request amended compact funds for private sector development in 2007.

Challenges in RMI Private Sector Development

Several challenges confront the RMI's efforts to achieve its private sector development goal of attracting new foreign investment and increasing local business activity. As we recently reported,⁶⁹ the RMI's private sector, like the FSM's, is hampered by its remote geographic location, inadequate infrastructure, and poor business environment. RMI officials reported that several legislative actions aimed at improving the business environment, such as bankruptcy and mortgage laws, were implemented in 2004 through 2006. According to RMI private sector representatives as well as various U.S., IMF, ADB, and country reports, enabling the business environment in the RMI requires substantial reforms in taxes, land ownership, and foreign investment regulations as well as a reduction in public sector competition with the private sector. However, progress on key policy reforms needed to stimulate investment has been slow. For example, although discussions on tax reform have

⁶⁷ GAO's *Compacts of Free Association: Development Prospects Remain Limited for Micronesia and Marshall Islands*, GAO-05-66 (Washington, D.C.; June 27, 2006)

⁶⁸ The Land Registration Authority stopped receiving compact funding in 2006.

⁶⁹ GAO-05-633.

begun in the RMI, these discussions have not yet produced agreement on changes to the government's tax structure.

ENCLOSURE VII

Environment

Environmental goals in the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) include engaging in environmental infrastructure planning, design, construction, and operation. Grants for the two countries' environment sectors were allocated to several offices to support activities such as environmental protection, marine conservation, solid waste management, and public education. However, several challenges have limited the achievement of both countries' goals, including lack of enforcement and a lack of trained professionals.

Environment Sector Grant Priorities and Terms

Under the amended compacts, the environment grants for the FSM and RMI are aimed in part at engaging in environmental infrastructure planning, design, construction, and operation. The fiscal procedures agreements between the United States and the two countries identify the following environment sector grant goals:

- establishment and management of conservation areas;
- environmental infrastructure planning, design, construction, and operation; and
- involving the citizens of the respective countries in the process of conserving their country's natural resources.

The FSM's strategic development plan contains nine goals for the environment that closely mirror the priorities in the fiscal procedures agreement, such as managing and protecting natural resources including protecting, conserving, and sustainably managing the FSM's marine, freshwater, and terrestrial ecosystems; and improving environmental awareness and education and increasing the involvement of the citizenry of the FSM in conserving their country's natural resources.

The RMI's annual development plan's priorities are to (1) increase the effectiveness of environmental protection and environmental programs in the RMI and (2) increase environmental education and awareness through effective management of information and human resources. The RMI is also focused on increasing environmental programs on the Kwajalein Atoll.

The FSM and RMI are subject to special terms and conditions imposed by JEMCO and JEMFAC. Grant conditions in the FSM and RMI included establishing performance measures and providing baseline data in 2004 and 2005. (For sector grant terms and conditions specific to the FSM and the RMI, respectively, see GAO-07-163, app. VI and VII).⁷⁰

⁷⁰ See GAO-07-163, appendixes VI and VII for details of the grant conditions and their status.

FSM Environment Sector

The FSM has used environment sector grants to support various environmental activities and offices throughout the FSM's various states. However, several factors have challenged the FSM's ability to achieve its environment sector goals.

Funding for the FSM Environment Sector

JEMCO allocated a total of approximately \$6.6 million in amended compact grants for the FSM's environment sector in 2004-2006.⁷¹ Table 12 shows the annual grants to the FSM national and state governments.

Table 12: Environment Sector Grants to FSM National and State Governments, Fiscal Years 2004 through 2006

FSM government	2004	2005	2006
National	\$ 79,477	\$ 111,421	\$ 0
Chuuk	378,394	502,499	798,428
Kosrae	302,523	296,592	355,240
Pohnpei	666,944	688,181	665,807
Yap	595,854	791,258	337,977
Total	\$2,023,192	\$2,389,951	\$2,137,452

Source: GAO analysis of FSM environmental sector grant agreements for 2004 through 2006.

The grants supported 21 offices in the FSM's national government and four states, including offices responsible for environmental protection, marine conservation, forestry, historic preservation, public works, and solid waste management.

Challenges in the FSM Environment Sector

The FSM has faced several challenges that have constrained its ability to achieve its environment sector goals. These challenges include limited enforcement of environmental regulations, a lack of trained professionals, and constrained funding.

- *Limited enforcement.* Enforcement of environmental regulations in the FSM has been limited. Environmental Protection Authorities (EPA) throughout the FSM have issued or threatened the imposition of citations, fines, and cease and desist orders in response to violations such as insufficient toilet facilities and lack of running water in schools, and faulty septic tank systems and raw sewage discharge, but enforcement of these penalties has been limited by the authorities' unwillingness to pursue the violators or because the judiciary has been unwilling, or was too overburdened with other cases, to prosecute them.

⁷¹In this report, all years cited are fiscal years (Oct. 1-Sept. 30) unless otherwise indicated.

An EPA official in Yap indicated that the Attorney General's office has not supported the EPA's attempts to prosecute environmental cases, in part because the Attorney General's office represents both the EPA and, often, those entities the EPA is trying to prosecute, such as the Department of Public Works. In Pohnpei, an EPA official noted that the courts were often "overloaded" and were unable to hear their cases. Furthermore, the official noted that although fines were levied, none were collected. Failure to collect fines is a problem in other states as well, and, according to an EPA official in Pohnpei, the lack of enforcement creates an impression that violating EPA regulations or failing to pay fines carries no consequences.

- *Lack of expertise.* A lack of environmental and technical expertise throughout the FSM affects the states' ability to ensure environmental activities' compliance with regulations. For example, in Pohnpei, the state wanted to build a new land fill and waste water site yet lacked the expertise to evaluate plans for such a site, according to an OIA official. In September 2005, Yap's EPA cited a community for building septic tank systems that did not meet general design requirements. The noncompliant septic systems used by residents were leaking, overflowing, and discharging sewage waste into the surrounding environment. Yap's Public Works department agreed to build three new facilities in the community, but as of April 2006, the facilities had not been built; according to the Yap EPA, the Public Works department claimed that it lacked the design capabilities to build them. Also in Yap, the EPA's Executive Director acknowledged his lack of environmental expertise, stating that he had tried to hire someone with the appropriate technical skills for the position of executive director but had not found a qualified applicant.
- *Funding constraints.* Funding constraints have also hindered FSM attempts to meet environment sector goals. In Yap, the Public Works department attributed its failure to construct the new septic systems in part to a lack of financial resources. Other entities whose activities have environmental consequences have also reported funding constraints. For example, according to the Chuuk Public Utility Corporation, it has lacked sufficient funding to adequately maintain Chuuk's sewage system, leading to broken equipment and consequent sewage overflows in the streets, according to Interior's Inspector General. Likewise, according to Pohnpei's EPA, the Pohnpei public utility has not had the resources to repair its sewer system.⁷² Chuuk reported that because of limited funds, it lacks manpower and staff capacity to protect the reef from contamination and marine life from illegal fishing practices.

⁷² The Asian Development Bank is supplying a loan partially targeted at building a new sewage treatment plant and repairing the existing collection system in Pohnpei; the project is scheduled to begin in 2008, according to a Pohnpei EPA official.

RMI Environment Sector

The RMI has used environment sector grants to support its environmental protection authority. However, several challenges have impeded the RMI's achievement of its environmental goals.

Funding for the RMI Environment Sector

JEMFAC approved allocations of about \$1.2 million for RMI environment sector grants in 2004 through 2006: \$400,000 in 2004, \$408,000 in 2005, and \$408,000 in 2006. The portion of the RMI EPA's budget supplied by compact funding grew from 42 percent in 2004 to 77 percent in 2006, because of decreased funding from other sources.

The RMI used the environment sector grants for, among other things, water quality testing, land and solid waste management, and public education.

Challenges in the RMI Environment Sector

Factors challenging the RMI's efforts to achieve its environment sector goals have included limited enforcement, inadequate numbers of trained professionals, and insufficient funding. Additionally, officials from the RMI EPA noted that their environmental impact assessment process is not effective and their regulations are outdated or inappropriate.

- *Limited enforcement.* Although the RMI EPA has issued citations, fines, and cease-and-desist orders for violations of environmental regulations, its assessments of penalties and enforcement of regulations were limited. For example, the EPA's General Manager said that although fines were levied for violations such as illegal landfills, the fines have not been collected because the violators lack the financial resources to pay them. Furthermore, according to the EPA's General Manager, although the EPA referred to the RMI Attorney General several cases involving RMI ministry violations of environmental regulations, none of the cases were prosecuted.
- *Lack of expertise.* The RMI EPA lacks the environmental expertise needed to develop, protect, and enforce environmental regulations. For example, only 2 of the EPA's 20 staff members have bachelor's degrees in environmental science. According to an EPA official, EPA applicants are often hired on the basis of their social connections rather than their expertise.
- *Resource constraints.* Funding and personnel constraints also affect the RMI's ability to carry out its environmental protection responsibilities. According to an EPA official, the office's work in the lagoon is planned on a weekly basis according to fuel affordability and boat operability. For the month of January

2006, the official said, the EPA was unable to sample water quality in the lagoon or to monitor fishing boats dumping solid waste, because the EPA's boat was under repair. EPA's General Manager also indicated that a lack of financial and personnel resources for Ebeye, the RMI's second largest population center, has limited environmental protection activities on the island.

Enclosure VIII
Comments from the Department of Interior



THE ASSOCIATE DEPUTY SECRETARY OF THE INTERIOR
WASHINGTON, DC 20240

MAY 3 2007

Mr. David Gootnik
Director
International Affairs and Trade
United States Government Accountability Office
Washington, D.C. 20548

Dear Mr. Gootnik:

Thank you for the opportunity to review and comment on the Government Accountability Office Draft Report, number GAO-07-514R, entitled, *Compacts of Free Association: Micronesia and the Marshall Islands' Use of Sector Grant Funds*, a supplement to your December 2006 Report. The Department of the Interior finds the Draft Report informative and clear in its identification of the challenges faced by the Federated States of Micronesia and the Republic of the Marshall Islands. The Department agrees with the conclusions and recommendations of the GAO Report of December 2006, number GAO-07-163, entitled, *Compacts of Free Association: Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability*.

The Department's Office of Insular Affairs is continuing actions in line with the recommendations of the GAO Report of December 2006. The actions are designed to improve the FSM's and the RMI's use of Compact funds by addressing challenges such as those identified in the Draft Report. The OIA will continue its actions and looks forward to the final report.

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 for Insular Affairs, or Nikolao Pula, Director of the Office of Insular Affairs, at (202) 208-4736.

Sincerely,

James E. Cason

Enclosure IX
Comments from the Federated States of Micronesia



EMBASSY OF THE
FEDERATED STATES OF MICRONESIA
1725 N STREET, N.W.
WASHINGTON, D.C. 20036

TELEPHONE (202) 223-4383
TELEFAX: (202) 223-4391
TELEX: 292003 FSME

April 30, 2007

Mr. David Gootnick
Director, International Affairs and Trade
United States Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Gootnick:

Once again, the Government of the Federated States of Micronesia extends its appreciation to the GAO for the opportunity to comment on the latest draft Report entitled, "Compacts of Free Association: Micronesia and the Marshall Islands' Use of Sector Grant Funds" (GAO-07-514R). We note that this Report is essentially an informational supplement to the December 2006 Report (GAO-07-163), "Micronesia and the Marshall Islands Face Challenges in Planning for Sustainability, Measuring Progress, and Ensuring Accountability."

Our comments on the December Report were submitted by letter dated December 4, 2006, and were published by your office along with the Report as Appendix IX. At this time we have only a few additional comments as follows:

First, with regard to the GAO comment number 2, added by GAO in response to our December 4 letter, where GAO states in part, "We believe that the [FSM's distribution] formula's impact on each State's performance and development should be continuously evaluated and the allocation of funds revised as necessary." We agree with this statement. It is undeniable that the FSM and the United States share a common interest in distributing Compact assistance in the FSM in a way that most effectively meets national goals and delivers services.

The original Compact mandated the FSM Government to certify the distribution to the US as a "term" of the assistance. It was decided to make the certification extend to each successive five-year period, subject to possible recertification by the FSM at any time. The idea was to leave open the door for periodic adjustment based on need and equity. In fact, such a process has been followed by the FSM Government over the years, and periodic adjustments have been made.

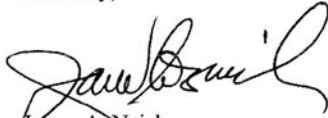
The point repeatedly made by GAO about the disparity in, for example, per-student distribution of Compact education grants among the FSM States may ultimately serve to indicate an inadequacy of Compact grants to achieve the assigned Compact objectives.

We appreciate the discussion on pages 24 and 25 of the Draft Report on the subject of inflation adjustment for the SEG. It is the FSM's belief that such inflation adjustment is a Compact obligation, a conclusion clearly borne out by the language from the interdepartmental MOA quoted in footnote 29, and, of course, by the language of Public Law 108-188.

Finally, we choose to take as useful and constructive criticism the findings in this and earlier GAO Reports of shortcomings in the FSM's efforts fully to meet the many requirements involved with implementing the Amended Compact which had not pertained during the first seventeen years of our Compact experience. We are trying very hard to improve performance, and are gratified when you give credit to the positive results of our effort in your reports. We are committed to continued improvement.

The FSM Government thanks the United States Congress and the GAO for your strong commitment to the successful implementation of the Compact and to the advancement of the FSM.

Sincerely,



James A. Naich
Charge d' Affaires Ad Interim

Enclosure X
Comments from the Republic of the Marshall Islands

Note: GAO Comments supplementing those in the report text appear at the end of this enclosure.



EMBASSY OF THE REPUBLIC OF THE MARSHALL ISLANDS

2433 Massachusetts Avenue, N.W.,
Washington, D.C. 20008
Tel. # (202) 234-5414
Fax # (202) 232-3236

May 4, 2007

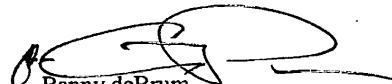
Mr. David Gootnick
Director
International Affairs and Trade
United States Government Accountability Office
Washington, D.C. 20548

Dear Mr. Gootnick:

Thank you for providing the Draft GAO Report (GAO-07-154R) "Compacts of Free Association: Micronesia and the Marshall Islands' Use of Compact Grants" to the Government of the Republic of the Marshall Islands for review and to make comments (please see attached).

The RMI Government welcomes GAO's input and looks forward to continuing to work with the GAO in identifying and address issues under the Compact of Free Association, as amended.

Sincerely,


Banny deBrum
Ambassador

Government of the Republic of the Marshall Islands
Comments on the GAO Report (GAO-07-154R)
"Compacts of Free Association: Micronesia and the Marshall Islands' Use of Compact Grants"

The following comments are based on a review of the draft document. The Republic of the Marshall Islands (RMI) would hope that the changes stated and observations made are clarified and reflected in the final report.¹

General Comments:

It is important to note that the GAO report is based on review of FY 2004 portfolios and FY 2004 quarterly and annual reports and FY 2005 quarterly reports. It should be emphasized that RMI was just beginning performance based budgeting (PBB) and reporting, and much information was still being collected, reviewed, redesigned and reformatted at the time of the review. Many changes, revisions and refocusing have occurred since FY 2005 and the GAO report takes no account of this.

Furthermore the GAO did not look at management capacity and changes in attitudes and understanding regarding planning and reporting, but instead focused only on areas in the reports (statistics) that were missing or inconsistent. It should be noted that there has been improvement in this area, especially in the last year, with some new staff and greater understanding and use of the new formats.

The report mentions the lack of planning for decrement management. However, the RMI's view is that this situation is made worse by the lack of full inflation adjustment that was requested during the Compact negotiations. RMI's position continues to be that grants under the Compact, as amended, should be subject to full inflation adjustment to help maintain service levels. That said, the Government manages the decrement through its Medium-Term Budget and Investment Framework by trying to restrict expenditures within nominal levels, while recognizing that over time this will place pressure on services.

The Government understands the need to strengthen the taxation system to provide growing revenues increases to offset the impact of the annual decrement. While changes to the tax structure have been limited, tax administration has improved significantly with improved tax auditing and better compliance leading to tangible revenue increases.

The RMI notes that the report contains many unattributed references to unsubstantiated opinions of officials and individuals in the RMI Government, the US Government and other organizations. In one paragraph alone (See: "*Lack of qualified teachers*", page 21-22), there are four references to unspecified persons voicing individual opinions. Such opinions should be attributed to the specific people or position, supported by specific evidence or confirmed by a second source before inclusion in the report. If the Government is answerable to individual opinions then those individuals should be required to stand by their comments.

¹ Page references may vary slightly from the GAO report.

See comment 1.

See comment 2.
Now on pp. 17-18.

Comments on Education:

The Supplemental Education Grant (SEG):

A significant portion of the report discusses the Supplemental Education Grant. RMI wishes to make three general points regarding the SEG.

1) Acceptable uses of the SEG: The GAO cites specific language from the fiscal procedures agreement, which states that these funds are meant for "direct educational services at the local school level focused on school readiness, early childhood education, primary and secondary education, vocational training, adult and family literacy, and the smooth transition of students from high school to post-secondary educational pursuits or rewarding career endeavors." In the discussion of the SEG, GAO notes that there is disagreement between the RMI and some federal agencies about the definition of "supplemental" and, therefore, what types of programs are eligible to be funded with this assistance.

The Government would request that GAO include a reference to the specific Compact legislation (Section 105, (f), 1, B, iii), which states that the funds are to "supplement grants under Section 211 (a)(1)" of the Compact. By any logical interpretation, this means that the grants can be used, unless otherwise specified, for any program allowable under the Compact education sector grant, whether it is to supplement an existing program, launch (and entirely fund) a new program, or fund any other allowable expenditure under the Compact. The language does not state that the grant is meant to provide for "supplemental programs" or even to "supplement programs." Thus, according to the specific language in the legislation, and the fiscal procedures agreement, the definition of "supplemental" is irrelevant. The only consideration for eligibility of program should be whether it meets the specific requirements set out in the fiscal procedures agreement and adheres to the original language of the Compact.

Further, the spirit of the agreement clearly suggests that the RMI use the funds to replace the U.S. programs such as Head Start and Workforce Investment Act that were "cashed out." With the efficiency gains due to not having to operate under the sometimes-restrictive conditions of the specific grants (that are meant for implementation of programs in the U.S. context), the RMI has been able to expand early childhood education for less money than was used for the Head Start program. Other programs are performing more efficiently as well, meaning that additional funds are available for textbook purchases, staff development, school feeding programs and other initiatives crucial to the long-term development of the RMI. Still, the continued misinterpretation of the Compact language by U.S. agencies hinders the effectiveness of the Supplemental Education Grant.

The Government intends to work with the federal agencies to develop a shared understanding, based on the language of the law, of the allowable uses of these funds. Without a shared understanding, this will continue to hinder effective and efficient use of this grant assistance.

2) Inflation adjustment for the SEG: The GAO makes note that the SEG has not yet been adjusted for inflation. Failure to do so, coupled with the overall reduction of the grant, has hindered effective and efficient use of this grant assistance. The Government

would request that GAO make note of the authorizing language in the Compact, which specifically states that the grant authorization is annually adjusted for 2/3 of U.S. inflation and further note that in its annual budget request, the Department of Education has not requested this adjustment. As seen in Table 1, the appropriation is now more than 7% below the authorization, and RMI is highly concerned that the value of the SEG has declined so sharply after only three years. The cost of textbooks, personnel, equipment, and other items funded by SEG rises with inflation. It is the RMI's position that the Department of Education (DOE) requests the full authorization, with inflation adjustment, for FY2008 and beyond. The Government recommends that GAO include a discussion of how the failure to adjust the SEG for inflation adversely affects delivery of services under the grant. GAO should also include a brief examination of whether DOE requests the full amount of authorized inflation adjustments for other programs.

Table 1: SEG Authorization vs. Appropriation

Year	Inflation	2/3 Inflation	SEG Authorization	SEG Appropriation
2005	3.29%	2.19%	\$6,100,000	\$6,100,000
2006	3.24%	2.16%	\$6,233,793	\$5,941,769
2007			\$6,368,443	\$5,990,490

As an example of the tangible problems, this loss in value is causing, the approximately \$400,000 that would have been available had the SEG been fully funded in FY 2007, could have been used to provide textbooks in one subject area for five grade levels.

3) Delays in Grant Approval: GAO is correct in pointing out that in the previous two fiscal years SEG has been significantly delayed. RMI wishes to elaborate on some of the difficulties that arise because the grant is subject to the annual U.S. appropriation process. The submission and approval process does not begin until the U.S. Congress approves the annual spending bill. As we have seen this year, this means that RMI cannot submit its initial SEG proposal until the fiscal year is half over. This difficulty should be noted where the report states, on page 21, that the RMI did not submit its plan until well into the fiscal year. In practice, this has resulted in a situation where the SEG basically runs one fiscal year behind our regular budget. The delays are largely beyond the control of the RMI and it is recommended that the US Government do all in its power to streamline the SEG appropriation process and ensure that the letter and the spirit of the SEG agreement be fulfilled.

Below we include specific comments on passages from the GAO report, with clarifications, factual corrections and questions about some of the findings.

Absenteeism:

Page 21 - Absenteeism, as the report notes, is a major problem that MOE is working to address. The Ministry has been granted the authority to suspend teachers by PSC, and in the last year, has acted on at least five cases. MOE still lacks the authority to terminate teachers who are chronically absent.

See comment 3,
footnote 24.
Now on p. 18.

High dropout rates:

Page 21 – “According to the RMI Ministry of Education, the dropout rate in 2005 was 23 percent at the primary school level (grades 1-8) and 38 percent for boys and 37 percent for girls at the secondary school level (grade 9-12). The ministry estimated that less than 25 percent of the students now enrolled in first grade will complete high school.”

The last sentence is not accurate since this figure is based on recorded completion rates for students who enrolled in first grade 12 years ago. The estimate was of historical performance, not a projection of future performance. Additionally, because the grade 1-8 completion rate has been understated, the overall completion rate for grades 1 to 12 has been understated. Previously, Ministry of Education (MOE) divided the number of students completing grade 8 by the number of students enrolling in grade 1 eight years earlier. Due to the high number of students who repeat grade 1, this overestimates the dropout rate. Using this methodology to calculate the dropouts between grade 1 and 2 would result in a nearly 25% dropout rate, but this is simply not true. MOE has examined the progress of a sample of grade 1 students and found that the high number of repeaters artificially inflates the dropout rate. Additionally, due to progress in early childhood enrollment, student retention, and expansion of the secondary school system, the MOE estimates the completion rate will be significantly higher for students enrolling in first grade today. Conservatively, MOE estimates that 50% of students who enroll in grade 1 today will complete high school, based on 95% enrollment in kindergarten, a 90% completion rate of 8th grade, a 95% transition rate to secondary school programs, and a 65% completion rate for secondary school.

Inadequate classroom facilities:

Page 22 - “Despite the use of compact infrastructure funds to build new classrooms at 6 schools, many RMI schools remain in poor condition. For example, classrooms at the Marshall Islands High School are unsafe because ceilings have collapsed (see fig. 5), while schools on Ebeye have no reliable electricity owing to rolling blackouts on the island. Access to secondary education is also limited by the lack of available classroom space; students take an entrance test to enter public secondary schools because of limited capacity at the schools. We calculated, based on data from the 1999 RMI census that current enrollment is only about 40 percent of the secondary school-aged population. The principal of Ebeye High School told us the school would not have enough classrooms for the new school year and that they were converting an old warehouse into classroom space.”

In footnote 25 to this section, the report states: “We estimated RMI’s 2005 secondary school-aged population at 8,583; however, the enrollment in RMI public and private secondary schools combined for that same period was only 3,414.”

First, RMI would request that GAO clarify the second sentence of this passage. In reading this section, it should be clear that only a few classrooms at the time of the team’s visit were in a state of disrepair where parts of the ceiling were loose. Additionally, the RMI wishes to update GAO on progress made with new construction at Marshall Islands High School (MIHS). Currently, classes are moving out of the old buildings into new ones, remedying the situation. Although these buildings had not been constructed at the time of the team’s visit, RMI would request that GAO note that plans

See comment 4,
new footnote 26.
Now on p. 18.

See comment 5,
footnote 27.
Now on p. 19.

for remedying the situation existed at the time of its visit, perhaps with a footnote noting that the new buildings are now being utilized.

Second, RMI requests clarification of the calculation of the secondary school-aged population included in the footnote. According to the report, based on calculations from the 1999 census the secondary school age population at the time of the report was approximately 8,583. RMI disputes this figure. The 1999 census says that there were 7,413 10-14 year olds, or about 1,480 per year cohort. Using this figure as a basis for a four-year secondary school population yields an estimate of just under 6,000 students. The most accurate estimate would calculate the number of 8-11 year olds at the time of the 1999 census, which MOE calculates to be 5,616. This estimate assumes that two years of the secondary school population in 2006 is made up of individuals who were 8 and 9 at the time of the 1999 census, and the other two years of the population is made up of individuals who were 10 and 11 at the time of the census.

If the GAO population estimate is referring to a larger age-range, the report should clearly state this, but RMI believes that the appropriate way to estimate school aged population is to assume one year per grade level. If MOE calculations are correct, this would yield a 61% enrollment rate for secondary schools.

Finally, MOE wishes to clarify that the "warehouse" discussed in the final sentence was actually an old classroom building from the previous school. Upon renovation, it has served the school well as a classroom building.

Comments on Infrastructure:

Absence of stakeholder engagement:

Page 37 – During 2006 the PMU carried out extensive handover training to MoPW personnel resulting in 3 staff members being transferred to the PMU. The training ranged from project identification to contract formulation and construction in the maintenance sector (upper management RMI Government). A series of meetings has been held with key government officials, award procedures have been revised and information is now more forthcoming as the various departments become more familiar with the procedures associated with the Compact.

Unresolved land issues

Page 38 – "as a result of ongoing land disputes between the RMI government and the landowners, the PMU developed three different designs for Uliga Elementary School in Majuro. As of November 2006, this issue remained unresolved, requiring the school to continue running split sessions to accommodate all students."

The RMI Environmental Protection Authority (EPA) closed down Uliga Elementary School and the students have been temporarily housed, with the assistance of the PMU. A Consortium has been established to reclaim land upon which the new Uliga Elementary School will be built. The project is currently in the EIA stage. Split schedules are no longer in use, and all UES students receive a full day of instruction. The school is now located on the campus of one of the local private schools until the construction of a new facility. Plans are moving forward to begin this large construction effort.

Page 38 – “the construction of Kwajalein Atoll High School has been delayed because of the inability of the RMI Government to secure a lease”

Funding for Kwajalein Atoll High School has been reprogrammed to cover shortfalls in other projects on sites with leases.

Lack of Assessment:

Page 38 - The Government’s infrastructure allocation for the College of the Marshall Islands (CMI) was encouraged by OIA as mentioned in the report. However, it seems somewhat contradictory for OIA to then criticize the RMI for not assessing the impact this will have on primary and secondary education. It also needs to be borne in mind that the \$5 million per year allocation for CMI over five years is subject to the CMI having projects ready for implementation. The allocation is not a blind allocation of funds to CMI for the College to then allocate to projects as it sees fit.

Page 38 – “RMI government has not assessed the sustainability of its current rate of infrastructure expenditures”. This is unclear, unless it refers to the lack of maintenance money being set aside to maintain new buildings.

Page 38 – “the RMI government has not assessed the trade offs of the PMU’s current designs that increase longevity and reduce maintenance by using expensive, brand name products”. There is a long history in the Marshall Islands of poor construction of public facilities using inferior materials and inadequate supervision. Combined with lack of adequate maintenance and the harsh environment, this has led to the need to Government having to replace buildings earlier than anticipated. The Government does not want a repeat of this. It has assessed that better quality construction, with better materials, is the best way to ensure the value for money from infrastructure funds. This assessment was mindful of relative life spans of infrastructure that would result from the use of differing quality materials.

Lack of technical capacity:

Page 39 – Under the RMI agreement with the PMU, it has trained MoPW staff in the formulation and execution of maintenance contracts. The Government concedes that there is a need to provide more locally trained engineers and architects. The Government scholarships program is trying to address this need to develop the capacity to implement the RMI’s capital building program.

Accountability Weaknesses

Page 40 – “*Noncompetitive procurement*” – After the completion of the infrastructure assessment for the entire stock of infrastructure for education and health and after the completion of the first batch of Project Development Plans (PDP) for the schools, the infrastructure projects were already running behind schedule, six months after the Compact, as Amended, came into force. All offices and agencies working with BECA were more than pleased with the quality and quantity of work being produced and there was a need to make sure that projects moved forward. In addition DOI/OIA was also pleased with the quality of work and was also concerned about the potential delays in

See comment 6.
Now on p. 34.

starting projects. In order to maintain momentum and reduce delays in construction, it was decided that using the sole sourcing provisions of the Fiscal Procedures Agreement was in the best interest of the RMI.

Comments on Health:

Having 54 health centers, let alone 45, scattered over an ocean area of 700,000 square miles of ocean is a realistic challenge. Transportation and communication problems will continue, even within an atoll. In 2004, 45 of the health centers mentioned here were operational, and not just open as stated here. The health centers that were closed were part of the Ministry's assessment to provide added responsibilities to health assistants to manage two health centers, especially those health centers and communities that are in close proximity to one another and with population of less than 50, and construct new ones. There were communities with no health center infrastructure, but the health assistants continue to provide primary care from their own homes. Currently 54 health centers are in operation.

Page 51 – Majuro/Ebeye hospital facilities

Such comments on the Majuro hospital annex do not truly reflect how much the health facilities are appreciated and utilized, and how important a 'working laboratory' is to diagnosing illness. It must be noted that the Majuro Hospital laboratory is currently developing its capabilities for histology and cytology as a referral lab. The RMI's goal to target prevention and primary health care will not be interrupted in the future and the MOH has already taken the initial step to review its organizational structure to reorganize to focus even more on prevention and primary health care at all levels of care.

Page 52-53 - Challenges in the RMI Health Sector

Increasing prevalence of lifestyle diseases: Like any developing country, changes in lifestyles affect the increase in both non-communicable and communicable diseases. Increasing people's understanding of health issues remains a challenge. MOH is taking steps to address these problems by, among other things: (i) the establishment of the Diabetes Wellness Center in collaboration with the Canvasback Incorporated; (ii) development of the Non-Communicable Disease Strategic Plan which includes physical activities, nutrition, food safety/production; and (iii) development of the RMI National HIV Strategic Plan.

Unsustainable spending: The user fees for outpatient clinics and inpatient services are not the only sources of revenue for the MOH. An \$8 fee is charged for physical examinations of food handlers and taxi drivers every six months and for students. Although fees are also charged at the Laura Health Center at a lower fee, other than delivery charge of the same \$5, the revenues generated from the Laura Health Center and outer islands health centers are still minimal. The MOH also has access to the Health Fund, which is levied as a deduction from wages and salaries. This revenue sources provided \$6.2 million to the Ministry in FY 2005.

See comment 7.
Now on pp. 50-51.

Comments on Public Sector Capacity Building

Page 58-59: The report is implicitly critical of the Government for not allocating any funds to addressing Public Sector Capacity Building. However, this is a deliberate policy of the Government in focusing its Compact sectoral grants in the education and health sectors, the Government's two top priorities. The view is the capacity building is best addressed, in the long term, through the education system rather than direct interventions in specific areas of the public sector. That said, the Government is considering assigning funds to this sector in order to support the implementation of Performance Based Budgeting (PBB), which in effect it has been done in the past with unspent carry over funds.

The Government has many other sources of funding to support public sector capacity building that reduces the need to allocate funding to this sector. The fact that funds are not allocated to this sector out of Compact sectoral grants does not necessarily mean the Government places a low priority on this area. There are other sources of funding from bilateral donors, regional and multilateral organizations to address these capacity building needs and these are often approached before consideration is given to reallocating funds from the other priority sectors. Despite this, capacity building funds should be available from the US Government outside of the sectoral grant allocation.

Comments on the Environment Sector

Page 69 - *Limited Enforcement*: The report singled out lack of enforcement of the regulations as one of the issues to overcome at the Environmental Sector, however this responsibility falls on not just Environmental Protection Authority but also the Attorney General's Office, Local Council, etc.

The following are GAO's comments on the Republic of the Marshall Islands letter dated May 4, 2007.

1. GAO conducted its field work in March 2006. At that time, only project reporting for the first quarter of fiscal year 2006 was available. We therefore chose not to include those reports in our scope. However, we will review the improved reporting during our next mandated review.
2. GAO's practice is to not specifically identify individuals by name. However, regarding the specific section, "Lack of Qualified Teachers" the RMI identified as an example of having unsubstantiated opinions, we have included the position titles of those individuals who provided us with information, including the Minister of Education, whom we believe to be an authoritative voice on the matters regarding RMI's educational system.
3. The RMI contends that about 50 percent of the students enrolling in first grade today will graduate high school, instead of the 25 percent we reported, which was in the Ministry of Education's 2005-2006 Portfolio document. The RMI told us that the 25 percent figure in the 2005-2006 Portfolio document was outdated and inaccurate.
4. Per the RMI's request we added a footnote indicating that the new buildings are now being utilized. However, we did corroborate this fact and therefore attribute the statement to the government of the RMI.
5. GAO's initial estimate of 8,583 was based on secondary schools including grades 7 through 12 (a 6 year period), whereas the RMI estimate based it's figure on secondary schools including only grades 9 through 12 (a 4 year period). To reconcile the difference in timeframes, GAO's new figure of approximately 6,000 students is based on the same 4 year period used by the RMI.
6. Concerns about the lack of an assessment by the RMI of its current rate of infrastructure expenditures were raised by OIA. The concerns relate to the overall sustainability of infrastructure as well as the lack of money being set aside for maintenance.
7. The compact identifies public sector capacity building as one of the sectors in which the annual grant assistance should be used. The RMI's continued reliance on external sources of funding to support public sector capacity building leaves it vulnerable to the decisions of donors and regional and multilateral organizations.

Enclosure XI
GAO Contact and Staff Acknowledgments

GAO Contact

David Gootnick (202) 512-3149

Staff Acknowledgments

In addition to the person named above, Emil Friberg (Assistant Director), Ming Chen, Tracy Guerrero, and Julie Hirshen were key contributors to this correspondence. Joe Carney, Etana Finkler, Reid Lowe, and Mary Moutsos provided technical assistance.

(320466)

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.