



February 2022

# COMPACTS OF FREE ASSOCIATION

## Implications of Planned Ending of Some U.S. Economic Assistance

Accessible Version

February 2022

# GAO Highlight

Highlights of [GAO-22-104436](#), a report to congressional requesters

## Why GAO Did This Study

The U.S. has provided economic assistance pursuant to its compacts with FSM and RMI since 1986 and with Palau since 1994. This assistance—grants overseen by the Department of the Interior as well as programs and services provided by various U.S. agencies—is intended to promote FSM's, RMI's, and Palau's economic advancement and self-sufficiency. The Department of State is responsible for bilateral relations.

The U.S. has also provided contributions to each country's compact trust fund. FSM and RMI compact trust fund earnings are intended to provide revenue after compact grant assistance ends. Palau is receiving disbursements from its compact trust fund, which is designed to provide revenue until 2045.

GAO was asked to provide an update on U.S. assistance to FSM, RMI, and Palau. This report examines, among other things, (1) the use and role of the U.S. funds and programs in each country's budgets and (2) the projected fiscal effects of the ending of compact grants and certain programs and services. This report also examines the implementation of the Compact Review Agreement for Palau. GAO reviewed compact agreements, U.S. law, and country documents; modeled future compact trust fund performance; and interviewed FSM, RMI, Palau, and U.S. government officials.

## What GAO Recommends

GAO is recommending that the Secretary of State, working with Interior, establish timeframes to constitute the Palau Advisory Group on Economic Reform. State concurred with this recommendation.

View [GAO-22-104436](#). For more information, contact Latesha Love at (202) 512-4409 or [LovelL@gao.gov](mailto:LovelL@gao.gov).

## COMPACTS OF FREE ASSOCIATION

### Implications of Planned Ending of Some U.S. Economic Assistance

## What GAO Found

The U.S. contributes to trust funds provided pursuant to Compacts of Free Association with the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Republic of Palau. These funds are meant to provide long-term budgetary support after certain grant assistance ends after fiscal year (FY) 2023 for FSM and RMI and after FY 2024 for Palau. GAO previously found the FSM and RMI trust funds may not provide sustainable income and recommended that the Department of the Interior work to develop a trust fund distribution policy to address the funds' sustainability. For this report, GAO was asked to project the effects of the ending of certain assistance under the compacts as well as the sustainability of compact trust fund disbursements to replace grants and financially support the three nations. GAO found the following:

**FSM.** FSM relied on compact sector grants and a supplemental education grant (SEG) ending in FY 2023 for 28 percent of expenditures in FY 2019. GAO projects that disbursements from FSM's compact trust fund will not cover all of the value of these grants, resulting in annual fiscal gaps. Because of rules governing the compact trust fund, FSM faces a 36 percent likelihood of zero disbursements from its compact trust fund in 1 or more years before FY 2034, even though the fund may have a substantial balance.

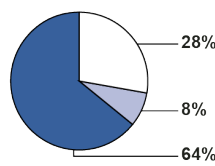
**RMI.** RMI relied on compact sector grants and a SEG ending in FY 2023 for 21 percent of expenditures in FY 2019. GAO projects that disbursements from RMI's compact trust fund will not cover all of the value of these grants, leading to annual fiscal gaps. Because of rules governing the compact trust fund, RMI faces a 12 percent likelihood of zero disbursements from its compact trust fund in 1 or more years before FY 2034, even with a projected increasing fund balance.

**Palau.** Palau relied on compact grants as well as disbursements from its compact trust fund for 13 percent of expenditures in FY 2019. GAO projects minimal disbursement risks to Palau's compact trust fund before FY 2044. As of September 2021, the Department of State, working with Interior, had not established timeframes to constitute the Palau Advisory Group on Economic Reform, which the Palau Compact Review Agreement stipulates is to recommend reforms to enhance long-term economic sustainability.

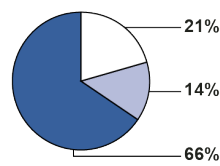
### FSM's, RMI's, and Palau's Total Government Expenditures, by Revenue Source, Fiscal Year 2019

Dollars in millions

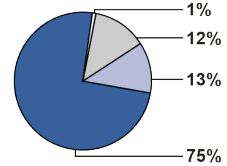
**FSM:**  
Total expenditures = \$232.7



**RMI:**  
Total expenditures = \$164.8



**Palau:**  
Total expenditures = \$129.0



Percentages may not sum to 100 due to rounding.

Legend:  
 □ Compact and supplemental education grants ending  
 □ Other U.S. grants  
 □ Palau compact trust fund disbursements  
 ■ Domestic sources and assistance from other countries

Source: GAO analysis of Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Republic of Palau single audit reports for fiscal year 2019. | GAO-22-104436

**Accessible Data Table for Highlight Figure (Part 1 of 3)****Federated States of Micronesia**

Compact and supplemental education grants ending in 2023	28%
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Other U.S. grants	8%
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Domestic sources and assistance from other countries	64%
--	-----

Palau compact trust fund disbursements	
--	--

Total	\$232.7
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**Accessible Data Table for Highlight Figure (Part 2 of 3)****Republic of the Marshall Islands**

Compact and supplemental education grants ending in 2023	21%
--	-----

Other U.S. grants	14%
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Domestic sources and assistance from other countries	66%
--	-----

Palau compact trust fund disbursements	
--	--

Total	\$164.8
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**Accessible Data Table for Highlight Figure (Part 3 of 3)****Republic of Palau**

Compact and supplemental education grants ending in 2023	1%
--	----

Other U.S. grants	13%
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Domestic sources and assistance from other countries	75%
--	-----

Palau compact trust fund disbursements	12%
--	-----

Total	\$129.0
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### Abbreviations

ADB	Asian Development Bank
DOD	Department of Defense
DOT	U.S. Department of Transportation
EEZ	exclusive economic zone
FAA	Federal Aviation Administration
FAS	Freely associated state
FDIC	Federal Deposit Insurance Corporation
FEMA	Federal Emergency Management Agency
FSM	Federated States of Micronesia
FY	fiscal year
GDP	gross domestic product
IMF	International Monetary Fund
JEMFAC	Joint Economic Management and Financial Accountability Committee
JEMCO	Joint Economic Management Committee
MUORA	Military Use and Operating Rights Agreement
NWS	National Weather Service
OIA	Office of Insular Affairs
OMB	Office of Management and Budget
RMI	Republic of the Marshall Islands
SEG	supplemental education grant
USAID	U.S. Agency for International Development
USPS	U.S. Postal Service

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February 14, 2022

The Honorable Joe Manchin III  
Chairman  
Committee on Energy and Natural Resources  
United States Senate

The Honorable Lisa Murkowski  
United States Senate

To promote the economic advancement and self-sufficiency of the Freely Associated States (FAS)—the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), and the Republic of Palau—the U.S. provides economic assistance through compacts of free association. This compact assistance, which the U.S. has provided to FSM and RMI since 1986 and to Palau since 1994, includes compact grants<sup>1</sup> that will end after fiscal year (FY) 2023 for FSM and RMI and after FY 2024 for Palau.<sup>2</sup> Additionally, the compacts provide for certain federal programs and services that generally will end in FY 2024 for FSM and RMI and after FY 2024 for Palau.<sup>3</sup> The U.S. has also contributed to a compact trust fund for each of the nations to provide long-term budgetary support after compact assistance ends. The U.S. Department of the Interior is

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<sup>1</sup>For purposes of this report, “compact grants” refers to the compact sector grants provided to FSM and RMI pursuant to Section 211 of their respective compacts, Kwajalein impact and use grants provided pursuant to Section 212 of the RMI compact, and grants provided to Palau under Article I of its compact and under the compact review agreement, as amended, between the U.S. and Palau that entered into force on September 19, 2018. Additionally, the FAS receive grants authorized by the compacts implementing legislation. See tables 21 and 22 within appendix IV for FAS eligibility under current law for these grants after FY 2023 for FSM and RMI and FY 2024 for Palau.

<sup>2</sup>In this report, we refer to certain grants’ ending because the provisions of relevant agreements that address these annual grants expire after FY 2023 for FSM and RMI and after FY 2024 for Palau. Some funding may flow to FSM, RMI, and Palau pursuant to existing grant agreements after the authority to provide new grants expires.

<sup>3</sup>Generally, federal programs and services are provided to FSM, RMI, and Palau through the Federal Programs and Services Agreement with each country. Most provisions of these agreements expire on September 30, 2023, for the FSM; April 30, 2024, for the RMI; and September 30, 2024, for Palau. However, certain provisions will remain in force after those dates.

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scheduled to have provided, in total, \$3.7 billion to FSM and \$2.5 billion to RMI by 2023 and \$803 million to Palau by 2024.

In 2019, the United States announced negotiations of each of its agreements with the FSM, RMI, and Palau governments related to expiring provisions for economic assistance and for federal programs and services, of its agreements with each government, according to the Department of State. According to State officials, the U.S. partnership with the FAS has contributed to the stability and prosperity of the Indo-Pacific region. We have previously reported on challenges affecting the management of, and accountability for, compact grants and on the sustainability of the trust funds.<sup>4</sup>

You asked us to provide an update on U.S. assistance to FSM, RMI, and Palau. This report examines, for each of the three countries, (1) the use and role of U.S. funds and programs in the country's budget, (2) the projected fiscal effects of the ending of compact grants and certain programs and services, and (3) the record of accountability for the use of U.S. funds.

To examine the use and role of U.S. funds and programs in the FSM, RMI, and Palau budgets, we reviewed U.S. law; the FSM, RMI, and Palau compacts and related agreements; and audited financial statements for each country's government for FYs 2015 through 2019.<sup>5</sup> To assess the reliability of federal program funding information, we reviewed single audit reports and concluded that these data were sufficiently reliable for presenting the role of federal programs in the FSM, RMI, and Palau budgets. To determine FSM's and RMI's eligibility after FY 2023 and

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<sup>4</sup>GAO, *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Income*, [GAO-18-415](#) (Washington, D.C.: May 17, 2018). In our May 2018 report, we recommended that the Department of the Interior work with the compact trust fund committees to develop distribution policies and fiscal procedures for the funds and to address disbursement timing. We discuss the status of the recommendations later in this report. We have also reported on Palau's use of compact assistance and accountability over these funds in 2008. See GAO, *Compacts of Free Association: Palau's Use of and Accountability for U.S. Assistance and Prospects for Economic Self-Sufficiency*, [GAO-08-732](#) (Washington, D.C.: June 10, 2008). In addition, we last reported on Palau's compact trust fund projections in 2016. GAO, *Compacts of Free Association: Proposed U.S. Assistance to Palau for Fiscal Years 2016 to 2024*, [GAO-16-788T](#) (Washington, D.C.: July 6, 2016).

<sup>5</sup>We chose to review single audit reports for fiscal years 2015 through 2019 because data for fiscal year 2019 were the most recent available for all three countries and because our report's intended scope was 5 years.



Palau's eligibility after FY 2024 for U.S. grants, programs, and services, we requested information from officials of U.S. agencies that provide grants, programs, or services in FSM, RMI, and Palau.<sup>6</sup> We also interviewed U.S., FSM, RMI, and Palau officials.

To examine the fiscal effects of the ending of compact grants and certain programs and services on FSM, RMI, and Palau, we reviewed compact documents and trust fund governance and reporting documents such as investment policy statements, audits, and annual reports. In addition, we interviewed or corresponded with U.S. agencies' officials; FSM, RMI, and Palau officials; and the FSM and RMI compact trust funds' administrator. We used a Monte Carlo simulation model to project outcomes related to the compact trust funds over a 40-year period.<sup>7</sup>

To examine the record of accountability for the use of U.S. funds provided to FSM, RMI, and Palau, we reviewed the single audit reports for the FSM, RMI, and Palau national governments and FSM state governments for FYs 2015 through 2019. We also interviewed FSM, RMI, and Palau officials as well as Interior officials who oversee and address audit findings. For more details of our objectives, scope, and methodology, see appendix I.

We conducted this performance audit from July 2020 through February 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>6</sup>We consulted officials from the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, the Interior, Labor, State, and Transportation; the Federal Deposit Insurance Corporation; the Institute of Museum and Library Sciences; the National Science Foundation; the Small Business Administration; the U.S. Agency for International Development; and the U.S. Postal Service.

<sup>7</sup>A Monte Carlo analysis is a problem-solving technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

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## Background

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### Overview of FSM, RMI, and Palau and Relations with the U.S.

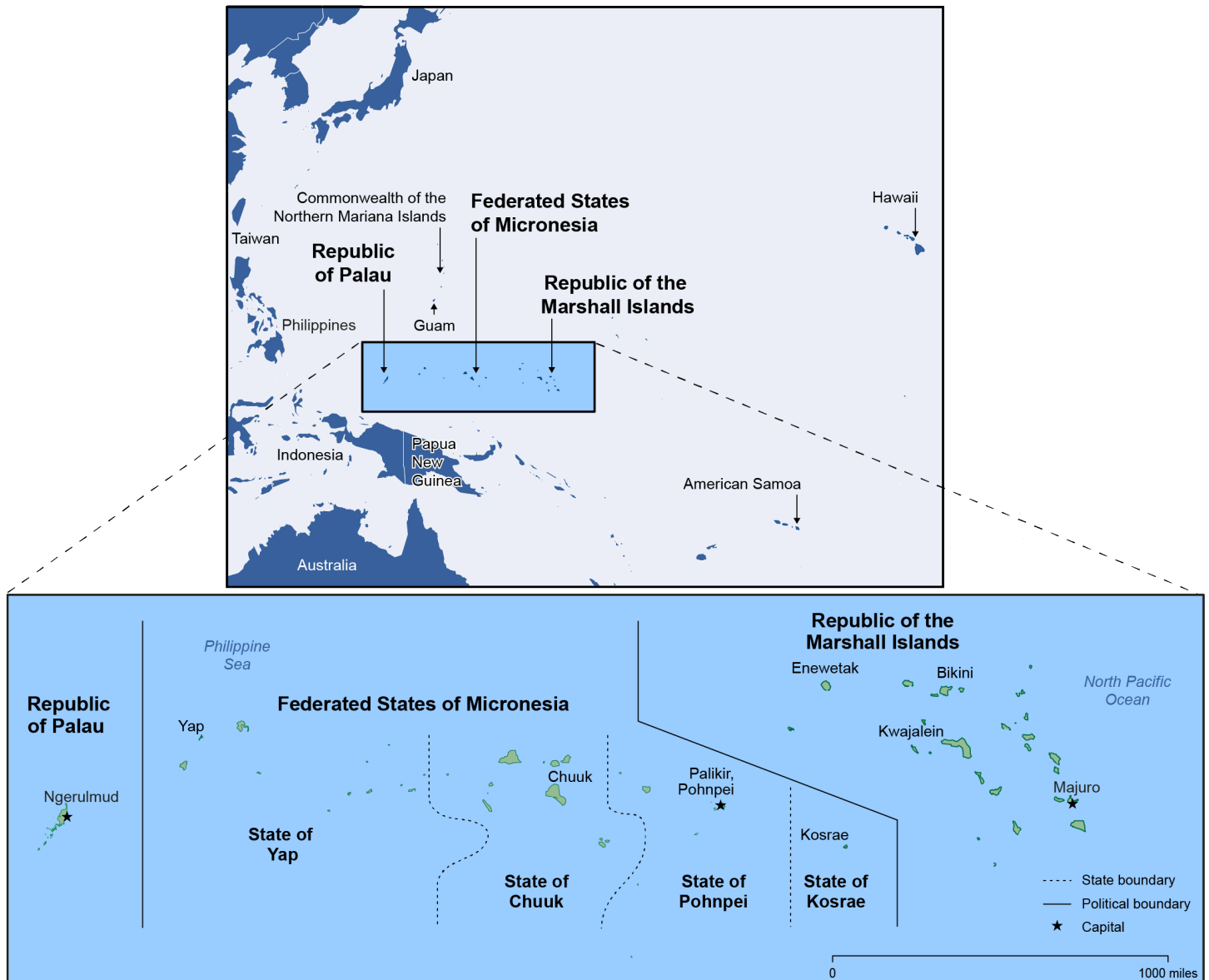
The FAS are among the world's smallest countries, with a combined population of about 176,000 as of 2018: 104,268 in FSM; 54,556 in RMI; and 17,543 in Palau. FSM is a federation of four states: Chuuk, Kosrae, Pohnpei, and Yap.<sup>8</sup> FSM and RMI are both approximately 3,000 miles southwest of Hawaii, and Palau is about 500 miles southeast of the Philippines (see fig. 1).<sup>9</sup>

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<sup>8</sup>The FSM states' estimated populations in 2018 were 49,337 for Chuuk; 36,704 for Pohnpei; 11,537 for Yap; and 6,709 for Kosrae. The FSM state governments receive a large proportion of the U.S. funding provided to the FSM national government. The 2018 estimated population data are from the Graduate School USA.

<sup>9</sup>FSM comprises a land mass area of less than 500 square miles but encompasses an ocean area of more than 1 million square miles. RMI consists of two archipelagic island chains of 29 coral atolls and five coral islands spreading across a sea area of 750,000 square miles and 70 square miles of land. Palau's territory of about 190 square miles includes eight main islands and more than 250 smaller islands.

**Figure 1: Locations of the Federated States of Micronesia, Republic of the Marshall Islands, and Republic of Palau**



Source: GAO. | GAO-22-104436

Note: The map does not depict actual country boundaries or exclusive economic zones.

The economies of the three FAS differ. FSM and RMI had similar levels of gross domestic product (GDP) per capita in 2018, according to estimates from Graduate School USA, while Palau's GDP per capita was almost

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four times higher than either FSM's or RMI's (see table 1).<sup>10</sup> The relative shares of GDP contributed by the public, private, and household sectors varied greatly among the FAS.<sup>11</sup> Private enterprises contributed less than 20 percent of GDP in FSM, compared with more than 30 percent in RMI and almost 50 percent in Palau. In contrast, households in FSM contributed almost twice as much to GDP as in RMI and three times as much as in Palau. FSM's and Palau's public sectors (i.e., government and public enterprise) contributed similar shares of GDP, while RMI's public sector contributed the largest share. (See app. II for an economic overview of the FAS.)

**Leading Donors for the Freely Associated States (FAS)**

A variety of donors have provided aid to the FAS, with the U.S. providing the largest amounts, according to data from the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC). In 2018 and 2019, the top five donors were, in descending order, the U.S., the World Bank, Japan, Australia, and New Zealand for the Federated States of Micronesia (FSM); the U.S., Japan, the World Bank, the EU Institutions, and the Asian Development Bank (ADB) for the Republic of the Marshall Islands (RMI); and the U.S., Japan, Australia, ADB, and South Korea for Palau.

Although the DAC data do not include Chinese aid, China has provided aid to FSM for more than 3 decades—a total of more than \$100 million in economic and technical assistance, according to the FSM national government. Similarly, although the DAC data for RMI do not include Taiwanese aid, Taiwan is a leading donor to RMI, according to the RMI's single audit report for fiscal year 2018.

Sources: Organisation for Economic Co-operation Development's Development Assistance Committee; national government of FSM; and RMI FY 2018 single audit report. | GAO-22-104436

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<sup>10</sup>The levels of GDP per capita for FSM and RMI were significantly lower than Palau's but comparable to the 2018 average for Pacific Island small states, \$4,337; in contrast, Palau's level was more than three and a half times greater, according to the World Bank's World Development Indicators. Similar to the economies of other Pacific Island countries, a large share of FSM's, RMI's, and Palau's national income consists of foreign aid.

<sup>11</sup>The household sector consists of individuals or groups of individuals as consumers and entrepreneurs producing market goods and nonfinancial and financial services, including goods and services for their own consumption.

**Table 1: Population and Economic Data for FSM, RMI, and Palau in FY 2018 and Average of FYs 2004-2018**

<b>FY 2018</b>			
	<b>FSM</b>	<b>RMI</b>	<b>Palau</b>
Population	104,286	54,556	17,543
GDP (millions of dollars) <sup>a</sup>	401.9	221.3	280.4
GDP (dollars per capita) <sup>a</sup>	3,854	4,056	15,986
GDP by sector (percentage)			
Government and public enterprise <sup>b</sup>	31.5	43.9	30.1
Private enterprise	18.6	31.4	47.3
Household sector <sup>c</sup>	26.1	13.9	8.8
Other <sup>d</sup>	23.9	10.8	13.8
<b>Average of FYs 2004-2018</b>			
	<b>FSM</b>	<b>RMI</b>	<b>Palau</b>
Foreign aid (dollars per capita)	1,025	1,157	2,494

Legend: FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands, FY = fiscal year, GDP = gross domestic product.

Source: GAO (analysis); Graduate School USA, Pacific and Virgin Islands Training Initiatives (data). | GAO-22-104436

<sup>a</sup>GDP and GDP per capita estimates for FSM are based on interim data.

<sup>b</sup>GDP for government and public enterprise is the sum of the market value of goods and services produced by national, state, municipality governments and by government agencies.

<sup>c</sup>The household sector consists of individuals or groups of individuals as consumers and as entrepreneurs producing market goods and nonfinancial and financial services, including goods and services for their own consumption.

<sup>d</sup>"Other" comprises the other institutional sectors of the economy, taxes, subsidies and financial intermediation services for which financial institutions did not explicitly charge fees.

The U.S. relationship with the FAS began when American forces liberated the islands from Japanese control near the end of World War II. In 1947, the U.S. entered into a trusteeship with the United Nations and became the administering authority over FSM, RMI, and Palau.<sup>12</sup> FSM and RMI remained subject to U.S. authority until 1986, when each entered a

<sup>12</sup>Under the United Nations trusteeship agreement, the U.S. was the administering authority for the Trust Territory of the Pacific Islands: Micronesia, the Marshall Islands, Palau, and the Northern Mariana Islands. In 1986, the Northern Marianas became a commonwealth in political union with the U.S.

compact of free association with the U.S.<sup>13</sup> Palau's compact of free association with the U.S. entered into force in 1994.<sup>14</sup> Under its compacts with FSM, RMI, and Palau, the U.S. provided economic assistance for defined time periods; has responsibility for defense and security matters; and allows eligible FAS citizens to enter, reside, and work in the U.S. without regard to certain visa and labor certification requirements of the Immigration and Nationality Act.<sup>15</sup> FSM and RMI became members of the United Nations in 1991, while Palau joined the organization in 1994.

In 2003, the U.S. entered into amended compacts with FSM and the RMI.<sup>16</sup> The U.S. also entered into an agreement with Palau, known as the Compact Review Agreement, which entered into force in 2018.<sup>17</sup> The Department of the Interior's Office of Insular Affairs (OIA) monitors and coordinates U.S. assistance to the FAS, and the Department of State conducts government-to-government relations.

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## U.S. Economic Assistance to FSM, RMI, and Palau

The FAS receive economic assistance in the form of compact grants and trust fund contributions as well as a range of U.S. federal programs and services. Some of the economic assistance is provided for defined time periods. Assistance is subject to specified accountability structures and audit requirements. The assistance structures of the FSM and RMI compacts are very similar to each other but differ from the assistance structure for Palau. For example, the compact trust funds for FSM and

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<sup>13</sup>Compact of Free Association Act of 1985, Pub. L. No. 99-239, 99 Stat. 1770 (Jan. 14, 1986).

<sup>14</sup>While Congress approved the Palau Compact in 1986, see Pub. L. No. 99-658, 100 Stat. 3672 (Nov. 14, 1986), the compact did not enter into force until 1994 following approval by the government of Palau in accordance with its constitutional processes and by a United Nations-observed plebiscite. See Proc. No. 6726, 59 Fed. Reg. 49,777 (Sept. 27, 1994).

<sup>15</sup>GAO, *Compacts of Free Association: Populations in U.S. Areas Have Grown, with Varying Reported Effects*, [GAO-20-491](#) (Washington, D.C.: June 15, 2020).

<sup>16</sup>See Compact of Free Association Amendments Act of 2003, Pub. L. No. 108-188, 117 Stat. 2720 (Dec. 17, 2003). The amended compacts and related agreements entered into force in 2004. See Treaties and Other International Acts Series (T.I.A.S.) 04-0501 (RMI) and T.I.A.S. 04-0625 (FSM).

<sup>17</sup>The Compact Review Agreement, reached pursuant to Section 432 of the Palau compact providing for periodic formal review of compact terms, consists of an agreement signed at Honolulu in 2010, with appendices, as amended by an agreement signed at Koror, Palau in 2018. See T.I.A.S. 18-919.

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RMI were designed to provide ongoing revenue to the respective governments for an indefinite period after FY 2023, while the compact trust fund for Palau—a “sinking fund”—was designed to provide revenue only until FY 2045.<sup>18</sup>

### FSM and RMI Economic Assistance Provisions

#### **U.S. Compact Grant and Trust Fund Contributions to FSM and RMI**

The U.S. provided about \$2.6 billion in funding for FSM and RMI, including about \$1.6 billion for FSM and about \$1.1 billion for RMI, for FYs 1987 through 2003.<sup>19</sup> In 2003, Congress approved amended compacts with the two countries. Assistance provided pursuant to the amended compacts is projected to total \$3.6 billion—around \$2.1 billion for FSM and \$1.4 billion for RMI. This assistance includes compact sector grants and trust fund contributions for both countries from FY 2004 through FY 2023, according to Interior, which has been providing the funding and economic assistance.<sup>20</sup> While the base amounts of direct U.S. financial assistance have decreased in most years, amounts equal to these annual decrements have been added to the amounts deposited in the two nations’ trust funds established under their amended compacts.

Under the amended compacts, grants provide support for the countries in six core sectors—education, health, infrastructure, environment, private

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<sup>18</sup>A sinking fund is not designed to provide ongoing revenue and instead is designed to last only through a particular date.

<sup>19</sup>See Department of the Interior, Office of Insular Affairs, *Budget Justifications and Performance Information, Fiscal Year 2021*.

<sup>20</sup>See Department of the Interior, Office of Insular Affairs, *Budget Justifications and Performance Information, Fiscal Year 2021*. The Compact of Free Association Act of 1985 provided for potential compensation of up to \$40 million to FSM and up to \$20 million to RMI if the respective government could demonstrate adverse impacts on its finances and economy as a result of the effects of Title IV of Public Law 99-239 on the compacts’ Title II provisions on tax and trade. The Compact of Free Association Amendments Act of 2003 referred to that provision and carried it forward in section 108(b). After RMI submitted a report on this matter, an interagency group convened by State concluded that RMI had reasonably demonstrated net adverse impacts, offset by the value of additional U.S. federal programs and services provided, based on the loss of Title II benefits in requesting \$20 million in further compensation under Section 111(d) of the Compact of Free Association Act of 1985. Per the terms of the amended compact, the \$20 million would be deposited into the compact trust fund. OIA’s enacted budgets for fiscal years 2020 and 2021 included a \$5 million dollar payment for each year to the Trust Fund for the People of the Republic of the Marshall Islands for Tax and Trade compensation.

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sector development, and public sector capacity building—prioritizing the education and health sectors.<sup>21</sup> The RMI compact states that RMI must target a specified amount of grant funding to Ebeye and other communities within Kwajalein Atoll.<sup>22</sup> The RMI Military Use and Operating Rights Agreement states that the Kwajalein-related funds provided to RMI in the compacts shall be provided through FY 2023 “and thereafter for as long as this agreement remains in effect.”<sup>23</sup>

### **FSM and RMI Joint Management Committees**

The amended compacts for FSM and RMI and their subsidiary fiscal procedures agreements established committees to oversee compact grants to the two countries—the Joint Economic Management Committee (JEMCO) for FSM and the Joint Economic Management and Financial Accountability Committee (JEMFAC) for RMI. Each five-member committee comprises three representatives from the U.S. government and two representatives from the corresponding country, with the Director of OIA serving as the chair.

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<sup>21</sup>These grants are described in section 211(a) of each compact and are referred to as compact sector grants or 211(a) grants. These grants are partially adjusted for inflation. Both compacts also provide annual grants to fund the cost of required annual audits. The amount provided is not adjusted for inflation and is equal to the lesser of (1) one-half of the cost of the annual audit or (2) \$500,000.

<sup>22</sup>These grants are described in section 211(b) of the RMI compact. In addition, section 212 of the RMI compact states that the U.S. shall provide \$15 million in fiscal year 2004 for U.S. military use and operating rights. This amount was to be partially adjusted for inflation from fiscal year 2005 through fiscal year 2013. In fiscal year 2014, the amount was to be revised to \$18 million or the amount provided in fiscal year 2013 partially adjusted for inflation, whichever amount was greater. In subsequent years, the payment was to be based on the amount provided in fiscal year 2014, partially adjusted for inflation. The RMI government uses the section 212 funds to compensate landowners on the Kwajalein Atoll.

<sup>23</sup>Agreement Regarding the Military Use and Operating Rights of the Government of the United States in the Republic of the Marshall Islands Concluded Pursuant to Sections 321 and 323 of the Compact of Free Association, as Amended,” accessed October 20, 2021, <https://www.doi.gov/oia/budget/authorities-public-law>. The agreement—which this report refers to as a subsidiary agreement between the U.S. and the Marshall Islands—extends until 2066, and the U.S. may renew it for an additional 20 years to 2086. The U.S. may terminate the RMI Military Use and Operating Rights Agreement after 2023 with 7 years advance notice. If termination occurs prior to 2053, the U.S. is required to make a termination payment equivalent to 1 or more years of annual grant assistance, depending on when the agreement is terminated.



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JEMCO and JEMFAC conduct oversight such as reviewing audits, which the compacts call for. In addition, JEMCO and JEMFAC allocate grants and—through resolutions that members discuss and vote on during the generally biannual meetings—may attach terms and conditions to grant awards to improve program performance and fiscal accountability. OIA administers and oversees the FSM and RMI compact sector grants and supplemental education grant (SEG).

### **FSM and RMI Compact Trust Fund Structure**

Investment returns from the FSM and RMI compact trust funds are intended to provide an annual source of revenue after compact sector grants end after FY 2023. FSM and RMI are not allowed to receive disbursements from the compact trust funds until October 2023, the start of FY 2024.<sup>24</sup> We define the maximum allowable disbursement<sup>25</sup> from each compact trust fund from FY 2024 onward as the amount of FY 2023 annual grant assistance, as defined by the trust fund agreement, with full

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<sup>24</sup>Pursuant to their respective trust fund agreements, each country's trust fund can make payments from the corpus (A) account for certain expenses, such as rental of hotel meeting space, but not for salaries, honoraria, travel, or per diem expenses, through September 30, 2022.

<sup>25</sup>Beginning in FY 2025, the disbursement can include additional amounts for special needs as approved by the trust fund committees. Special needs are defined as projects that the government of the FSM or RMI deems necessary as a supplement to that portion of an annual budget to be financed by the compact trust funds, so long as the projects are for the purposes of Section 211 of the compact, as amended, and are decided on by the trust fund committees.

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adjustment for inflation.<sup>26</sup> The compact trust fund agreements do not establish or guarantee a minimum disbursement level.

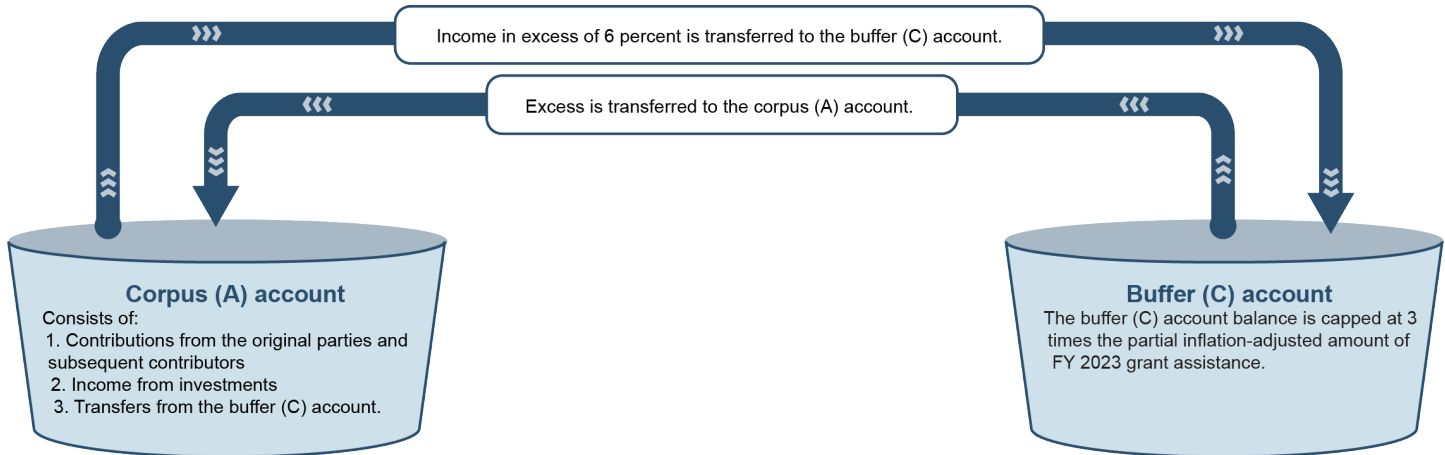
Each country's compact trust fund consists of three interrelated accounts: the corpus (A) account; the buffer (C) account; and the disbursement (B) account, which is to be created at the beginning of FY 2023, on October 1, 2022.<sup>27</sup> Figure 2 shows the compact trust fund account structure and associated rules for the FSM and RMI compact trust funds before FY 2023.

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<sup>26</sup>The trust fund agreements do not use the term "maximum allowable disbursement." However, under the trust fund agreements, the maximum allowed disbursement in FY 2024 is estimated with full adjustment for inflation and with a cumulative full inflation adjustment thereafter. The FSM agreement defines annual grant assistance as annual monetary assistance provided for the purposes set forth in section 211 of the compact as amended. The RMI compact trust fund agreement defines annual grant assistance as annual monetary assistance provided for the purposes set forth in subsections (a), (d), and (e) of section 211 of the compact, as amended. The agreement thus excludes from the calculation of the allowed disbursement the amount of the Kwajalein-related assistance defined in section 211(b) of the RMI compact as well as the humanitarian assistance defined at section 211(c) of the RMI compact. Full inflation is defined as the full percentage change in the U.S. GDP implicit price deflator in the applicable fiscal year compared with the immediate preceding fiscal year. Our definition of maximum allowable disbursement does not include amounts for special needs as approved by the trust fund committees. Special needs are defined as projects that the government of the FSM or RMI deems necessary as a supplement to that portion of an annual budget to be financed by the compact trust funds, so long as the projects are for the purposes of Section 211 of the compact, as amended, and are decided on by the trust fund committees.

<sup>27</sup>The compact trust fund agreements do not use the term "buffer" for the (C) account. For the purpose of this report, we refer to the "(C) account" as the "buffer (C) account."

**Figure 2: Account Structure and Associated Rules for FSM and RMI Compact Trust Funds before Fiscal Year 2023**



**On October 1, 2022, the disbursement (B) account is to be created.**

Source: GAO analysis of Federated States of Micronesia (FSM) and Republic of the Marshall Islands (RMI) Compact Trust Fund Agreements. | GAO-22-104436

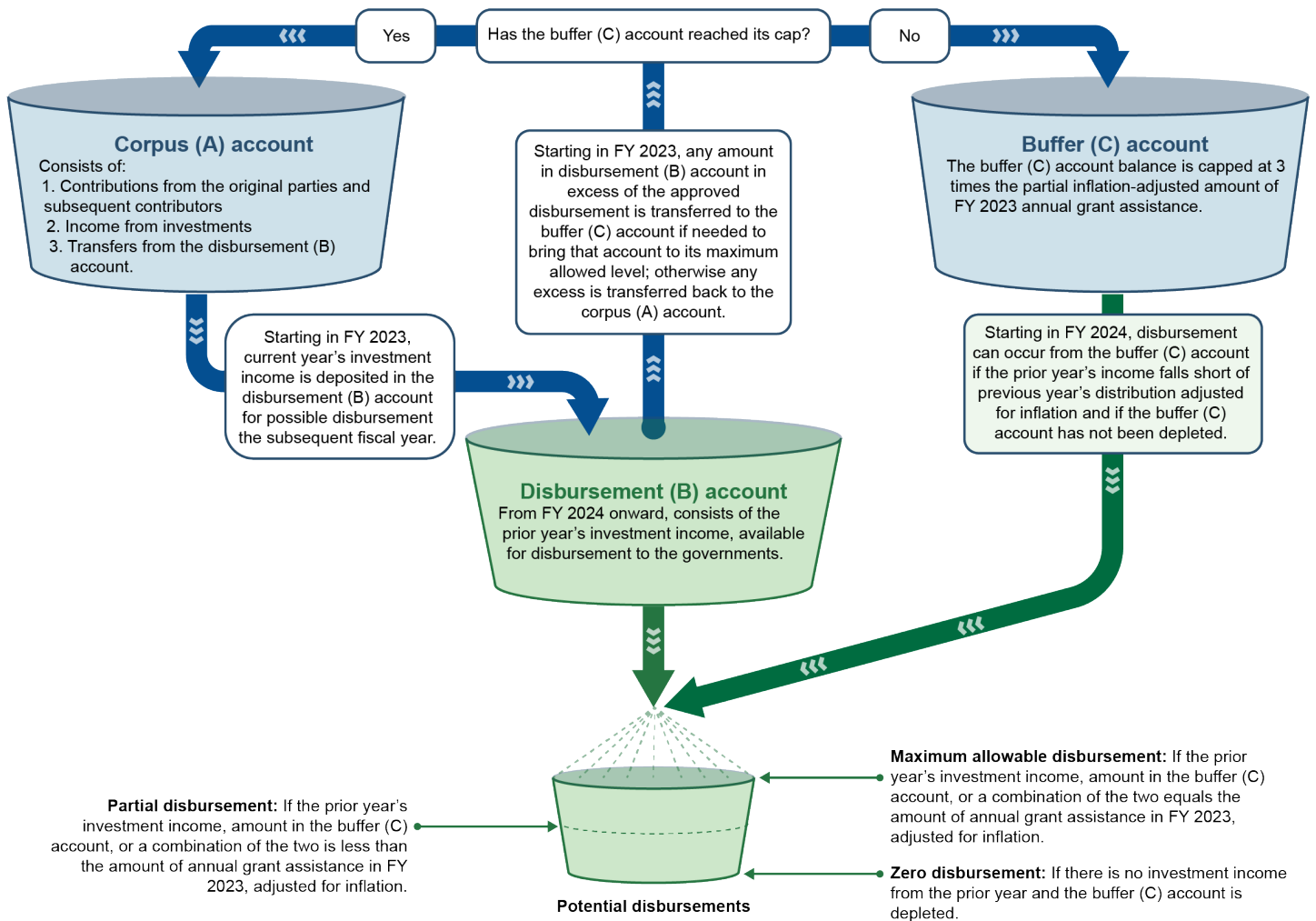
Note: The compact agreements do not use the term "buffer (C) account."

The corpus (A) account contains the initial, and any additional, U.S. and FSM or RMI contributions; contributions from subsequent contributors; and investment earnings.<sup>28</sup> No funds, other than specified trust fund administrative expenses, may be disbursed from the corpus (A) account. Through FY 2022, any annual income exceeding 6 percent of the fund balance is deposited in the buffer (C) account. If the buffer (C) account's balance has reached its maximum level (i.e., three times the partial inflation-adjusted amount of FY 2023 annual grant assistance), the excess amount is returned to the corpus (A) account. Because FSM and RMI are not allowed to receive disbursements from the compact trust funds until the start of FY 2024, the corpus (A), disbursement (B), and buffer (C) accounts cannot be used to disburse funds until that time.

<sup>28</sup>Each compact trust fund maintains a portfolio of assets, such as bonds, stocks, and other holdings. Investment strategies vary in their levels of returns and volatility. A more conservative investment strategy usually carries a lower level of volatility but also brings lower expected returns over time; a more aggressive investment strategy seeks higher returns but is likely to have higher volatility, with returns on the investment varying more widely year to year. By varying the weight of each investment asset, investors can vary their return and risk levels.

Figure 3 shows the compact trust fund account structure and associated rules starting in FY 2023 and potential disbursements for the FSM and RMI compact trust funds starting in FY 2024.

**Figure 3: Account Structure and Associated Rules, Starting in Fiscal Year (FY) 2023, and Potential Disbursements for FSM and RMI Compact Trust Funds, Starting in FY 2024**



Not directly disbursement related  
Disbursement related

Source: GAO analysis of Federated States of Micronesia (FSM) and Republic of the Marshall Islands (RMI) Compact Trust Fund Agreements. | GAO-22-104436

Notes: Annual disbursement is limited to inflation-adjusted compact annual grant assistance in FY 2023, plus any amounts for special needs approved by the Trust Fund Committees if funds are available in the disbursement (B) account or buffer (C) account.

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The disbursement (B) account is to be created on October 1, 2022.

The compact agreements do not use the term “buffer (C) account.”

All income earned in FY 2023 will be deposited in the disbursement (B) account for possible disbursement in FY 2024. Each subsequent year’s investment income from the corpus (A) account will be deposited in the disbursement (B) account for possible disbursement or transfer to the corpus (A) or buffer (C) account the following year.<sup>29</sup> If there is no investment income, no funds will be deposited in the disbursement (B) account.

From FY 2023 onward, if annual income from the corpus (A) account is less than the previous year’s disbursement, adjusted for inflation, the buffer (C) account may be tapped to address the shortfall. After FY 2023, any funds in the disbursement (B) account in excess of the amount approved for disbursement the following fiscal year are to be used to replenish the buffer (C) account as needed, up to the maximum size of the account. The size of the buffer (C) account is capped at three times the amount of the estimated compact annual grant assistance in FY 2023 and is partially adjusted for inflation according to a formula set forth in section 217 of the FSM compact and section 218 of the RMI compact. If there are no funds in the buffer (C) account and no prior-year investment income in the disbursement (B) account, no funds will be available for disbursement to the countries in the current year.

According to the U.S. trust fund agreements with FSM and RMI, contributions to the compact trust funds from other donors are permitted. In May 2005, Taiwan and RMI reached an agreement that Taiwan will contribute a total of \$40 million to RMI’s compact trust fund corpus (A) account between 2004 and 2023.

A “D” account may also be established to hold any contributions by the FSM and RMI governments of revenue or income from unanticipated sources. According to the trust fund agreements, the D account must be a separate account, not mixed with the rest of the trust fund. RMI has a D account, governed in part by an agreement between Taiwan and RMI.

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<sup>29</sup>Beginning in fiscal year 2023, the trust fund committees shall transfer to the corpus (A) account any funds in the disbursement (B) account in excess of the amount approved for disbursement in the following fiscal year, unless such excess funds are needed to bring the buffer (C) account to the maximum level set by the trust fund agreements.

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## **FSM and RMI Compact Trust Fund Committees**

The amended compacts and their subsidiary trust fund agreements provided that the FSM and RMI trust funds are to be managed by compact trust fund committees.<sup>30</sup> Each compact trust fund committee includes representatives from the U.S. and the respective country, but the trust fund agreements require that the U.S. hold the majority of votes on each committee. The Director of OIA chairs each committee.

Trust fund committee responsibilities include overseeing fund operation, supervision, and management; investing and distributing the fund's resources; and making arrangements with subsequent contributors. The committees' oversight responsibilities also include establishing an investment and distribution policy. In addition, the committees are to determine fiscal procedures to be used in implementing the trust fund agreements, based on the fiscal procedures used for compact grant administration, unless otherwise agreed by the parties to the agreement.

## **Palau Economic Assistance Provisions**

### **U.S. Compact Grant and Trust Fund Contributions to Palau**

According to Interior, the U.S. provided, pursuant to Palau's compact, almost \$574 million for FYs 1995 through 2009 for assistance to the government, contributions to a trust fund, construction of a road, and federal services.<sup>31</sup> On September 19, 2018, the Compact Review Agreement entered into force, extending a variety of recurrent funding through FY 2024—for example, funding for infrastructure maintenance—

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<sup>30</sup>The trust fund agreements allow for written amendments at any time, with mutual consent of the U.S. and the FSM and RMI governments, respectively. However, the U.S. legislation approving the amended compacts requires that any amendment, change, or termination of all or any part of the compact trust fund agreements shall not enter into force until incorporated into an act of Congress.

<sup>31</sup>See Department of the Interior, Office of Insular Affairs, *Budget Justifications and Performance Information, Fiscal Year 2021*. A Federal Programs and Services agreement concluded pursuant to Article II of Title Two and Section 232 of the Palau compact sets up the legal status of programs and related services, federal agencies, U.S. contractors, and personnel of U.S. agencies implementing both compact federal services and discretionary federal programs. The agreement does not mandate the provision of discretionary programs in Palau. U.S. legislation establishes Palau's eligibility for these programs, with funding for the programs appropriated by Congress.

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and providing for additional trust fund contributions.<sup>32</sup> According to Interior, direct assistance to Palau will total over \$229 million for fiscal years 2010 through 2024, including \$105 million that Congress provided in annual appropriations in FYs 2010 through 2017.<sup>33</sup>

### Palau Advisory Group

The Compact Review Agreement required Palau and the U.S. to establish an Advisory Group on Economic Reform to contribute to Palau's long-term economic sustainability by recommending economic, financial, and management reforms. The Compact Review Agreement stated that the advisory group should be established effective on the day the agreement entered into force, which occurred in September 2018. The group was to be composed of five members, including two members designated by the President of Palau and two members designated by the U.S. government. The agreement also sets forth procedures by which the fifth member should be selected.<sup>34</sup>

The agreement states that the group shall recommend economic, financial, and management reforms and the schedule on which the reforms should be implemented. The agreement stipulates that the advisory group should meet twice a year, unless otherwise agreed by the members, until the group terminates at the end of fiscal year 2023, unless otherwise agreed by the governments of Palau and the U.S.

### Palau Compact Trust Fund Structure

Section 211(f) of the Palau compact required the U.S. to establish a trust fund for Palau with an initial investment of \$70 million by the compact's third year. The trust fund was established in 1994. In accordance with

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<sup>32</sup>The Compact Review Agreement consists of an agreement signed at Honolulu in 2010, with appendices, as amended by an agreement signed at Koror, Palau, in 2018. See T.I.A.S. 18-919. The U.S. provided stopgap funding from FY 2010 to FY 2017. In FY 2018, the U.S. provided almost \$112 million to Palau, of which about \$65 million was designated for the Palau compact trust fund.

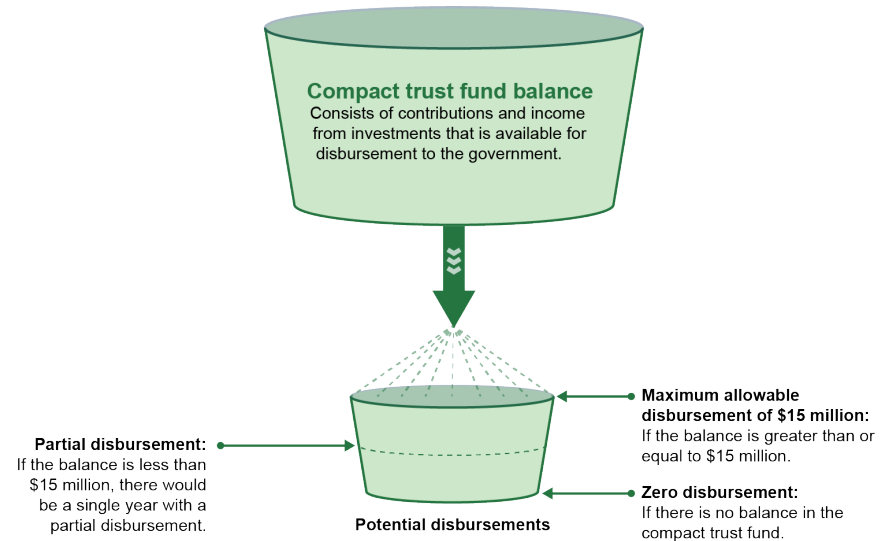
<sup>33</sup>See Department of the Interior, Office of Insular Affairs, *Budget Justifications and Performance Information, Fiscal Year 2021*.

<sup>34</sup>The fifth member is chosen by the U.S. government from a list of three or more persons who are not residents of Palau, submitted by the president of Palau. If the U.S. government rejects the persons enumerated in the list submitted by the president, the fifth member shall be chosen by the president of Palau from a list of three or more persons submitted by the U.S. government.

terms of the trust fund agreement, \$5 million in annual section 211(f) assistance has been available from the trust fund since FY 1999, although Palau did not begin taking this disbursement until FY 2002. An additional \$65.25 million in U.S. contributions was deposited into the fund in FY 2018, increasing the likelihood that the trust fund will be able to provide the maximum annual disbursements allowed by the trust fund agreement through FY 2044.<sup>35</sup> The current maximum allowable annual disbursement from the compact trust fund is \$15 million.<sup>36</sup>

Figure 4 shows the current disbursement structure for Palau's compact trust fund. As long as the balance of the compact trust fund is greater than or equal to \$15 million, Palau can receive the maximum allowable annual disbursement of \$15 million. If the balance were less than \$15 million, there would be a single year with a partial disbursement. The balance of the compact trust fund would then be depleted, and zero disbursements would occur for the subsequent years.

**Figure 4: Current Compact Trust Fund Disbursement Structure for Palau**



Source: GAO analysis of Republic of Palau compact trust fund documents. | GAO-22-104436

<sup>35</sup>Palau's compact trust fund—a sinking fund—was designed to provide revenue only until FY 2045.

<sup>36</sup>Palau began taking \$15 million in compact trust fund disbursements in fiscal year 2019, according to information in Palau's single audit reports.



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## Palau Compact Trust Fund Board

Palau's trust fund is managed exclusively by the Palau government. The Trust Fund Board of Trustees, composed of five members appointed by the President of Palau and confirmed by Palau's Senate, is tasked with the oversight and management of the trust fund. According to Palau officials, the Board of Trustees meets regularly each month to review and discuss the trust fund's investment performance. In addition, the board holds annual review meetings with each investment manager and the board's investment advisor.<sup>37</sup>

## Federal Programs and Services

Federal programs and services are provided to FSM, RMI, and Palau through compact agreements, compact implementing legislation, and other U.S. legislation.

**Compacts and relevant agreements.** Each compact extends certain programs and services agreements to FSM, RMI, or Palau.<sup>38</sup>

- **FSM and RMI.** The programs and services agreements with FSM and RMI identify the following programs and services as being available to each country: postal services, weather services, civil aviation, disaster preparedness and response, and telecommunications. In addition, the compact with FSM provides that the Bank of the Federated States of Micronesia is eligible for insurance from the Federal Deposit Insurance Corporation. The agreement with FSM ends on September 30, 2023, and the agreement with RMI ends on April 30, 2024. However, certain provisions of these agreements are subject to separate duration times.
- **Palau.** The programs and services agreement with Palau identifies the following programs and services as being available: postal services, weather services, and civil aviation. A separate agreement concluded pursuant to section 132 of the Palau compact addressed the operation of telecommunications services necessary for the U.S.

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<sup>37</sup>According to Palau officials, the current investment advisor is Raymond James & Associates' Asia Pacific Group, based in Guam.

<sup>38</sup>The specific nature, extent and contractual agreements of these programs and services as well as other arrangements in connection with a program or service provided by the United States are set forth in separate subsidiary programs and services agreements that entered into force simultaneously with each countries compact.

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to fulfil its obligations under the compact and related agreements. Provisions relating to the federal programs and services provided to Palau end on September 30, 2024. Certain provisions of the section 132 telecommunications agreement remain in force as long as the Palau Military Use and Operating Rights Agreement remains in force, but they can be terminated by mutual consent.<sup>39</sup> Other provisions of the telecommunications agreement expire on September 30, 2024.

**Compact implementing legislation.** The amended compacts' implementing legislation authorizes certain U.S. grants, programs, and services for FSM and RMI.<sup>40</sup> These include an annual supplemental education grant for FSM and RMI in fiscal years 2005 through 2023, to be awarded in place of grants formerly awarded to the countries under several U.S. education, health, and labor programs. FSM and RMI are not eligible for the programs replaced by the SEG<sup>41</sup> during these years.<sup>42</sup> Unlike the FSM and RMI compact sector grants, the amended compacts' implementing legislation authorized the SEG but did not appropriate funds for it. Funding for the SEG is appropriated annually to the U.S. Department of Education (Education) and transferred to Interior for disbursement.

Other provisions of the amended compacts' implementing legislation make FSM, RMI, and Palau eligible for a number of additional programs, including rural utilities service grants and loans from the U.S. Department of Agriculture. In addition, RMI is eligible for environment monitoring and

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<sup>39</sup>The Palau Military Use and Operating Rights Agreement remains in effect until 2044.

<sup>40</sup>See Pub. L. No. 108-188, §105(f).

<sup>41</sup>The amended compacts implementing legislation included a provision allowing Palau to remain eligible for grants under programs replaced by the SEG and under other specified provisions of law. See Pub. L. No. 108-188, § 105(f)(1)(B)(ix), 117 Stat. 2751 and Pub. L. No. 115-91, § 1259C(c), 131 Stat. 1283, 1687 (extending Palau's eligibility for programs replaced by the SEG through fiscal year 2024).

<sup>42</sup>The amended compacts' implementing legislation authorized annual appropriations of about \$12.2 million for the FSM and \$6.1 million for the RMI, adjusted for inflation, from 2005 through 2023. Permitted uses of the SEG include, among other things, support for direct educational services at the local school level, focused on school readiness, early childhood education, elementary 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. In fiscal year 2017, \$16.7 million was appropriated to the Secretary of Education to carry out the SEG program: of this amount Education provided \$11.1 million to the FSM and \$5.6 million to the RMI. For each country, this amount is lower than the authorized SEG amount and is also lower than the authorized amount after inflation adjustments.

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for a radiological health care program. Federal departments administer and oversee their respective programs in FSM, RMI, and Palau.

**Other U.S. legislation.** Other U.S. legislation authorizes grants and programs to FSM, RMI, and Palau. These include public health services, cooperative forest health protection, and an airport improvement program for all three countries as well as housing programs and historic preservation funds for FSM and RMI.

### Financial Accountability over U.S. Assistance

FSM, RMI, and Palau are required to submit annual single audit reports, within the meaning of the Single Audit Act as amended.<sup>43</sup> The single audits, which are a type of financial audit report, cover, among other things, the use of U.S. grants and are conducted by third-party auditors. Single audits are a critical element in the federal government's ability to ensure that federal funds are used properly and that federal agencies have information to fulfill their oversight responsibility for the funds they award to nonfederal entities.

A single audit report includes the following: (1) the entity's audited financial statements; (2) the schedule of expenditures of federal awards and the auditor's opinion on whether the schedule is reported fairly in relation to the financial statements as a whole; (3) the auditor's opinion (or disclaimer of opinion) regarding whether the auditee complied with the laws, regulations, and provisions of contracts and grant agreements (such as the compact), which could have a direct and material effect on each major federal program; and (4) a report of findings on internal controls related to federal programs. Auditors issue various types of opinions in audit reports—unmodified, qualified, or adverse.<sup>44</sup> The audit reports also include any findings related to material weaknesses or significant

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<sup>43</sup>Pub. L. No. 98-502, 98 Stat. 2327, as amended and codified at 31 U.S.C. § 7501 et seq. Currently, all nonfederal entities that expend \$750,000 or more of federal awards in a year are required to obtain an annual audit in accordance with the Single Audit Act, as amended. See 2 C.F.R. § 200.501(d).

<sup>44</sup>An unmodified opinion is given when the auditor is reasonably assured that the financial statements are free of material misstatements. A qualified opinion is given when the auditor obtains sufficient appropriate audit evidence but finds conditions such as a lack of supporting evidence or a restriction on the scope of the audit. An adverse opinion is given when the auditor concludes, after obtaining sufficient, appropriate evidence, that misstatements are both material and pervasive to the financial statements.

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deficiencies in internal controls or financial reporting.<sup>45</sup> In addition, the reports may include questioned costs.<sup>46</sup>

Federal award recipients are required to submit their single audit reporting packages to the Federal Audit Clearinghouse within the shorter of two time frames—either 30 days after receipt of the single audit report from the auditor or 9 months after the end of the award recipient’s fiscal year. Federal awarding agencies are to ensure that each award recipient submits its single audit reporting package to the Federal Audit Clearinghouse in accordance with the Office of Management and Budget’s (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) requirements. Under the time frames provided by the Single Audit Act and the OMB Uniform Guidance,<sup>47</sup> the award recipient must initiate corrective action for single audit findings within 15 months or provide a statement explaining why it believed the audit finding was not valid or a corrective action plan was not necessary.

For example, if a single audit report had identified a finding in fiscal year 2018 for an entity whose fiscal year ended on September 30, the award recipient would have been required to submit the report to the Federal Audit Clearinghouse—along with either a corrective action plan or a statement explaining why it believed the audit finding was not valid or a corrective action plan was not necessary—within 9 months after the fiscal year’s end, or no later than June 30, 2019. The federal awarding agency would then have had 6 months from receipt of the single audit report, or until December 31, 2019, to communicate a written management decision to the award recipient.

Award recipients’ actions to correct the single audit finding can be started as soon as possible but may be delayed. As a result, it may take up to 15

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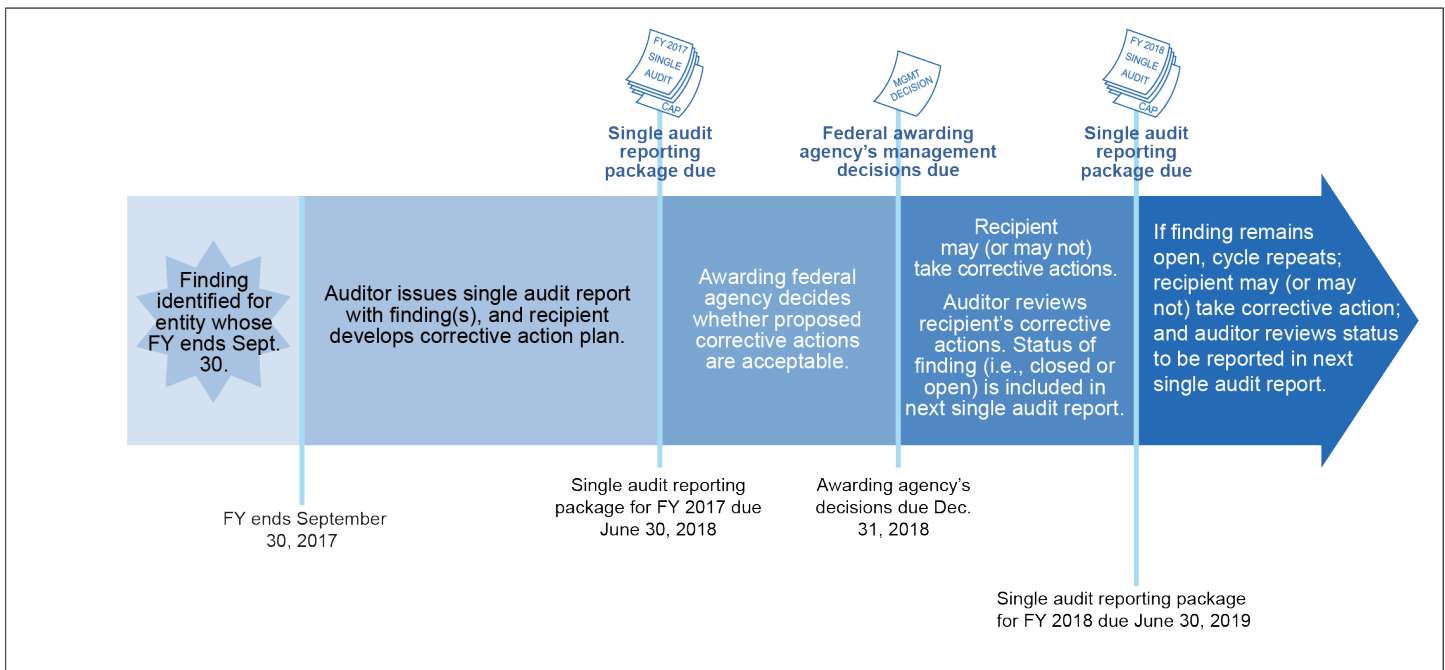
<sup>45</sup>A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented or will not be detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

<sup>46</sup>A questioned cost is a cost that is questioned by the third-party auditor for several reasons, such as the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost, at the time of the audit, was not supported by adequate documentation; or (3) the cost incurred appears unreasonable.

<sup>47</sup>2 C.F.R. Part 200.

months after the end of the fiscal year in which the single audit finding was initially identified before corrective action begins. Award recipients report their progress in a schedule of prior single audit findings, where the status of each finding is reported as either corrected (closed), partially corrected, or not corrected (open). The auditor then reviews this schedule and includes it in the next single audit report. When the awarding agency delays issuing a management decision to the award recipient, initiation of corrective action may also be delayed. As a result, the single audit finding may remain open. Figure 5 provides an illustrative timeline for single audit reports with findings.

**Figure 5: Illustrative Timeline for Single Audit Reports with Findings**



A finding can be a questioned cost, a matter of noncompliance, or an internal control deficiency or material weakness that exists in an entity's internal controls.



Single audit reporting package includes audited financial statements, auditor's reports on internal controls, recipient's corrective action plan to address each finding identified in the auditor's reports, and other schedules according to the Office of Management and Budget supercircular.



Federal awarding agency's written evaluation of recipient's proposed corrective action plan to address findings related to programs the agency administers. Management decision can concur with recipient's proposed corrective actions or provide other guidance to address the finding.

FY = fiscal year.

Source: GAO analysis of Office of Management and Budget Uniform Guidance requirements. | GAO-22-104436

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## Defense and Migration Related Compact Provisions

**Defense provisions.** Under the compacts, the U.S. has responsibility for defense and security matters in, and relating to, the FAS, and subsidiary agreements pursuant to the compacts provide for U.S. military use and operating rights in the three countries.<sup>48</sup> According to the Department of Defense (DOD), the compacts have enabled it to maintain a critical strategic position in the Indo-Pacific region.<sup>49</sup> The 1986 compact with RMI included an agreement to settle all claims resulting from nuclear tests that the U.S. conducted in the Marshall Islands from 1946 through 1958.<sup>50</sup> In addition, a subsidiary agreement with RMI secured U.S. access to the U.S. military facilities on Kwajalein Atoll, which are used for missile testing and space tracking activities.<sup>51</sup>

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<sup>48</sup>The Military Use and Operating Rights Agreements provide the U.S. with special and substantial access to, and control of, defense sites in each country.

<sup>49</sup>*Statement by Randall G. Schriver, Assistant Secretary of Defense for Indo-Pacific Security Affairs, Office of the Secretary of Defense, Before the U.S. House Committees on Foreign Affairs and Natural Resources, September 26, 2019.*

<sup>50</sup>The U.S. conducted nuclear tests in the Marshall Islands from 1946 to 1958. Under the agreement for the implementation of Section 177 of the compact (Section 177 Agreement), the U.S. government provided \$150 million to the Marshall Islands to establish a nuclear claims fund and an independent Nuclear Claims Tribunal to adjudicate all claims. While the Section 177 Agreement constituted a full and final settlement of all claims resulting from the U.S. nuclear testing program, Article IX of the Section 177 Agreement, titled “Changed Circumstances,” provides for the government of the Marshall Islands to request the U.S. Congress to consider the provision of additional compensation for injuries resulting from the U.S. nuclear testing program in the circumstances specified. Article IX provides that “[i]f loss or damage to property and person of the citizens of the Marshall Islands, resulting from the Nuclear Testing Program, arises or is discovered after the effective date of this Agreement, and such injuries were not and could not reasonably have been identified as of the effective date of this Agreement, and if such injuries render the provisions of this Agreement manifestly inadequate,” the government of the Marshall Islands may request that the U.S. government provide additional compensation for such injuries by submitting such a request to the U.S. Congress. Article IX explicitly states that it is understood that it does not commit Congress to authorize and appropriate funds. The government of the Marshall Islands submitted such a petition in September 2000. In November 2004, the Executive Branch provided a report evaluating this petition. The report advised that the facts did not constitute changed circumstances warranting compensation beyond the \$150 million contained in the compact.

<sup>51</sup>RMI hosts the U.S. Army Kwajalein Atoll Ronald Reagan Ballistic Missile Test Site. See GAO, *Foreign Relations: Kwajalein Atoll Is the Key U.S. Defense Interest in Two Micronesian Nations*, [GAO-02-119](#) (Washington, D.C.: Jan. 22, 2002).

According to DOD, the U.S. is working in Palau to provide coastal surveillance systems and technical support critical to improve maritime domain awareness and enhance Palau's maritime law enforcement capability. Further, DOD components have engaged in military exercises with Palau; provided training to Palau for defense-related equipment; and supported infrastructure projects, such as expansion of Palau's airstrips.

**Migration provisions.** Under the compacts, eligible FAS citizens are exempt from certain visa and labor certification requirements of the Immigration and Nationality Act as amended.<sup>52</sup> The migration-related provisions of the compacts allow eligible FAS citizens to be admitted into the U.S. (including all states, territories, and possessions) without a visa and to lawfully work and reside in the U.S. indefinitely.<sup>53</sup> In 2020, we reported that compact migrants move to U.S. areas for a range of reasons, including greater economic and educational opportunities, better access to health care, a desire to join family members in the U.S., and greater personal freedom.<sup>54</sup>

In December 2003, Congress took steps in the FSM and RMI amended compacts' implementing legislation to help defray affected U.S. jurisdictions' costs for migrant services in designated U.S. areas.<sup>55</sup> The implementing legislation for the amended compacts authorized and

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<sup>52</sup>The compacts of free association use the term "immigration" when referring to these provisions. For the purposes of this report, we refer to them as migration provisions.

<sup>53</sup>Compact migrants from Micronesia and the Marshall Islands must have a valid machine-readable passport to be admitted into the U.S. While the compacts allow eligible FAS citizens to work in the U.S., documentation issued by the U.S. government may be required to demonstrate work authorization to employers. For example, an FAS citizen from Micronesia or the Marshall Islands may present an unexpired FAS passport and Form I-94 Arrival/Departure Record (known as Form I-94) to employers to demonstrate identity and employment authorization.

<sup>54</sup>[GAO-20-491](#).

<sup>55</sup>See Pub. L. No. 108-188, § 104(e)(3). The amended compacts' implementing legislation also "authorized to be appropriated to the Secretary of the Interior such sums as may be necessary to reimburse health care institutions in the affected jurisdictions for costs resulting from the migration of citizens of the Republic of the Marshall Islands, the Federated States of Micronesia and the Republic of Palau to the affected jurisdictions as a result of the implementation of the [compacts]." The amended compacts' implementing legislation requires the Secretary of Defense to make DOD medical facilities available to properly referred citizens of Micronesia and the Marshall Islands on a space-available and reimbursable basis. Pub. L. No. 108-188, § 104(e)(6), (e)(7).

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appropriated \$30 million for each fiscal year from 2004 through 2023 for grants to the affected jurisdictions.<sup>56</sup>

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## Prior GAO Reporting and Findings on Compacts of Free Association Topics

We have previously reported and made recommendations on topics such as assistance provided under the compacts with FSM, RMI, and Palau; accountability over funds; and compact trust fund disbursement. For example:

- **Compact assistance.** In 2005 we reported, among other things, that grant administration and oversight could be improved for assistance provided to FSM and RMI.<sup>57</sup> Specifically, we found that compact sector grant allocations were not clearly tied to broad development goals and that the extent to which existing grants contribute to the countries' long-term development was therefore unclear. We recommended, among other things, that Interior, in coordination with other U.S. agencies that participate in FSM's JEMCO and RMI's JEMFAC, work with the FSM and RMI governments to establish compact sector grant levels that would assist in promoting long-term development goals such as economic advancement and budgetary self-reliance. Interior agreed with these recommendations but has not implemented them.<sup>58</sup>
- **Accountability over funds.** In 2013 we found, among other things, that the single audit reports we reviewed indicated challenges to ensuring accountability for compact and other U.S. assistance in FSM

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<sup>56</sup>The amended compacts' implementing legislation defined the affected jurisdictions as Guam, Hawaii, the Commonwealth of the Northern Mariana Islands, and American Samoa. Interior allocates the \$30 million as impact grants in proportion to the population of compact migrants enumerated as required every 5 years. At the end of FY 2023, the period of availability for the obligation of the \$30 million in annual compact impact assistance grants expires.

<sup>57</sup>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).

<sup>58</sup>In accordance with our policy, after 4 years we designated the recommendation "Closed—not implemented" after determining that Interior had not taken steps to address it. Therefore, we have not assessed any recent actions that Interior may have taken with respect to the recommendation.



and RMI.<sup>59</sup> Specifically, the governments' single audits showed repeated findings and persistent problems in noncompliance with U.S. program requirements, such as accounting for equipment. We recommended that Interior ensure that FSM and RMI address audit findings in a timely manner. In addition, in 2008, we found that Palau's single audit reports showed that Palau's internal controls over financial reporting and its compliance with federal award requirements had persistent weaknesses and that Palau had limited capacity to address these weaknesses in a timely manner.<sup>60</sup> We recommended that Interior formally consult with the government of Palau regarding Palau's financial management challenges and target future technical assistance toward building Palau's financial management capacity. Interior agreed with, and implemented, our 2008 recommendation. Interior also generally agreed with our 2013 recommendation but has not implemented it.<sup>61</sup>

- **Compact trust fund disbursement.** In 2018, we reported that disbursements from the compact trust funds for FSM and RMI faced risks that the trust fund committees had not addressed.<sup>62</sup> We recommended, among other things, that Interior work with other members of the committees to develop a distribution policy for the FSM and RMI compact trust funds, as required by the compact trust fund agreements, that takes into account potential strategies that could address risks to the funds' ability to provide a source of income after fiscal year 2023. We made six recommendations—three pertaining to FSM and three pertaining to RMI. Interior concurred with the recommendations and indicated that the target date for implementing all of them was October 1, 2023. More recently, we included our 2018 recommendations in a 2021 priority letter to the Secretary of the Interior.<sup>63</sup> The priority letter noted that these

<sup>59</sup>GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, [GAO-13-675](#) (Washington, D.C.: Sept. 20, 2013).

<sup>60</sup>GAO, *Compacts of Free Association: Palau's Use of and Accountability for U.S. Assistance and Prospects for Economic Self-Sufficiency*, [GAO-08-732](#) (Washington, D.C.: June 10, 2008).

<sup>61</sup>In accordance with our policy, after 4 years we designated the recommendation "Closed—not implemented" after determining that Interior had not taken steps to address it. Therefore, we have not assessed any recent actions that Interior may have taken with respect to the recommendation.

<sup>62</sup>[GAO-18-415](#).

<sup>63</sup>GAO, *Priority Open Recommendations: Department of the Interior*, [GAO-21-535PR](#) (Washington, D.C.: June 22, 2021).

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recommendations call for Interior to work with the compact trust fund committee for each nation to develop distribution policies and fiscal procedures for the trust funds and to address the timing of trust fund disbursements. We noted that ongoing bilateral negotiations between the governments of both nations and the U.S. government may address our recommendations or modify the trust fund structures in the future and that addressing these issues would help to reduce the risks to the availability of future trust fund disbursements.

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## FSM: Use and Role of U.S. Funds, Projected Fiscal Effects of Expiring Assistance, and Record of Accountability

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### U.S. Compact and Other Grants Cover More than One-Third of FSM National and State Government Expenditures

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U.S. assistance provides a substantial percentage of the FSM national and state governments' budget expenditures for programs. Compact grants, the SEG, and other U.S. grants—about \$83 million in total—supported more than one-third of FSM national and state government expenditures in FY 2019 (the most recent data available during our audit).<sup>64</sup> In addition, the FSM government relies on programs and services provided pursuant to its programs and services agreement that are scheduled to end on September 30, 2023 but are not reflected as part of the government's expenditures. Compact grants and the SEG that are scheduled to end after FY 2023 supported 28 percent of FSM national and state government expenditures in FY 2019, while other U.S. grants supported an additional 8 percent of total FSM government expenditures (see fig. 6).<sup>65</sup> (App. III provides additional information, by year, about U.S. assistance provided to the FSM national and state governments, as reflected in the governments' expenditures for FYs 2015 through 2019.)

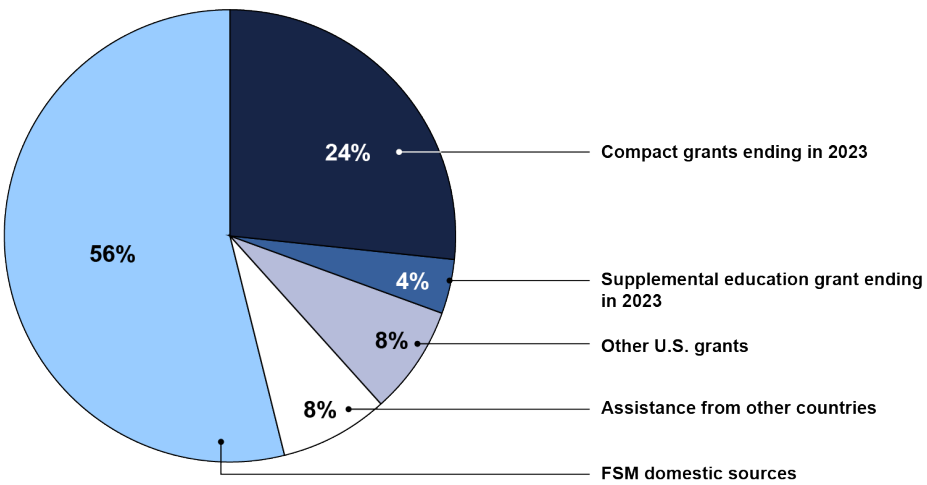
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<sup>64</sup>Throughout this report, we present observations about the status of grants and programs under current U.S. law. Changes to the relevant laws before 2023 could alter FSM's eligibility status. The availability of some grants and programs in the future is subject to the availability of appropriations provided for that purpose.

<sup>65</sup>A small number of other compact-related grants are set to end in 2023, such as Interior grants for FSM audits of funds and emergency management performance grants, according to agency officials.

**Figure 6: Total Expenditures of FSM National and State Governments, by Source, Fiscal Year 2019**

FY 2019 total expenditures = \$232.7 million



Source: GAO analysis of the Federated States of Micronesia (FSM) national and state single audits for fiscal year 2019. | GAO-22-104436

**Accessible Data Table for Figure 6**

FSM	Percent
Compact grant ending in 2023	24%
Supplemental education grants ending in 2023	4%
Other U.S. grants	8%
Assistance from other countries	8%
FSM domestic sources	56%

Notes: The percentages shown do not include government component units, such as the College of Micronesia and public utilities. While the supplemental education grant ends in 2023, agency officials noted that FSM would be eligible for some programs that the grant replaced. A small number of other U.S. grants also end after FY 2023, according to agency officials. Information depicted does not include programs and services provided in the compact that are scheduled to end in 2023 but are not reflected as part of the government's expenditures.

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### Compact Sector and Supplemental Education Grants

The compact sector grants are intended to provide support for the FSM national and state governments in six core sectors: education, health, infrastructure, environment, private sector development, and public sector capacity building.<sup>66</sup> In addition, the SEG provides support for educational services at the local school level, focused on school readiness, early childhood education, elementary and secondary education, vocational training, adult and family literacy, and students' transition from high school to postsecondary educational pursuits or careers. The health and education sectors represented 72 percent of total sector grant expenditures in FY 2019 for the FSM national and state governments—34 percent for health and 38 percent for education.<sup>67</sup> For the status of all compact-related grants to FSM, see appendix IV.

FSM state governments rely on U.S. assistance for expenditures more than the FSM national government does. In FY 2019, compact sector grants and the SEG together supported 1 percent of national government expenditures but about 50 percent or more of each state's government expenditures. Among the FSM states, Chuuk, the largest state and the one with the lowest per capita income, had the highest percentage of expenditures—64 percent—supported by compact sector grants and SEG. See table 2 for a summary of FSM national and state government expenditures supported by compact sector grants and the SEG and by other U.S. grants for fiscal year 2019. See appendix IV for compact and other grants related to education provided to FSM.

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<sup>66</sup>In 2011, JEMCO agreed on a resolution to create an additional sector—enhanced reporting and accountability—to support FSM's efforts to address the complexities and costs of complying with budgeting, financial accountability, and financial and reporting requirements specified in the amended compact. The U.S. and FSM created this sector in 2012 and have supported it with grant funds. According to Interior officials, FSM includes allocation requests for this sector in its annual submissions to JEMCO, and JEMCO has approved such requests.

<sup>67</sup>These percentages do not include the SEG, which represented 15 percent of FSM's total sector grants and SEG expenditures combined in FY 2019.

**Table 2: FSM National and State Government Expenditures of Compact Grants, SEG, and Other U.S. Grants in Fiscal Year 2019**

Dollars in millions

	Expenditures of compact sector grants and SEG <sup>a</sup>			Expenditures of other U.S. grants		Total expenditures of compact sector, SEG, and other U.S. grants	
	Total government expenditures (dollars)	Amount (dollars)	Percentage of total government expenditures	Amount (dollars)	Percentage of total government expenditures	Amount (dollars)	Percentage of total government expenditures
FSM national government	119.4	1.8	1	8.3	7	10.1	8
FSM states							
Chuuk	38.2	24.5	64	2.2	6	26.7	70
Kosrae	12.7	7.5	59	1.7	14	9.3	73
Pohnpei	39.5	20.1	51	2.8	7	22.8	58
Yap	22.8	11.0	48	2.7	12	13.7	60
<b>Total</b>	<b>232.6</b>	<b>64.9</b>	<b>28</b>	<b>17.7</b>	<b>8</b>	<b>82.6</b>	<b>36</b>

Legend: FSM = Federated States of Micronesia; SEG = supplemental education grant.

Source: GAO analysis of FSM national and state government fiscal year 2019 single audit reports. | GAO-22-104436

Note: Expenditures and percentages shown have been rounded.

<sup>a</sup>Amounts and percentages shown do not include FSM national and state government component units, such as public utilities and port authorities.

Compact sector grants and the SEG also support a high proportion of FSM states' health and education expenditures.<sup>68</sup> In FY 2019, compact sector grants and the SEG supported 63 percent or more of states' health expenditures and 86 percent or more of states' education expenditures. Table 3 shows the states' health and education expenditures of compact sector grants and the SEG in FY 2019.

<sup>68</sup>The compact sector grants for the FSM education and health sectors provide support for advancing education in FSM and improve the delivery of preventative and curative care and improve the financial resources for delivery of such care, among other things.

**Table 3: FSM States' Health and Education Expenditures of Compact Grants and Supplemental Education Grant (SEG), Fiscal Year 2019**

Dollars in millions

Sector and state	Total government expenditures (dollars)	Expenditures of compact sector grants and SEG <sup>a</sup>	
		Amount (dollars)	Percentage of total expenditures
Education			
Chuuk	13.1	12.2	93
Kosrae	4.5	4.0	88
Pohnpei	11.6	10.2	88
Yap	6.7	5.7	86
Health			
Chuuk	11.4	9.9	86
Kosrae	3.5	2.4	70
Pohnpei	9.6	6.0	63
Yap	6.2	4.2	67

Source: GAO analysis of the Federated States of Micronesia (FSM) states' fiscal year 2019 single audit reports. | GAO-22-104436

Note: Expenditures and percentages shown have been rounded.

<sup>a</sup>The SEG was used only in the education sector. The amounts and percentages shown for the education sector do not include the College of Micronesia.

### Federal Programs and Services

FSM receives U.S. assistance in the form of postal, weather, aviation services, and disaster assistance as outlined in the FSM's compact's Federal Programs and Services Agreement. However, unlike the compact sector grants, SEG, and other U.S. grants, these services are not reflected in FSM government expenditures. Rather, in some cases, U.S. agencies incur costs for the services.<sup>69</sup> In addition, the Federal Emergency Management Agency provides disaster response funding and management to FSM, and the Federal Deposit Insurance Corporation provides deposit insurance for only the Bank of the Federated States of Micronesia.

<sup>69</sup>According to U.S. Postal Service (USPS) officials, under the current arrangement with the U.S., postage rates for mail from the U.S. to the FAS are maintained at domestic levels, which are lower than international rates. If the agreements lapse, USPS will no longer bear the costs of subsidizing shipping and mail prices for the FAS, according to USPS officials.

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While most provisions of the FSM Federal Programs and Services agreement expire September 30, 2023, some will remain in force. Moreover, some of the programs and services scheduled to expire pursuant to that agreement could continue under other legal authorities, according to agency officials (see app. IV for additional information about federal programs and services that support the FSM government).

### Other U.S. Grants

The FSM government is eligible for, and receives, other U.S. grants, including assistance for agriculture and health services, as reported by U.S. agencies (see app. IV for a list and descriptions of U.S. grants for which FSM is eligible, according to information provided by agencies). In FY 2019, FSM recorded expenditures of U.S. grants provided by agencies such as the Departments of Agriculture, Commerce, Transportation, and Health and Human Services.

In addition to the national and state governments, other FSM entities have also received U.S. grants. For example, the College of Micronesia and Pohnpei Utilities Corporation used U.S. funding for their operations during the FYs 2015 through 2019.

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## Ending of U.S. Grants Will Cause Fiscal Gaps for FSM National and State Governments, and Risks to Compact Trust Fund Disbursements Continue

According to our projections, the scheduled ending of some U.S. grants after FY 2023 will result in fiscal gaps for FSM's national and state governments, leading to shortfalls in the governments' ability to financially support the nation.<sup>70</sup> In total, an estimated \$108.93 million worth of annual U.S. grants, programs, and services to FSM's national and state governments will end. Our projections show an increasing likelihood that in some years, the FSM compact trust fund will be unable to provide disbursements to make up for the amount of U.S. compact sector grants that will end after FY 2023. Further, because of structural restrictions

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<sup>70</sup>In this context, "fiscal gap" refers to the projected shortfall in government operational funding that will result from the ending of assistance that had been included in past FSM government expenditures and that future compact trust fund disbursements will not replace. The ending of U.S. federal programs and services will likely have a further economic effect on FSM.

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governing disbursements, FSM faces an increasing risk of receiving no disbursement from the compact trust fund in some years, even if the corpus has a substantial balance. We project a 36 percent likelihood that FSM will receive no disbursement from the compact trust fund in 1 or more years in FYs 2024 through 2033, even with an average projected yearly balance of \$905 million during this period.<sup>71</sup> This risk increases to 73 percent in FYs 2034 through 2043 and continues to grow in subsequent years. In addition to our analysis on this topic, other reports and officials have examined the ending of some U.S. assistance to FSM.<sup>72</sup>

**Estimated \$109 Million of Annual Compact Grants and Other U.S. Assistance to FSM Is Scheduled to End, Resulting in Fiscal Gaps**

We estimate that the U.S. grants and other services related to the FSM compact that will end will be worth an estimated \$108.93 million.<sup>73</sup>

Because disbursements from the compact trust fund will not replace the amount of all grants that will end, FSM's national and state governments will face annual fiscal gaps. We estimate the total value of the grants that will end at \$93.03 million and the value of services that will end at approximately \$15.90 million.<sup>74</sup>

- **Grants.** Annual grants that support FSM government expenditures but will end after FY 2023 are projected to total \$93.03 million. These grants include the compact sector grants, estimated at \$81.37 million in FY 2023, as well as an estimated \$11.66 million for other grants—

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<sup>71</sup>We used a Monte Carlo simulation model to project outcomes related to the compact trust fund over a 40-year period. A Monte Carlo analysis is a computational technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

<sup>72</sup>For example, we reviewed previous studies of FSM, including the Staff Report for the International Monetary Fund's Article IV Consultation and Graduate School USA's Economic Review.

<sup>73</sup>Certain grants, programs, and services that the U.S. makes available to FSM under the compact will end unless the authority under which they are provided is extended; however, some U.S. agencies may continue to provide other programs and services to FSM under other authorities. See appendix IV for additional details of the status of U.S. grants and programs in FSM after FY 2023.

<sup>74</sup>Several other federal programs and services will also end but are not included in our estimate because of a lack of available data. Therefore, our estimate is likely a lower bound.



namely, audit, supplemental education, and emergency management performance grants.<sup>75</sup> Although the compact trust fund was established to provide an annual source of revenue for FSM, the maximum allowable disbursement—equal to the FY 2023 compact sector grant amount that will end, plus an inflation adjustment—does not include the value of these other grants. This will contribute to annual fiscal gaps for FSM's national and state governments.

- **Services.** At least \$15.90 million in annual U.S. agency funding for services to FSM will end. These services include disaster services, postal service, weather service, and judicial training, which will end after September 2023. Past FSM government expenditures did not reflect the value of these services. Several other federal programs and services will also end but are not included in our estimate because of data issues, including a lack of available data and difficulty quantifying the value of some services (e.g., deposit insurance); therefore, our estimate is likely a lower bound.<sup>76</sup>

Table 4 shows the types and estimated amounts of compact-related annual assistance to FSM that will end.

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<sup>75</sup>According to agency officials, in FY 2024 FSM will be eligible for programs that the SEG, which will end, had replaced: the Higher Education Act of 1965—Subpart 3 of part A of title IV (Federal Supplemental Education Opportunity Grant) and the Higher Education Act of 1965—Part C of title IV (Federal Work-Study Programs).

<sup>76</sup>These other federal programs and services include federal deposit insurance for the Bank of the Federated States of Micronesia, civil aviation safety and economic services and related programs, and telecommunications services. See appendix IV for additional details on the status of U.S. grants and programs in FSM after FY 2023.

**Table 4: Estimated Compact-Related Annual U.S. Assistance to the Federated States of Micronesia (FSM) That Will End**

Dollars in millions

Type of assistance	Grant or service	Amount
U.S. grant assistance provided to FSM national and state governments and included in FSM government expenditures.	Compact sector grants <sup>a</sup>	81.37
	Compact provision of audit costs	0.50
	Supplemental education grant <sup>b</sup>	11.13
	Emergency management performance grants	0.03
	<b>Subtotal</b>	<b>93.03</b>
U.S. services provided to FSM, which are not included in past FSM government expenditures.	Disaster services for Presidential disaster declarations <sup>c</sup>	7.19
	Postal service	5.84
	Weather service <sup>d</sup>	2.60
	Judicial training <sup>e</sup>	0.27
	<b>Subtotal</b>	<b>15.90</b>
<b>Total</b>		<b>108.93</b>

Source: GAO analysis of U.S. agency documents, responses, and interviews. | GAO-22-104436

Notes: The amounts shown reflect assistance recorded in data from various U.S. agencies. If an agency provided an estimated fiscal year (FY) 2023 value, we used that value. Otherwise, we assumed the FY 2023 value of assistance will be equal to the most recent available estimates or average of estimates that the agencies provided. Several other federal programs and services will also end but are not included in our estimate because of a lack of available data. Most federal programs and services provided through an agreement with FSM will end on September 30, 2023.

<sup>a</sup>The amount shown for compact sector grants includes funds expended by the FSM national government and four state governments as well as component units such as the College of Micronesia and utilities. U.S. contributions to FSM's Disaster Assistance Emergency Fund are included in this total.

<sup>b</sup>This estimate represents an upper bound of assistance that will end after FY 2023. The amount of assistance that will end could be lower, because in FY 2024, according to agency officials, FSM will become eligible for the Higher Education Act of 1965—Subpart 3 of part A of title IV (Federal Supplemental Education Opportunity Grant) and the Higher Education Act of 1965—Part C of title IV (Federal Work-Study Programs), which the supplemental education grant (SEG) that will end had replaced. In FY 2004, the year before the SEG commenced, grants under these two programs to the freely associated states totaled \$664,036.

<sup>c</sup>According to agency officials, annual funding for disaster services fluctuates widely on the basis of the impacts of disaster-causing events. This estimate represents an average annual amount.

<sup>d</sup>According to agency officials, one-time capital improvements or major infrastructure projects may increase the funding provided for weather service in some years. Therefore, the estimate shown represents the minimum baseline annual amount.

<sup>e</sup>According to Interior officials, funds are provided directly to the U.S. Ninth Circuit Court through an interagency reimbursable agreement.

### Projections Show Risks to FSM Compact Trust Fund Disbursements Even with a Substantial Projected Balance in FYs 2024–2063

Our projections indicate a growing risk in FYs 2024 through 2063 that the FSM compact trust fund will not generate enough returns to provide the

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FSM government its maximum allowable disbursement in some years.<sup>77</sup> In addition, we project that the average shortfall between the maximum allowable disbursement and potential disbursement will likely increase over time. Furthermore, FSM faces an increasing risk of receiving zero disbursement in some years. Because of structural restrictions governing disbursements from the compact trust fund, the FSM compact trust fund faces these risks in spite of a likely substantial projected balance.<sup>78</sup> However, we project that the average yearly balance will likely decrease over time.

We based our projections on the compact trust fund's balance at the end of FY 2020—\$629.40 million in the corpus (A) account and \$154.48 million in the buffer (C) account<sup>79</sup>—and on current compact trust fund rules.<sup>80</sup> Our projections account for planned contributions from the U.S. but do not account for FSM's own trust fund, which, according to FSM officials, had a balance of \$307 million at the end of FY 2020. In addition, our projections assume a 6.5 percent nominal net-of-fees return. (See app. V for the projection results with alternative net returns of 5, 6, 7, and 8 percent.) Our projections also assume that the trust fund committee will choose to disburse the maximum allowable amount each year if funds are available, although the committee has the option to distribute a lower amount. (See app. I for a full description of our methodology.)

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<sup>77</sup>In addition to approving the maximum allowable disbursement, the FSM compact trust fund committee may approve additional amounts for special needs (i.e., projects that the FSM government deems necessary as a supplement to that portion of an annual budget to be financed by the compact trust fund) if the projects are for the purposes of Section 211 of the compact as amended.

<sup>78</sup>The averages we present are affected by extreme values from the simulated cases. For more information about the distribution of the simulation results for the compact trust fund balance, see appendix V.

<sup>79</sup>The size of the buffer (C) account is capped at three times the amount of the estimated compact annual grant assistance that expires in FY 2023, partially adjusted for inflation pursuant to the formula set forth in section 217 of FSM's compact. According to the FY 2020 compact trust fund annual report, FSM's buffer (C) account was not yet at its full value.

<sup>80</sup>Our projections are based on current compact trust fund rules. We previously reported on potential strategies for improving the outlook of FSM's compact trust fund, including reducing disbursements, making additional contributions, and changing disbursement policies. See GAO, *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Income*, [GAO-18-415](#) (Washington, D.C.: May 17, 2018).

- **Disbursement as a percentage of the maximum is projected to decrease over time.** We project an increasing likelihood that the FSM compact trust fund will be unable to provide maximum disbursements in some years.<sup>81</sup> Our projections show that, excluding amounts for special needs, FSM may receive, on average, 85 percent of the maximum allowable annual disbursement—the inflation-adjusted amount of FY 2023 compact sector grants (i.e., \$81.37 million adjusted for inflation)—during the first decade (FYs 2024 through 2033). These projection results do not account for any future additional disbursements for special needs. Further, we project that this disbursement will decrease significantly during the second decade (FY 2034 through FY 2043), when FSM is likely to receive, on average, 55 percent of the maximum allowable annual disbursement.
- **The average shortfall is projected to increase over time.** We project that the decrease in the annual disbursement as a percentage of the maximum allowable disbursement will correspond to a likely increasing dollar shortfall between the maximum allowable disbursement and the projected disbursement.<sup>82</sup> Specifically, our projections show a likely average annual shortfall of \$14 million between the maximum allowable disbursement and the projected disbursement in the first decade of disbursements. This projected shortfall increases to \$51 million per year in the following decade and increases further in subsequent decades. In addition, the amount available for disbursement may fluctuate substantially from year to year, because it depends on the compact trust fund's performance in the previous year and the amount, if any, in the buffer (C) account.
- **The likelihood of zero disbursement is projected to increase over time.** We project that the compact trust fund will likely be unable to disburse any funds in 1 or more years, a risk we project to increase over time.<sup>83</sup> Specifically, our projections indicate a 36 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 1 or

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<sup>81</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>82</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>83</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

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more years during the first decade.<sup>84</sup> The likelihood of being unable to disburse any funds in 1 or more years increases over time, to 92 percent in FYs 2054 through 2063.

- **The compact trust fund's balance is projected to decrease over time but will likely remain substantial over the period.** Because of structural restrictions preventing disbursements from the compact trust fund's corpus (A) account, the risk of zero disbursement during some years exists even with a substantial projected average yearly balance. Specifically, for FYs 2024 through 2063, we project an average compact trust fund balance of more than \$400 million across only those simulations projecting a zero disbursement. However, across all simulations we project that the average yearly balance will likely decrease over time.<sup>85</sup> Specifically, we project that on average, the yearly balance of the compact trust fund may be \$905 million during the first decade of disbursements but may decrease to \$668 million in FYs 2054 through 2063.

Figure 7 shows the results of our projections of the FSM compact trust fund's disbursement outcomes and balance for FYs 2024 through 2063.

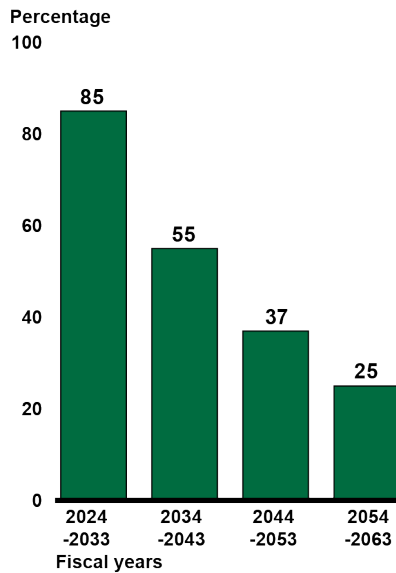
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<sup>84</sup>The 36 percent likelihood can be broken down to a 30 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 1 or 2 years of the first decade of compact trust fund disbursements and a 6 percent likelihood that it will be unable to disburse any funds in 3 to 6 years. (For more information about the zero disbursement risk in terms of its distribution of years, see app. V.) We project a 64 percent likelihood that the FSM compact trust fund will be able to disburse funds in every year of the first decade of compact trust fund disbursements.

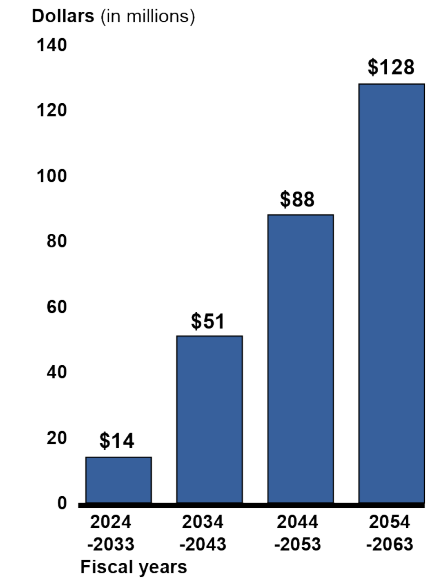
<sup>85</sup>This trend varies with alternative annual net returns that we considered. With an annual net return of 5 percent, 6 percent, or 6.5 percent, we project that, on average, the yearly balance will likely decrease over time. With an annual net return of 7 percent, we project that, on average, the yearly balance will likely decrease from FY 2024 through FY 2053 but may increase from FY 2053 through FY 2063. With an annual net return of 8 percent, we project that, on average, the yearly balance will likely increase over time. For more information, see appendix V.

**Figure 7: Projected FSM Compact Trust Fund Disbursement Outcomes and Balance, Fiscal Years 2024–2063**

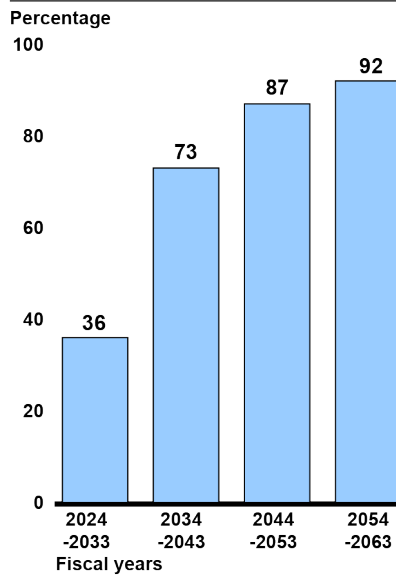
Disbursement: projected average disbursement as a percentage of maximum disbursement



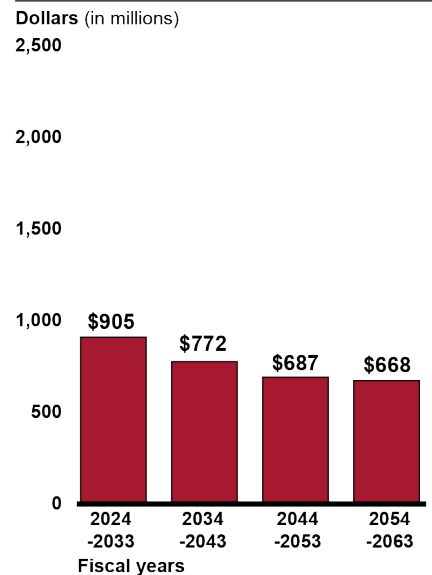
Average shortfall: maximum disbursement less projected disbursement



Zero disbursement: likelihood of one or more years with zero disbursement in a given period



Compact trust fund balance: projected average balance



Source: GAO analysis of Federated States of Micronesia (FSM) compact trust fund documents. | GAO-22-104436

### Accessible Data Table for Figure 7

	FY24- FY33	FY34- FY43	FY44- FY53	FY54- FY63
Disbursement: projected average disbursement as a percentage of maximum disbursement	85%	55%	37%	25%
Average shortfall: maximum disbursement less projected disbursement	\$14	\$51	\$88	\$128
Compact trust fund balance: projected average balance	\$905	\$772	\$687	\$668
Zero disbursement: likelihood of one or more years with zero disbursement in a given period	36%	73%	87%	92%

Notes: The projections shown are based on the current trust fund rules, the compact trust fund's audited balance at the end of fiscal year (FY) 2020, and planned contributions. We assumed that the trust fund's annual net return will have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee will choose to disburse the maximum allowable amount each year if funds are available. The averages we present are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty. For example, our estimates of the average balances are higher than the medians for each period shown. For more information, as well as additional results based on alternative annual net returns, see GAO-22-104436, appendix V.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

As we previously reported, a series of years with low or negative returns could exhaust the compact trust fund's buffer (C) account, which is designed to provide disbursements in years when the trust fund does not earn enough to fund the disbursement.<sup>86</sup> Because the FSM compact trust fund agreement prohibits disbursement from the fund's corpus (A) account to cover any shortfall in the buffer (C) account, FSM would receive no disbursement from the compact trust fund if the buffer (C) account was exhausted and the previous year's returns were zero or negative.<sup>87</sup> Thus, there may be no funds available to disburse even with the likelihood that the compact trust fund will have a substantial projected balance from FY 2024 through FY 2063. As a result of low or zero

<sup>86</sup>For an example of how the buffer (C) account could be exhausted, see appendix V.

<sup>87</sup>Because the buffer (C) account, like the corpus (A) account, can earn investment income, reductions in the buffer (C) account would reduce both the value of the trust fund and the potential amount of future trust fund earnings.

disbursements, FSM could face economic and fiscal shocks and challenges in planning programs and budgets.

The Secretary of the Interior has not implemented our 2018 recommendation that the Director of the Office of Insular Affairs, as Chairman of the FSM compact trust fund committee, work with other members of the committee to develop a distribution policy, as required by the compact trust fund agreement, that takes into account potential strategies that could address risks to the fund's ability to provide a source of income after FY 2023.<sup>88</sup> Interior concurred with the recommendation and indicated that the target date for implementing it is October 1, 2023, the date when FSM can start taking disbursements from the compact trust fund. The compact trust fund agreement allows for written amendments at any time, with mutual consent of both the U.S. and FSM. However, the U.S. legislation approving the amended compact requires that any amendment, change, or termination of all or any part of the compact trust fund agreement shall not enter into force until incorporated into an act of Congress.

#### Reports and Officials Point to Future Fiscal Challenges for FSM

Reports and comments from experts at several institutions, such as the International Monetary Fund (IMF) and the World Bank, have noted challenges that may confront FSM when U.S. compact assistance ends. FSM and U.S. officials have also identified challenges FSM may face, such as the need to make fiscal adjustments, identify alternative sources of financial assistance, and obtain additional donor funds.

**IMF report warning of “fiscal cliff.”** According to the 2021 IMF Article IV staff report on FSM, the expiration of compact grants, which may be only partially compensated by disbursements from the compact trust fund, could result in a fiscal cliff.<sup>89</sup> In addition, the report noted that

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<sup>88</sup>GAO-18-415. Our 2021 priority letter to Interior included the recommendations contained in this 2018 report.

<sup>89</sup>International Monetary Fund, *Federated States of Micronesia: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: Oct. 5, 2021). IMF's country surveillance efforts include conducting Article IV consultations, in which an IMF team of economists visits a country to assess economic and financial developments and discuss the country's economic and financial policies with government and central bank officials. IMF conducted Article IV consultations in FSM in 2021, 2019, 2017, 2015, 2010, 2008, 2006, 2004, and 2002.



disbursements from the compact trust fund after FY 2023 are subject to investment returns, which will result in large fiscal revenue volatility. According to the 2019 IMF Article IV staff report on FSM, disbursement restrictions on the compact trust fund could lead to significant revenue volatility.<sup>90</sup> The 2021 IMF report indicated that uncertainty related to the ending of support under the compact could undermine investor confidence and weigh significantly on the medium-term economic prospects, particularly FSM's capacity to cope with a potential fiscal cliff after FY 2023.<sup>91</sup>

The 2019 IMF report, published before the COVID-19 pandemic, recommended that FSM prepare for the potential fiscal cliff by making gradual fiscal adjustments of 4 to 5 percent of GDP by introducing a value-added tax, improvements in tax administration, public financial management reforms, and limits to wage bill growth and nonessential expenditures. Since then, according to IMF officials, FSM's fiscal position has weakened owing to increases in health and stimulus expenditures related to the COVID-19 pandemic and declining revenue. The 2021 IMF report estimated that real GDP had declined by 1.8 percent in FY 2020, and the report projected that real GDP would decline by 3.2 percent in FY 2021. According to the report, FSM had made limited progress in implementing previous IMF advice, in part because of capacity constraints and the stalling of reform efforts due to COVID-19-induced travel restrictions.

**Graduate School USA report predicting need for fiscal adjustments.** Graduate School USA's FY 2018 Economic Review for FSM estimates losses equal to 24 percent of FSM's GDP—a truly severe outcome, according to the report—as a result of the potential loss of U.S. federal

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<sup>90</sup>International Monetary Fund, *Federated States of Micronesia: Staff Report for the 2019 Article IV Consultation* (Washington, D.C.: July 30, 2019).

<sup>91</sup>An IMF and World Bank 2021 debt sustainability analysis included in the 2021 IMF Article IV Staff report concluded that FSM's external and overall debt levels had a high risk of debt distress but were sustainable; however, the analysis noted that future assessment of the risk of debt distress will critically depend on the outcome of the compact renegotiation, including the size, composition, and duration of any grant support. According to the debt sustainability analysis, FSM authorities emphasized to IMF staff that the government is unlikely to be able to borrow more than 10 percent of financing needs domestically after FY 2023. FSM does not have any transactions or financial flows with IMF but can access IMF resources if certain conditions are met, according to IMF officials.

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programs and services if a requirement for sustainable disbursements<sup>92</sup> from the compact trust fund were imposed.<sup>93</sup> Assuming that compact trust fund drawdowns will be reduced to a sustainable level, the report projects that the fiscal balance at the national-government level will deteriorate but that adjustments in FY 2024 will enable FSM's state governments to remain open. Specifically, the report projects that the FSM economy may decline by 0.8 percent in FY 2024 as the national government cuts expenditures in order to transfer revenues to keep the state governments open.

Further, the Graduate School USA report states that "[t]he projected compact trust fund in FY 2023 is likely to be significantly below a level required to provide a reliable yield to support government operations." According to the report, although FSM has not funded the D account within the compact trust fund, FSM has made significant progress in building up its own trust fund that may be used after FY 2023 to support fiscal stability. The authors of the report argue that FSM should continue to save resources in its own trust fund to support anticipated shortfalls from the compact trust fund. However, the report's projections indicate that even with additional funds in FSM's trust fund, the compact trust fund and FSM's trust fund together will not provide sufficient resources to replace the compact sector grants after FY 2023.

A 2020 Graduate School USA report projected that FSM's GDP would drop by 4.9 percent in FY 2020 and by 2.0 percent in FY 2021 because of the COVID-19 pandemic.<sup>94</sup>

**World Bank report projecting need for other assistance.** Projections included in a 2016 World Bank report suggest that the scheduled end of compact grants in FY 2023 will have, absent alternative sources of financial assistance, a significant adverse effect on the North Pacific

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<sup>92</sup>Graduate School USA's FY 2018 Economic Review for FSM presents the sustainability-adjustment-for-enhanced-reliability rule as an alternative to the existing disbursement rules and a way to provide sustainable drawdowns. The economic review is an annual report that represents an independent assessment of FSM's economic performance and policy environment. See Graduate School USA, *Economic Review: Federated States of Micronesia, Fiscal Year 2018* (March 2020).

<sup>93</sup>Graduate School USA, *Economic Review Federated States of Micronesia Fiscal Year 2018* (March 2020).

<sup>94</sup>Graduate School USA, *Assessing the Impact of COVID-19 on the Federated States of Micronesia Economy* (June 2020).

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economies.<sup>95</sup> The report projects that FSM's compact trust fund could fully finance fiscal gaps through 2040 but that the fund's real per capita value will decline. The report estimates that without improvements to the growth outlook, an increase in aid will likely be needed to avoid the emergence of unsustainable budget deficits and allow FSM to undertake development-enhancing public expenditures while preserving the capital of the compact trust fund. According to World Bank officials, FSM used its entire allocation of grants from the International Development Association of the World Bank in 2018 but could obtain money from World Bank trust funds.

**Asian Development Bank (ADB) officials' prediction of limited help from other donors.** ADB officials observed that other donors have a limited ability to fill the gap that would result from the end of compact grant assistance. The officials also noted that other donors expect the compact grant assistance to be extended and are not actively planning to increase their support.<sup>96</sup> According to ADB officials, the potential end of compact grant assistance would not change the ADB financing available to FSM. A 2019 ADB Pacific Finance Sector brief stated that FSM's primary development challenges are stimulating economic growth through private sector development and attaining long-term fiscal sustainability, particularly in light of the gradual phasing out of the compact grants by the end of FY 2023.<sup>97</sup> Owing to the scheduled decrease in compact assistance, FSM's state governments are increasingly constrained in the delivery of vital services, according to a 2020 ADB member fact sheet covering the FSM.<sup>98</sup>

**FSM government statements on financial assistance, fiscal reforms, and trust funds.** In a September 2019 statement before the House Committee on Natural Resources and the House Committee on Foreign

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<sup>95</sup>World Bank, *Financing Pacific Governments for Pacific Development. Pacific Possible Background Paper No. 7* (Washington, D.C.: 2016).

<sup>96</sup>ADB commissioned a project to examine the economic impacts of the end of compact grant assistance. The draft report on the project's results examines the potential loss in assistance in the FSM and the potential fiscal responses that the government may need to make if compact transfers end.

<sup>97</sup>Asian Development Bank, *Federated States of Micronesia Pacific Finance Sector Brief* (Sydney, Australia: October 2019).

<sup>98</sup>Asian Development Bank, *Federated States of Micronesia Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020).

Affairs, the FSM Ambassador indicated that the U.S.-provided financial assistance to FSM is a central pillar of the strong relationship between the two countries. The Ambassador also indicated that the potential end of the financial assistance has created uncertainty for the FSM government and its people.<sup>99</sup> According to FSM officials, the national government continues to work on tax reform, tax compliance, and implementation of a value-added tax. In addition, the officials noted that the U.S. is, by far, FSM's largest and most important donor and that U.S. support for infrastructure projects has been crucial to FSM's economic development and the employment of FSM citizens.

FSM has conducted assessments of the compact trust fund as well as its own trust fund.

- The FSM Economic and Fiscal Update 2019 estimates that the compact trust fund will have a value of \$1.0 billion in FY 2023<sup>100</sup> and that annual returns of 6.5 percent would maintain the corpus of the fund post FY 2023, with FSM drawing down \$50 million in FY 2024.<sup>101</sup> However, the report also notes risks, including the risk that a market recession at any time during the period from FY 2023 through FY 2028 could erode the corpus, potentially undermining future returns.
- A 2019 audit of FSM's trust fund estimated that if it were used to fill the gap that may be created by the cessation of all foreign grants, FSM's trust fund would be exhausted in 28 to 60 months.<sup>102</sup> However,

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<sup>99</sup>Hearing on Sustaining U.S. Pacific Insular Relationships, Before the House Committees on Natural Resources and Foreign Affairs, 116 Cong. (Sept. 26, 2019) (statement of Akillino H. SUSAIA, Ambassador of the Federated States of Micronesia to the United States).

<sup>100</sup>The projections we present for the FSM compact trust fund differ from those in the FSM Economic and Fiscal Update 2019 in part because we present an average of the compact trust fund balance in FYs 2024 through 2033. For FY 2023 alone, we project an average balance of \$970 million across all 10,000 simulation cases. These projections account for planned contributions from the U.S. and assume a 6.5 percent net rate of return and 13 percent standard deviation.

<sup>101</sup>FSM Department of Finance and Administration, *Economic & Fiscal Update 2019* (Palikir, Pohnpei: 2019).

<sup>102</sup>FSM Office of the National Public Auditor, *The FSM Trust Fund: Actions Are Required to Effectively and Efficiently Achieve the Goals of the FSM Trust Fund* (Palikir, Pohnpei: Dec. 2, 2020).

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according to FSM officials, the FSM Congress determined that there would be no disbursement from FSM's trust fund before FY 2031.<sup>103</sup>

**U.S. officials' statements on grant assistance and FSM compact trust fund.** As of July 2019, an interagency group comprising representatives of OIA, State, and DOD had begun consulting about possible plans to pay for any extension of financial assistance to FSM.<sup>104</sup> In September 2019, the OIA Director indicated that if grant assistance is allowed to end and is not extended, there is a very real risk of adverse impact on the FSM economy.<sup>105</sup>

Regarding the compact trust fund, the OIA Director also indicated in his September 2019 statement that there is significant concern about the volatility and size of the disbursements to support FSM's post-FY 2023 budgets. The Director noted that the trust fund committee was analyzing and discussing disbursement policy options to provide more consistent disbursements with less volatility and no years of zero distributions.<sup>106</sup>

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<sup>103</sup>We previously reported that, according to FSM officials, FSM can withdraw only the compact trust fund's earnings and cannot withdraw the inflation-adjusted value of its corpus. See GAO, *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Income*, [GAO-18-415](#) (Washington, D.C.: May 17, 2018).

<sup>104</sup>*The United States' Interests in the Freely Associated States*, Before the Committee on Energy and Natural Resources, 116th Cong. 116-331 (2019) (statement of Sandra Oudkirk, Deputy Assistant Secretary for Australia, New Zealand, and Pacific Islands, Bureau of East Asian and Pacific Affairs, Department of State and statement of Douglas Domenech, Assistant Secretary, Insular and International Affairs, Department of the Interior).

<sup>105</sup>*Hearing on Sustaining U.S. Pacific Insular Relationships, Before the House Committees on Natural Resources and Foreign Affairs*, 116 Cong. (Sept. 26, 2019) (statement of Nikolao Pula, Director, Office of Insular Affairs, Department of the Interior).

<sup>106</sup>Director Pula also noted in his statement that disbursement policy options are limited unless the trust fund agreement is amended by the original parties to the agreement.

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## Weaknesses in FSM Grant Accountability Remain, while JEMCO Continues its Oversight

### FY 2015–2019 Audits Indicate Weaknesses in FSM's Accountability

Single audits of the FSM national government and four state governments for FYs 2015 through 2019<sup>107</sup> demonstrated that weaknesses remain in the governments' accountability for their use of U.S. funds.<sup>108</sup> The FSM single audits for FY 2015 and FY 2019 reported 23 and 19 audit findings, respectively, some of which recurred over the 5-year period. Our analysis determined that during this period, the majority of FSM states did not receive unmodified auditor's opinions on their financial statements, indicating that the auditor was not reasonably assured that the financial statements did not provide misstatements that could substantively misinform users of the statements. We determined that one state qualified as a low-risk auditee because, among other things, it had submitted a timely single audit report for the 2 preceding years.

Table 5 summarizes selected information from the FSM national government's and four state governments' single audits for FYs 2015 through 2019.<sup>109</sup>

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<sup>107</sup>We previously reported that in FY 2006, three of five audits reported unqualified opinions on the Schedule of Expenditures of Federal Awards. Also in 2006, a total of 93 audit findings were reported. See [GAO-16-760SP](#), an E-supplement to [GAO-16-550T](#), for additional information.

<sup>108</sup>Single audit reports include the following: the entity's audited financial statements; the schedule of expenditures of federal awards and the auditor's opinion on whether the schedule is reported fairly in relation to the financial statements as a whole; the auditor's opinion (or disclaimer of opinion) regarding whether the auditee complied with the laws, regulations, and provisions of contracts and grant agreements (such as the compact), which could have a direct and material effect on each major federal program; and a report on findings on internal controls related to federal programs. Auditors issue various types of opinions in audit reports, including unmodified, qualified, disclaimer, and adverse. The audit reports also include findings, which are material weaknesses or significant deficiencies in internal controls or financial reporting.

<sup>109</sup>For a detailed summary of our review of the FSM single audit reports, see appendix VI.

**Table 5: Selected Information from Single Audits of FSM's National Government and Four State Governments, FYs 2015–2019**

Single audit component	Fiscal Year				
	2015	2016	2017	2018	2019
Financial reporting (auditor's opinion and number of opinions <sup>a</sup> )	U (3)	U (2)	U (2)	U (2)	U (2)
	Q (1)	Q (2)	Q (2)	Q (2)	Q (2)
	A (1)	A (1)	A (1)	A (1)	A (1)
Schedule of Expenditures of Federal Awards (auditor's opinion and number of opinions <sup>b</sup> )	U (5)	U (5)	U (5)	U (5)	U (5)
Compliance with requirements of major federal programs (auditor's opinion and number of opinions <sup>c</sup> )	U (2)	U (4)	U (4)	U (3)	U (2)
	Q (3)	Q (1)	Q (1)	Q (2)	Q (3)
Audit findings (total number)	23	15	9	11	19
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	6,556	2,401	1,254	1,238	1,999
Timely submission of single audit package <sup>e</sup>	Y (5)	Y (4)	Y (5)	Y (5)	Y (4)
	N (0)	N (1)	N (0)	N (0)	N (1)
Low-risk auditee <sup>f</sup>	Y (1)	Y (1)	Y (1)	Y (1)	Y (1)
	N (4)	N (4)	N (4)	N (4)	N (4)

Legend: U = unmodified opinion, Q = qualified opinion, A = adverse opinion, Y = yes, N = no.

Source: GAO analysis of the Federated States of Micronesia (FSM) single audit reports for fiscal years (FY) 2015–2019. | GAO-22-104436

Notes: Five single audits are conducted every year for, respectively, the FSM national government and four state governments.

Numbers in parentheses indicate the total number of entities whose single audits showed the relevant information. The numbers of audit findings and questioned costs represent the total numbers for all five entities.

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements. A qualified opinion is given when the auditor (1) obtains sufficient appropriate audit evidence and concludes that misstatements in the financial statement are material but not pervasive or (2) was unable to obtain sufficient appropriate audit evidence and concludes that the possible effects on the financial statements of any undetected misstatements could be material but not pervasive. The effect of the auditor's qualified opinion can be significant enough to reduce the usefulness and reliability of the auditee's financial statements. An adverse opinion is given when the auditor concludes, after obtaining sufficient, appropriate evidence, that misstatements in the auditee's financial statement are both material and pervasive.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal wards for the period covered by the award recipients' financial statements. This schedule has a number of reporting requirements, including (1) reporting the individual federal programs, by federal agency; (2) providing the total federal awards expended for each federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor's opinion is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>An unmodified opinion on compliance with requirements of major federal programs is given when the auditor concludes with respect to the auditee's major programs that the auditee was in compliance with the provisions of federal statutes, regulations and the terms and conditions of federal awards. A qualified opinion on compliance is given when the auditor concludes the auditee for its major programs has not complied with provisions of federal statutes, regulations, and the terms and conditions of federal awards.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost, at the time of the

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audit, was not supported by adequate documentation; or (3) the cost incurred appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the entity's fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

The following provides additional information about the single audits for the FSM national and state governments for FYs 2015 through 2019.<sup>110</sup>

**Financial reporting.** The single audits for the FSM national and state governments' annual financial statements for FYs 2015 through 2019 produced a combined total of 11 unmodified audit opinions, nine qualified opinions, and five adverse opinions.<sup>111</sup> For example, each year Yap's auditors issued an unmodified opinion and an adverse opinion. The auditors issued an unmodified opinion because they determined that the financial statements presented fairly the financial position of the state's governmental activities, business activities, and other fund information. However, the auditors issued an adverse opinion as a result of the statement's omission of the Yap Fishing Authority and the Gagil-Tomil Water Authority financial information.

**Compliance with requirements of major federal programs.** The single audits of the FSM national and state governments' compliance with major federal program requirements for FYs 2015 through 2019 produced a combined total of 15 unmodified opinions and 10 qualified opinions. In none of the 5 years, did all five governments received unmodified opinions. An opinion on compliance with requirements for major programs is based on the extent of the material weaknesses and significant deficiencies observed by the auditors during the course of the audit. In this case, the reasons the auditors issued 10 qualified opinions included lack of adequate support for expenditures and noncompliance with procurement requirements.

**Audit findings.** The single audits for the FSM national and state governments resulted, in total, in 23 audit findings for FY 2015 and 19 audit findings for FY 2019. The findings included, but were not limited to,

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<sup>110</sup>For a detailed summary of our review of the FSM single audits, see appendix VI.

<sup>111</sup>Each year, the FSM national and state governments submit a combined total of five single audit packages, including financial statements and five audit opinions. Accordingly, for FYs 2015 through 2019, FSM submitted 25 financial statements and related audit opinions.



noncompliance with allowable cost principles, equipment and real-property management, and procurement. Although still significant, this range of audit findings represented an improvement from the prior 15 years; during the period from FY 2006 through FY 2010, audit findings ranged from 93 to 31. Generally, the improvement in the number of findings from FY 2015 to FY 2019 related to improvements made by the FSM national government in cash management, compliance with allowable cost principles, and cost-sharing provision areas.

However, in FYs 2015 through 2019, auditors found weaknesses in internal controls for two states, Chuuk and Pohnpei. For example, the FY 2019 findings for Chuuk and Pohnpei included a lack of internal controls over equipment: Chuuk lacked documented procedures for required maintenance of equipment, and Pohnpei had not performed at least one inventory of equipment in the past 2 years. Another FY 2019 finding for Pohnpei was based on the auditor's concern about Pohnpei's ability to repay an Asian Development Bank loan that the state had guaranteed. Our analysis of the single audits for FYs 2015 through 2019 determined that some accountability issues in Pohnpei were persistent. One finding for Pohnpei recurred in 4 of the 5 years. Another finding related to the lack of accountability for equipment occurred in all 5 years.

In addition to the single audits of the FSM national and state governments conducted by independent auditors, several performance audits of U.S. grant-funded programs that the state public auditors conducted found internal control weaknesses. Officials at the National Public Auditor (ONPA) of the Federated States of Micronesia whom we interviewed indicated that,<sup>112</sup> during FYs 2015 through 2019, ONPA, the Pohnpei Office of the Public Auditor, and the Office of Chuuk State Public Auditor generally conducted performance audits of entities that are supported by non-U.S. funds.<sup>113</sup> However, the Office of Chuuk State Public Auditor also conducted an audit of an education project that used compact sector

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<sup>112</sup>According to ONPA officials, ONPA has approximately 15 professional staff. Other relevant audit offices include the Pohnpei Office of Public Auditor, the Office of the Chuuk State Public Auditor, the State of Yap Office of Public Auditor, and the Kosrea Office of the Public Auditor.

<sup>113</sup>Sources of funding for these entities include non-U.S. sources. Examples of these performance audits include an ONPA audit of the We Care Kosrea Patient Referral Program (2016), an OPA Compliance Audit of the Infrastructure Maintenance Funds (2018), and an ONPA audit of the National Oceanic Resource Management Authority Fisheries Access Agreement (2017).

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funds.<sup>114</sup> The audit found that expenditures were not in accordance with laws and regulations and that the program did not meet project goals. For example, the audit reported that the project's management used the grant money to build a structure on private land, in violation of JEMCO resolutions and Chuuk state constitutional requirements. Also, the project's management could not provide verification that it conducted required daily classes for 500 students.<sup>115</sup>

The FSM national and state governments are making some progress and taking steps to ensure accountability for the use of U.S. funding, according to OIA. OIA officials reported that their analysis has found the FSM governments continue to improve the accuracy of reporting financial data and accountability in the use of federal funds. According to OIA officials who administer and oversee compact grants, OIA's goal related to accountability is for the FSM governments to implement and enforce internal controls that help ensure that the use of federal funding complies with JEMCO resolutions, the approved budgets, and applicable requirements. For audit purposes, OIA's specific goal is to help the FSM governments obtain unmodified auditor opinions on the annual audits of financial reporting, increase compliance with federal grant awards, and have no material internal control findings or questioned costs related to expenditures of federal awards.<sup>116</sup> OIA officials stated that they are working closely with FSM government personnel in the offices of finance and audits and, as necessary, directly with FSM government program personnel responsible for resolution of the audit findings. OIA officials also stated that OIA provides resources for training to help increase the capacity of the FSM government workforce.

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<sup>114</sup>Office of Chuuk State Public Auditor, *Faichuk Educational Development and Research Project: Issues Found on Expenditures and on Project Outcomes and Deliverables*, Audit Report No. 2018-1 (Weno, Chuuk: Dec. 19, 2018). This report included 27 recommendations. Management disagreed with this report.

<sup>115</sup>According to ONPA, the Public Auditor of Chuuk State has not followed-up on the prior audit findings involving the Faichuk Educational Audit due to lack of staff and the COVID-19 pandemic.

<sup>116</sup>State officials confirmed what Interior told us that State's overall objective related to accountability is to ensure the funds are used for their intended purpose consistent with the FSM's obligation under the compact, as amended, as well as the fiscal procedures agreement. An additional objective is to reduce questioned costs or quickly resolve them when they occur.

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In addition, ONPA officials told us that the number of findings and questioned costs for their single audits have been decreasing over the past few years, indicating that there has been improvement in FSM accountability. They attributed the improvement to efforts to raise awareness about the single audit analysis, particularly through their annual conferences, during which efforts are made to assess all units' finances and stress the importance of the audits.<sup>117</sup> However, FSM officials told us that they still face challenges in strengthening their accountability efforts, particularly with respect to the need for more local accountants to assist in preparing the financial statements so that auditors can audit them.<sup>118</sup>

#### JEMCO Conducts Oversight of Financial Accountability of Compact Grants in FSM

JEMCO is responsible for conducting oversight to help ensure that U.S. compact funds are achieving their intended goals and that financial internal controls are in place to support accountability. Working through JEMCO, U.S. members, with support from OIA grant managers, have led accountability discussions during joint meetings between the U.S. government and the FSM national and state governments, which have supported efforts to improve compact fund accountability. For example, at the 2016 and 2018 annual JEMCO meetings, FSM and U.S. JEMCO members reported that they recognized the challenges faced by the FSM government in health care and the Pohnpei Utilities Corporation. During these meetings, JEMCO members developed action plans, in the form of

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<sup>117</sup>In February 2019, OPA conducted fraud awareness and prevention training in Chuuk at the FSM Finance Municipal Training. This was part of OPA's efforts to promote good governance, accountability, and transparency in government.

<sup>118</sup>According to the Department of Justice and the Department of Transportation, in 2019, a Micronesian official was sentenced to prison for involvement in a money laundering scheme. According to the Department of Justice, this official admitted that between 2006 and 2016, a Hawaii-based engineering and consulting company paid bribes to FSM officials, including himself, to obtain and retain, in violation of federal law, contracts valued at nearly \$8 million with the FSM national government. The official plead guilty to committing federal program fraud and was sentenced to serve 18 months in prison. According to the ONPA, the office has audits planned on the Department of Transportation, Infrastructure and Communication for 2021, 2022, and another one in 2023. The audits will be structured to look into any actions taken on the prior audit findings involving the program fraud. On the investigation side, a meeting was scheduled related to the investigation of the fraud but did not occur due to the border lockdown after the COVID-19 pandemic hit, according to an ONPA official.

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resolutions, to help address the challenges and strengthen FMS's ability to demonstrate the effective use and management of U.S. grant funds.

The following are examples of such challenges and JEMCO's resolutions to address them.

- JEMCO recognized the need for the FSM government to continue to improve its health sector performance measures for initiatives funded by compact funds.<sup>119</sup> As a result, JEMCO adopted a resolution requiring that at least \$500,000 in compact grant assistance be used to enhance FSM's ability to produce reliable health performance data and indicators.<sup>120</sup>
- The Pohnpei 2016 single audit reported that the Pohnpei Department of Treasury and Administration was experiencing challenges in meeting the financial obligations incurred by the Pohnpei Utilities Corporation (PUC). The PUC received a loan from ADB, which the Pohnpei state government guaranteed.<sup>121</sup> As in prior years, because the PUC continued to be unable to meet its debt commitments to the ADB, the Pohnpei state government had to pay for these loans. The U.S. compact sector grants and ADB provide funding to Pohnpei to support infrastructure funding. At its 2018 annual meeting, JEMCO issued a resolution for the PUC to comply with special grant terms and conditions.<sup>122</sup> The resolution also allocated \$1.3 million to the public infrastructure sector but required that a preliminary implementation schedule be submitted to OIA before the drawdown of funds.
- According to State officials, JEMCO passed a resolution in 2016 to set aside an amount of FSM compact sector grant assistance for FY 2018, with release of these funds contingent on the resolution of costs

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<sup>119</sup>We recommended that the Director of Insular Affairs, as chairman of JEMCO, take all necessary steps to ensure that the FSM produces reliable data used to monitor progress in education and health. See GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, [GAO-13-675](#) (Washington, D.C.: Sept. 20, 2013).

<sup>120</sup>Resolution JEMCO 2016-1: Performance Indicators and Reliable Data—Health Sector, adopted Aug. 24, 2016.

<sup>121</sup>The auditors qualified the Pohnpei single audits for FYs 2016 through 2019 because of the PUC repayment issues and the Pohnpei government's lack of recognition of the ADB loan as a liability.

<sup>122</sup>Resolution JEMCO 2018-1: Pohnpei Utilities Corporation Institutional Reform, adopted Aug. 21, 2018.

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that were questioned in previous single audits. This amount would be equivalent to the total cumulative questioned costs that remained unresolved after December 31, 2016. Since then, FSM has undertaken efforts to reduce the number of questioned costs and to resolve outstanding questioned costs. By FY 2018, questioned costs had fallen by \$687 million.

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## RMI: Use and Role of U.S. Funds, Projected Fiscal Effects of Expiring Assistance, and Record of Accountability

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### U.S. Compact Grants and Other Grants Cover More than One-Third of RMI Government Expenditures

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U.S. assistance covers a substantial proportion of the RMI government's budget expenditures for programs. Compact grants, the SEG, and other U.S. grants—\$56 million in total—supported more than one-third of RMI national government expenditures in FY 2019 (the most recent data available during our audit).<sup>123</sup> In addition, the RMI government relies on programs and services pursuant to its programs and services agreement that are scheduled to end in 2024 but are not reflected in the government's expenditures. Compact grants and the SEG that are scheduled to end after FY 2023 supported about 21 percent of RMI government expenditures in FY 2019.<sup>124</sup> Kwajalein-related grants that do not end in 2023 supported an additional 7 percent and other U.S. grants supported 7 percent of total RMI government expenditures (see fig 8). (App. III provides additional information, by year, about U.S. assistance to the RMI government as reflected in the government's expenditures for FYs 2015 through 2019.)

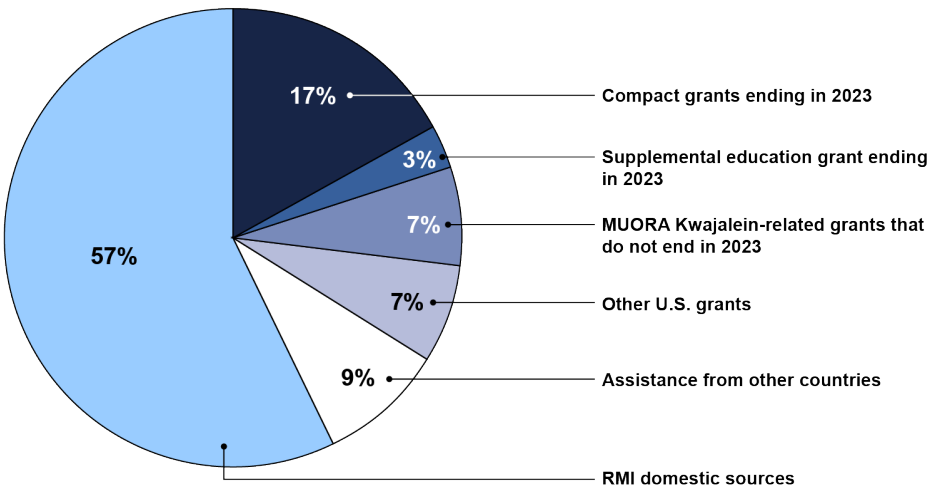
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<sup>123</sup>Throughout this report, we present observations about the status of grants and programs under current U.S. law, as reported by U.S. agencies. Changes to the relevant laws before 2023 could alter RMI's eligibility status. The availability of some grants and programs in the future is subject to the availability of appropriations provided for that purpose.

<sup>124</sup>A small number of other compact-related grants are set to end after fiscal year 2023, such as Interior grants for RMI audits of funds and emergency management performance grants, according to agency officials.

Figure 8: Total RMI Government Expenditures, by Source, Fiscal Year 2019

FY 2019 total expenditures = \$164.8 million



Source: GAO analysis of the Republic of the Marshall Islands (RMI) single audit for fiscal year 2019. | GAO-22-104436

Accessible Data Table for Figure 8

Government Expenditures	Percent
Compact grant ending in 2023	17%
Supplemental education grants ending in 2023	3%
MUORA Kwajalein-related grants that do not end in 2023	7%
Other U.S. grants	7%
Assistance from other countries	9%
RMI domestic sources	57%

Legend: MUORA = Military Use and Operating Rights Agreement.

Notes: The percentages shown do not include government component units, such as the College of the Marshall Islands and public utilities, and do not include the \$18 million annually, partially inflation adjusted, provided to the RMI government that it uses to compensate Kwajalein Atoll landowners for U.S. access to the atoll. Although the supplemental education grant ends after 2023, agency officials noted that RMI would be eligible for some programs that the grant replaced. Information depicted does not include programs and services provided in the compact that are scheduled to end in 2024 but are not reflected as part of the government’s expenditures.

Compact Sector and Supplemental Education Grants

The compact sector grants are intended to provide support for the RMI government in six core sectors—education, health, infrastructure, environment, private sector development, and public sector capacity building—prioritizing the education and health sectors. In addition, at the local school level, the SEG provides support for educational services focused on school readiness, early childhood education, elementary and

secondary education, vocational training, adult and family literacy, and the transition of students from high school to postsecondary educational pursuits or careers. The health and education sectors represented 40 percent of total sector grant expenditures in FY 2019 for the RMI government—16 percent for health and 24 percent for education.<sup>125</sup>

Compact sector grants and the SEG support a high proportion of RMI health and education expenditures. In FY 2019, compact sector grants and SEG scheduled to end after FY 2023 supported approximately 25 percent of RMI health expenditures and approximately 49 percent of RMI education expenditures (see table 6). Kwajalein-related grants that will not end after FY 2023 covered 6 percent of health expenditures and 7 percent of education expenditures.

**Table 6: RMI Health and Education Expenditures of Compact Sector Grants, SEG, and Kwajalein-Related Grants, Fiscal Year 2019**

Dollars in millions

Sector	Total government expenditures (dollars)	Expenditures of compact sector grants and SEG <sup>a</sup>		Expenditures of Kwajalein-related grants		Total expenditures of compact sector grants, SEG, and Kwajalein-related grants	
		Amount (dollars)	Percentage of total expenditures	Amount (dollars)	Percentage of total expenditures	Amount (dollars)	Percentage of total expenditures
Education	35.9	17.7	49	2.4	7	20.0	56
Health	33.1	8.2	25	2.0	6	10.2	31

Legend: RMI = Republic of the Marshall Islands; SEG = supplemental education grant.

Source: GAO analysis of the Republic of the Marshall Islands (RMI) fiscal year 2019 single audit report. | GAO-22-104436

Notes: Expenditures and percentages shown have been rounded. Education data are from the RMI Ministry of Education, Sports and Training. Health data are from the RMI Ministry of Health and Environment. The amounts and percentages shown for the education sector do not include the College of the Marshall Islands.

<sup>a</sup>The SEG was used only in the education sector.

See appendix IV for compact and other education-related grants provided to RMI and for the status of all compact-related grants in RMI.

<sup>125</sup>These percentages do not include the SEG, which represented 12 percent of RMI's total sector grants and SEG expenditures combined in FY 2019. The compact sector grants for the education and health sectors provide support for improving education curriculum and student performance in RMI and for certain disease elimination and prevention and management activities, among other things, according to an Interior report.

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## Federal Programs and Services

RMI also receives U.S. assistance for postal, weather, aviation, and disaster assistance, as outlined in the RMI compact's Federal Programs and Services Agreements. However, unlike compact sector grants, the SEG, and other U.S. grants, this assistance is not reflected in RMI's government expenditures; rather, U.S. agencies incur costs in some cases for the services.<sup>126</sup> Some of the federal programs and services are set to expire in 2024, while others could continue under various legal authorities (see app. IV for additional information about federal programs and services that support the RMI government).

## Other U.S. Grants

The RMI government is also eligible for, and receives, other U.S. grants, including funding for agriculture programs, environmental monitoring programs for nuclear-affected areas, and public health programs, as reported by U.S. agencies (see app. IV for a list and descriptions of U.S. grants RMI is eligible for, according to U.S. agencies). In FY 2019, RMI recorded expenditures of U.S. grants and programs provided by agencies such as the Departments of Agriculture, Commerce, and Health and Human Services. In addition to the national government, other RMI entities have also received federal grants and loans. For example, the College of the Marshall Islands and the Marshalls Energy Company expended U.S. funding for operations during the FYs 2015 through 2019 time period.

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## Ending of U.S. Grants Will Cause a Fiscal Gap for RMI, and Risks to Compact Trust Fund Disbursements Continue

According to our projections, the scheduled ending of some U.S. grants after FY 2023 will result in a fiscal gap for RMI's government, leading to

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<sup>126</sup>According to USPS officials, under the current arrangement with the U.S., postage rates for mail from the U.S. to the FAS are maintained at domestic levels, which are lower than international rates. If the agreements lapse, USPS will no longer bear the costs of subsidizing shipping and mail prices for the FAS, according to USPS officials.



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shortfalls in the government's ability to financially support the nation.<sup>127</sup> In total, an estimated \$39.55 million worth of annual U.S. grants, programs, and services to RMI will end. Our projections show an increasing likelihood that in some years, the RMI compact trust fund will be unable to provide disbursements to make up for the amount of U.S. compact sector grants that will end after FY 2023. Further, because of structural restrictions governing disbursements, RMI faces an increasing risk of receiving no disbursement from the compact trust fund in some years, even if the corpus has a substantial balance. We project a 12 percent likelihood that RMI will receive no disbursement from the compact trust fund in 1 or more years in FYs 2024 through 2033, even with an average projected yearly balance of \$758 million.<sup>128</sup> This risk increases to 26 percent in FYs 2034 through 2043 and continues to grow in subsequent years. In addition to our analysis on this topic, other reports and officials have examined the ending of some U.S. assistance to RMI.<sup>129</sup>

**Estimated \$40 Million of Annual Compact Grants and Other U.S. Assistance to RMI Is Scheduled to End, Resulting in a Fiscal Gap**

We estimate that the U.S. grants and other services related to the RMI compact that will end will be worth an estimated \$39.55 million.<sup>130</sup> Because disbursements from the compact trust fund will not replace the amount of all grants that will end, RMI's government will face an annual fiscal gap. We estimate the total value of the grants that will end as

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<sup>127</sup>In this context, "fiscal gap" refers to the projected shortfall in government operational funding that will result from the ending of assistance that had been included in past RMI government expenditures and that future compact trust fund disbursements will not replace. The ending of U.S. federal programs and services will likely have a further economic effect on RMI.

<sup>128</sup>We used a Monte Carlo simulation model to project outcomes related to the compact trust fund over a 40-year period. A Monte Carlo analysis is a computational technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

<sup>129</sup>For example, we reviewed previous studies of RMI, including the Staff Report for the International Monetary Fund's Article IV Consultation and Graduate School USA's Economic Review.

<sup>130</sup>Certain grants, programs, and services that the U.S. makes available to RMI under the compact will end unless the authority under which they are provided is extended; however, some U.S. agencies may continue to provide other programs and services to RMI under other authorities. See appendix IV for additional details of the status of U.S. grants and programs in RMI after FY 2023.

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\$32.81 million and the value of the services that will end at approximately \$6.75 million.<sup>131</sup>

- **Grants.** Annual grants that support RMI government expenditures but will end after FY 2023 are projected to total \$32.81 million. These grants include the compact sector grants, estimated at \$26.71 million in FY 2023, as well as an estimated \$6.09 million<sup>132</sup> for other grants—namely, audit, supplemental education, and emergency management performance grants.<sup>133</sup> Although the compact trust fund was established to provide an annual source of revenue for RMI, the maximum allowable disbursement—equal to the FY 2023 compact sector grant amount that will end, plus an inflation adjustment—does not include the value of these other grants. This will contribute to annual fiscal gaps for the RMI government.
- **Services.** At least \$6.75 million in annual U.S. agency funding for services to RMI will end. These services include postal service, weather service, and disaster services, which will end by May 1, 2024, and a planting and agricultural maintenance program on Enewetak and judicial training, which will end after September 30, 2023.<sup>134</sup> Past RMI government expenditures did not reflect the value of these services. Several other federal programs and services will also end but are not included in our estimate because of a lack of available data; therefore, our estimate is likely a lower bound.<sup>135</sup>

Table 7 shows the types and estimated amounts of compact-related annual assistance to RMI that will end.

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<sup>131</sup>Several other federal programs and services will also end but are not included in our estimate because of a lack of available data. Therefore, this estimate is likely a lower bound.

<sup>132</sup>Because of rounding, the sum of the estimated assistance differs from the sum of the values shown in table 7.

<sup>133</sup>According to agency officials, in FY 2024 RMI will be eligible for programs that the SEG, which will end, had replaced: Higher Education Act of 1965—Subpart 3 of Part A of title IV (Federal Supplemental Education Opportunity Grant) and Higher Education Act of 1965—Part C of title IV (Federal Work-Study Programs).

<sup>134</sup>Enewetak is an atoll in RMI that was affected by U.S. nuclear testing.

<sup>135</sup>These other federal programs and services include civil aviation safety and economic services and related programs and telecommunications services. See appendix IV for additional details of the status of U.S. grants and programs in RMI after FY 2023.

**Table 7: Estimated Compact-Related Annual U.S. Assistance to the Republic of the Marshall Islands (RMI) That Will End**

Millions of dollars

Type of assistance	Grant or service	Amount
U.S. grant assistance provided to the RMI government and included in RMI government expenditures.	Compact sector grants <sup>a</sup>	26.71
	Compact provision of audit costs	0.50
	Supplemental education grant <sup>b</sup>	5.57
	Emergency management performance grants	0.03
	<b>Subtotal</b>	<b>32.81</b>
U.S. services provided to RMI, which are not included in past RMI government expenditures.	Postal service	3.66
	Planting and Agricultural Maintenance Program on Enewetak	1.69
	Weather service <sup>c</sup>	0.89
	Disaster services for Presidential disaster declarations <sup>d</sup>	0.38
	Judicial training <sup>e</sup>	0.12
	<b>Subtotal<sup>f</sup></b>	<b>6.75</b>
<b>Total</b>		<b>39.55</b>

Source: GAO analysis of U.S. agency documents, responses, and interviews. | GAO-22-104436

Notes: The amounts shown reflect assistance data provided by various U.S. agencies. If an agency provided an estimated fiscal year (FY) 2023 value, we used that value. Otherwise, we assumed the FY 2023 value of assistance will be equal to the most recent available estimates or average of estimates that the agencies provided. Several other federal programs and services will also end but are not included in our estimate because of a lack of available data. Federal programs and services provided through an agreement with RMI end by May 1, 2024.

<sup>a</sup>This amount shown for compact sector grants includes funds expended by the RMI government and component units such as the College of the Marshall Islands and utilities. U.S. contributions to RMI's Disaster Assistance Emergency Fund are included in this total.

<sup>b</sup>This estimate represents an upper bound of assistance that will end after FY 2023. The amount of assistance that will end could be lower, because in FY 2024, according to agency officials, RMI will become eligible for the Higher Education Act of 1965—Subpart 3 of part A of title IV (Federal Supplemental Education Opportunity Grant) and the Higher Education Act of 1965—Part C of title IV (Federal Work-Study Programs), which the supplemental education grant (SEG) that will end had replaced. In FY 2004, the year before the SEG commenced, grants under these two programs to the freely associated states totaled \$664,036.

<sup>c</sup>According to agency officials, one-time capital improvements or major infrastructure projects may increase the funding provided for weather service in some years. Therefore, the estimate shown represents the minimum baseline annual amount.

<sup>d</sup>According to agency officials, annual funding for disaster services fluctuates widely on the basis of the impacts of disaster-causing events. This estimate represents an average annual amount.

<sup>e</sup>According to Interior officials, funds are provided directly to the U.S. Ninth Circuit Court through an interagency reimbursable agreement.

<sup>f</sup>Because of rounding, the subtotal components shown do not sum to the subtotal shown.

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Projections Show Risks to RMI Compact Trust Fund Disbursements though Average Yearly Balance May Increase in FYs 2024–2063

Our projections indicate a growing risk in FYs 2024 through 2063 that the RMI compact trust fund will not generate enough returns to provide the RMI government its maximum allowable disbursement during some years.<sup>136</sup> In addition, we project that the average shortfall between the maximum allowable disbursement and potential disbursement will likely increase over time. Furthermore, RMI faces an increasing risk of receiving zero disbursement in some years. Because of structural restrictions governing disbursements from the compact trust fund, the RMI compact trust fund faces these risks in spite of likely growth in its projected average yearly balance over time.<sup>137</sup>

We based our projections on the balance at the end of FY 2020—\$435.22 million in the corpus (A) account and \$79.21 million in the buffer (C) account<sup>138</sup>—and on current compact trust fund rules.<sup>139</sup> Our projections account for planned contributions from the U.S., RMI, and Taiwan but do not factor in RMI's own trust fund (D account), which, according to RMI

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<sup>136</sup>In addition to approving the maximum allowable disbursement, RMI's trust fund committee may approve additional amounts for special needs (i.e., defined as projects that the RMI government deems necessary as a supplement to that portion of an annual budget to be financed by the compact trust fund), if the projects are for the purposes of Section 211 of the compact as amended.

<sup>137</sup>The averages we present are affected by extreme values from the simulated cases. For more information about the distribution of the simulation results for the compact trust fund balance, see appendix V.

<sup>138</sup>The size of the buffer (C) account is capped at three times the amount of the estimated compact annual grant assistance that expires in FY 2023, partially adjusted for inflation pursuant to the formula set forth in section 218 of RMI's compact. According to the FY 2020 compact trust fund annual report, RMI's buffer (C) account was at its full value.

<sup>139</sup>Our projections are based on current compact trust fund rules. We previously reported on potential strategies for improving the outlook of RMI's compact trust fund, including reducing disbursements, making additional contributions, and changing disbursement policies. See GAO, *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Income*, [GAO-18-415](#) (Washington, D.C.: May 17, 2018).

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officials, had a balance of about \$12 million at the end of FY 2020.<sup>140</sup> Our projections assume a 6.5 percent nominal net-of-fees return. (See app. V for the projection results with alternative net returns of 5, 6, 7, and 8 percent.) Our projections also assume that the trust fund committee will choose to disburse the maximum allowable amount each year if funds are available, although the committee has the option to distribute a lower amount. (See app. I for a full description of our methodology.)

- **Disbursement as a percentage of the maximum is projected to decrease over time.** We project an increasing likelihood that the RMI compact trust fund will be unable to provide maximum disbursements in some years.<sup>141</sup> Our projections show that, excluding amounts for special needs, RMI may receive, on average, 96 percent of the maximum allowable annual disbursement—the inflation-adjusted amount of FY 2023 compact sector grants (i.e., \$26.71 million adjusted for inflation)—during the first decade, FYs 2024 through 2033. (These projection results do not account for any future additional disbursements for special needs.) Further, we project that this disbursement will decrease during the second decade, FYs 2034 through 2043, when RMI is likely to receive, on average, 90 percent of the maximum allowable annual disbursement.
- **The average shortfall is projected to increase over time.** We project that the decrease in the annual disbursement as a percentage of the maximum allowable disbursement corresponds to a likely increasing dollar shortfall between the maximum allowable and the projected disbursement.<sup>142</sup> Specifically, our projections show a likely average annual shortfall of \$1 million between the maximum allowable disbursement and the projected disbursement in the first decade. This projected shortfall increases to \$4 million a year in the following decade and increases further in subsequent decades. In addition, the amount available for disbursement may fluctuate substantially from year to year, because it depends on the compact trust fund's

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<sup>140</sup>Our projections include Taiwan's contributions to the RMI compact trust fund. By fiscal year 2023, Taiwan will have contributed a total of \$40 million to the compact trust fund corpus (A) account. Additionally, our projections include \$5 million that the U.S. provided to RMI as compensation for tax and trade provisions in FY 2021, which was deposited into the RMI compact trust fund's corpus (A) account as a RMI government contribution.

<sup>141</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>142</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

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performance in the previous year and the amount, if any, in the buffer (C) account.

- **The zero disbursement likelihood is projected to increase over time.** We project that the compact trust fund will likely be unable to disburse any funds in 1 or more years, a risk we project will increase over time.<sup>143</sup> Specifically, our projections indicate a 12 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 1 or more years during the first decade.<sup>144</sup> The likelihood of being unable to disburse any funds in 1 or more years increases over time, to 46 percent in FYs 2054 through 2063.
- **The compact trust fund balance is projected to increase over time and will likely remain substantial over the period.** Because of structural restrictions preventing disbursements from the compact trust fund's corpus (A) account, the risk of zero disbursement during some years exists even with a substantial projected average yearly balance. Specifically, for FYs 2024 through 2063, we project an average compact trust fund balance of \$343 million across only those simulations projecting a zero disbursement. However, across all simulations, we project that the average yearly balance will likely increase over time.<sup>145</sup> Specifically, we project that the average yearly balance of the compact trust fund may be \$758 million during the first decade of disbursements and may increase to \$2.1 billion in FYs 2054 through 2063.

Figure 9 shows the results of our projections of the RMI compact trust fund's disbursement outcomes and balance for FYs 2024 through 2063.

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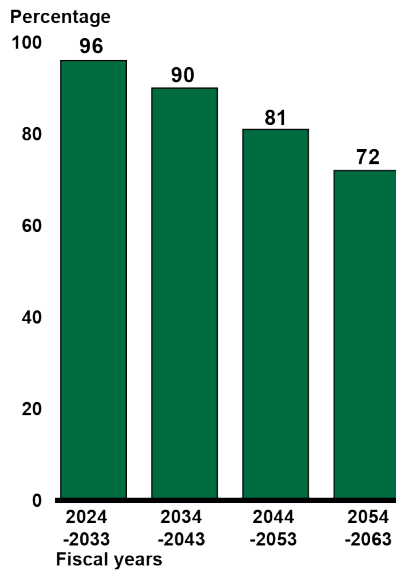
<sup>143</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>144</sup>The 12 percent likelihood can be broken down to a 10 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 1 or 2 years of the first decade of compact trust fund disbursements and a 1 percent likelihood that it will be unable to disburse any funds in 3 to 6 years (these percentages do not sum precisely to 12 percent because of rounding). (For more information about the zero disbursement risk in terms of its distribution of years, see appendix V.) We project an 88 percent likelihood that the RMI compact trust fund will be able to disburse funds in every year of the first decade of compact trust fund disbursements.

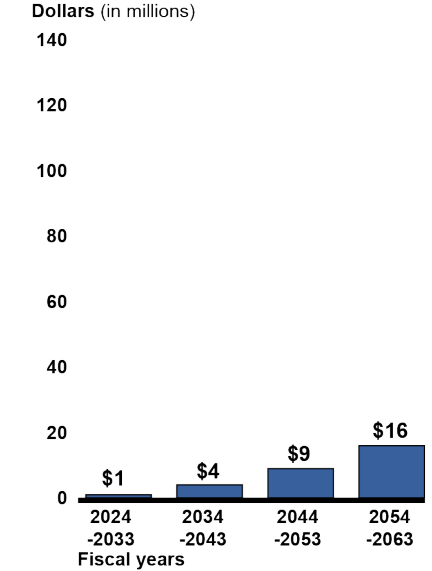
<sup>145</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

**Figure 9: Projected RMI Compact Trust Fund Disbursement Outcomes and Balance, Fiscal Years 2024–2063**

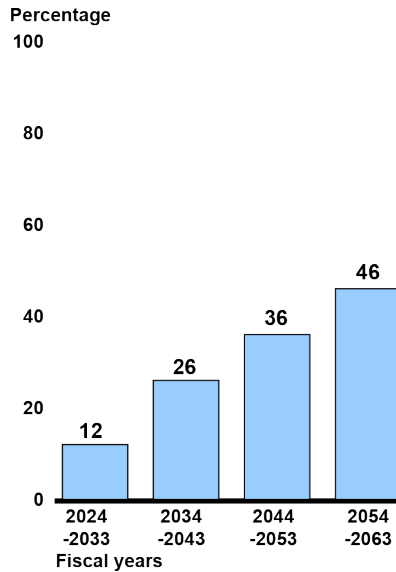
Disbursement: projected average disbursement as a percentage of maximum disbursement



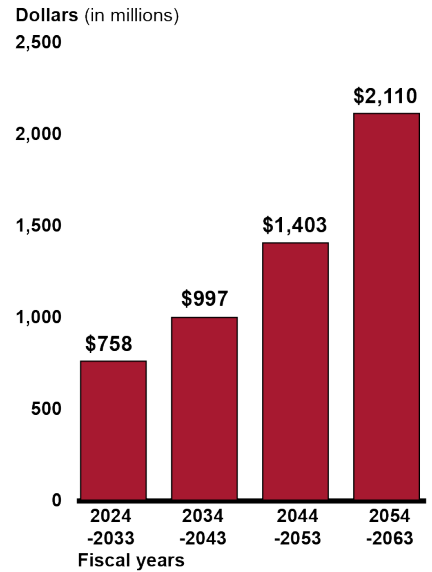
Average shortfall: maximum disbursement less projected disbursement



Zero disbursement: likelihood of one or more years with zero disbursement in a given period



Compact trust fund balance: projected average balance



Source: GAO analysis of Republic of Marshall Islands (RMI) compact trust fund documents. | GAO-22-104436

**Accessible Data Table for Figure 9**

	<b>FY24- FY33</b>	<b>FY34- FY43</b>	<b>FY44- FY53</b>	<b>FY54- FY63</b>
Disbursement: projected average disbursement as a percentage of maximum disbursement	96%	90%	81%	72%
Average shortfall: maximum disbursement less projected disbursement	\$1	\$4	\$9	\$16
Compact trust fund balance: projected average balance	\$758	\$997	\$1,403	\$2,110
Zero disbursement: likelihood of one or more years with zero disbursement in a given period	12%	26%	36%	46%

Notes: The projections shown are based on the current trust fund rules, the compact trust fund's audited balance at the end of fiscal year (FY) 2020, and planned contributions. We assumed that the trust fund's annual net return will have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee will choose to disburse the maximum allowable amount each year if funds are available. The averages shown are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty. For example, our estimates of the average balances are higher than the medians for each period shown. For more information, as well as additional results based on alternative net annual returns, see GAO-22-104436, appendix V.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

As we previously reported, a series of years with low or negative returns could exhaust the compact trust fund's buffer (C) account, which is designed to provide disbursements in years when the trust fund does not earn enough to fund the disbursement.<sup>146</sup> Because the RMI trust fund agreement prohibits disbursement from the fund's corpus (A) account to cover any shortfall in the buffer (C) account, RMI would receive no disbursement from the compact trust fund if the buffer (C) account were exhausted and the previous year's returns were zero or negative.<sup>147</sup> Thus, there may be no funds available to disburse even with the likelihood of a substantial projected balance from FY 2024 through FY 2063. As a result

<sup>146</sup>For an example of how the buffer (C) account could be exhausted, see appendix V.

<sup>147</sup>Because, like the corpus (A) account, the buffer (C) account can earn investment income, reductions in the buffer (C) account would reduce both the value of the trust fund and the potential amount of future trust fund earnings.



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of low or zero disbursements, RMI could face economic and fiscal shocks and challenges in planning programs and budgets.

The Secretary of the Interior has not implemented our 2018 recommendation that the Director of the Office of Insular Affairs, as Chairman of the RMI compact trust fund committee, work with other members of the committee to develop a distribution policy, as required by the trust fund agreement, that takes into account potential strategies that could address risks to the fund's ability to provide a source of income after FY 2023.<sup>148</sup> Interior concurred with the recommendation and indicated that the target date for implementing it is October 1, 2023, the date when RMI can start taking disbursements from the compact trust fund. The trust fund agreement allows for written amendments at any time, with mutual consent of both the U.S. and RMI. However, the U.S. legislation approving the amended compact requires that any amendment, change, or termination of all or any part of the compact trust fund agreement shall not enter into force until incorporated into an act of Congress.

#### Reports and Officials Point to Future Fiscal Challenges for RMI

Reports and comments from experts at several institutions, such as IMF and the World Bank, have noted challenges that may confront RMI when U.S. compact assistance ends. RMI and U.S. officials have also identified challenges RMI may face, such as the need to make fiscal adjustments, the compact trust fund's inability to cover fiscal gaps, and challenges in obtaining additional donor funds.

**IMF report warning of “fiscal cliff.”** According to the 2021 IMF Article IV staff report on RMI, RMI will, absent adequate fiscal consolidation, face increased risks of a fiscal cliff if compact grants are reduced in FY 2023 and other revenue sources remain stagnant.<sup>149</sup> The report notes that the potential for the fiscal cliff exists because donors may not be willing to

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<sup>148</sup>[GAO-18-415](#). Our 2021 priority letter to Interior included the recommendations contained in this 2018 report.

<sup>149</sup>International Monetary Fund, *Republic of the Marshall Islands: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: May 6, 2021). IMF's country surveillance efforts include conducting Article IV consultations, in which an IMF team of economists visits a country to assess economic and financial developments and discuss the country's economic and financial policies with government and central bank officials. IMF conducted Article IV consultations in RMI in 2021, 2018, 2016, 2013, 2011, 2009, 2008, and 2005.

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finance budget deficits beyond current and committed grants, among other reasons.<sup>150</sup> To implement fiscal consolidation, the IMF Executive Board recommends that as RMI recovers from the COVID-19 pandemic, it should reduce recurrent spending, implement tax reforms, strengthen public financial management, and establish a medium-term fiscal framework.<sup>151</sup>

In addition, the IMF report notes that the compact trust fund has a liquidity issue associated with its current disbursement rules. According to the baseline no-fiscal-adjustment scenario in the IMF report's projections, the compact trust fund's buffer (C) account will be depleted in FY 2039, and the compact trust fund's real value and its value as a percentage of GDP will erode in the medium term.

**Graduate School USA report predicting need for fiscal adjustments.**

Graduate School USA's FY 2018 Economic Review for RMI notes considerable uncertainty regarding the continuation of many special and federal programs and services that RMI receives from the U.S., such as the SEG.<sup>152</sup> The long-term economic outlook for RMI included in that report estimates a need for fiscal adjustment in FY 2024, assuming that compact trust fund drawdowns are reduced to a sustainable level.<sup>153</sup>

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<sup>150</sup>An IMF and World Bank 2021 debt sustainability analysis included in the 2021 IMF Article IV Staff report concluded that RMI's public debt levels had a high risk of debt distress but were sustainable; however, the analysis noted the need for fiscal and structural reform to contain the risks. RMI does not have any transactions or financial flows with IMF but can access IMF resources if certain conditions are met, according to IMF officials.

<sup>151</sup>In addition, IMF's 2018 Selected Issues report and 2021 Article IV report recommended that the RMI authorities seriously reconsider issuance of the sovereign (SOV). The SOV is a digital currency that RMI is pursuing; the main motivation for the SOV, according to IMF's 2018 Selected Issues report, is to generate government revenues. However, according to the 2021 IMF Article IV report, the RMI government is commissioning a comprehensive due-diligence study that will serve as the basis for the RMI parliament's decision to potentially repeal the 2018 SOV Act. See International Monetary Fund, *Republic of the Marshall Islands: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: May 6, 2021) and International Monetary Fund, *Republic of the Marshall Islands: Selected Issues* (Washington, D.C.: Aug. 10, 2018).

<sup>152</sup>Graduate School USA, *Economic Review Republic of the Marshall Islands Fiscal Year 2018* (November 2019). The economic review is an annual report that represents an independent assessment of RMI's economic performance.

<sup>153</sup>Graduate School USA's FY 2018 Economic Review for RMI presents the sustainability adjustment for enhanced reliability rule as an alternative to the existing disbursement rules and a way to provide sustainable drawdowns. Graduate School USA, *Economic Review Republic of the Marshall Islands Fiscal Year 2018* (November 2019).

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Specifically, the report projects that nonpayroll expenditures and infrastructure allocations will be cut to maintain fiscal balance.

Further, the Graduate School USA report states that compact trust fund “performance under compact of free association [rules] is far from satisfactory.” The report projects “unacceptably high” likelihoods of a declining real value of the compact trust fund corpus and of at least 1 fiscal year in which a zero disbursement from the compact trust fund will be allowed under prevailing rules. The report notes that although a favorable compact trust fund corpus value does not eliminate risk, joint or unilateral efforts to mobilize additional contributions to the compact trust fund would improve RMI’s long-term fiscal stability and economic security. Specifically, the report indicates an urgency to consider opportunities to achieve mutual agreement on a disbursement policy or amendments to enhance the compact trust fund agreement. Finally, the report notes that RMI has funded the D account within the compact trust fund and, to the extent that it makes additional contributions to the D account, could develop an important supplemental funding source to mitigate periodic or sustained fiscal shocks.

Another Graduate School USA report projects, as a result of the COVID-19 pandemic, a 5.5 percent drop in RMI’s GDP in FY 2020 and a 1.4 percent drop in GDP in FY 2021.<sup>154</sup>

**World Bank report projecting fiscal gaps.** Projections included in a 2016 World Bank report suggest that the scheduled end of compact grants in FY 2023 will, absent alternative sources of financial assistance, have a significant adverse effect on the North Pacific economies.<sup>155</sup> The report projects that RMI’s compact trust fund will likely be unable to finance baseline fiscal gaps through 2040 and that the spending required to improve human development outcomes will likely create even greater fiscal pressures. According to World Bank officials, RMI used its entire allocation of grants from the International Development Association of the World Bank in 2018 but could obtain money from World Bank trust funds.

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<sup>154</sup>Graduate School USA, *Assessing the Impact of COVID-19 on the Marshall Islands Economy* (May 2020).

<sup>155</sup>World Bank, *Financing Pacific Governments for Pacific Development. Pacific Possible Background Paper No. 7* (Washington, D.C.: 2016).

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**ADB officials' prediction of limited help from other donors.** A 2020 ADB member fact sheet covering RMI observed that the U.S. is currently the most significant partner, providing primarily budget support in education and health.<sup>156</sup> According to ADB officials, other donors have a limited ability to fill the gap that would result from the end of compact grant assistance. The officials stated that other donors expect the compact grant assistance to be extended and are not actively planning to increase their support.<sup>157</sup> ADB officials also noted that the potential end of compact grant assistance would not change the ADB financing available to RMI. A 2019 ADB Pacific Finance Sector brief notes that long-term fiscal sustainability is a primary concern for RMI, given the forthcoming end to the compact grants.<sup>158</sup>

According to the 2020 ADB member fact sheet, the gradual reduction in the value of RMI's annual compact grants has resulted in budget constraints affecting the government's ability to provide basic services. The fact sheet recommends improving the management of government spending and revenue generation to achieve fiscal sustainability. The fact sheet also recommends budgetary consolidation and structural reforms to ensure long-term economic sustainability and increase private sector development.

**RMI government statements on assistance and fiscal reforms.** In a September 2019 statement before the House Committee on Natural Resources and the House Committee on Foreign Affairs, the RMI Ambassador noted that the compact trust fund's capital is insufficient and that, owing to the country's tiny economy of scale, RMI would not be able to replace the essential services provided under the Federal Programs and Services Agreement.<sup>159</sup> The statement further argued for the SEG to

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<sup>156</sup>Asian Development Bank, *Marshall Islands Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020).

<sup>157</sup>ADB commissioned a project to examine the economic impacts of the end of compact grant assistance. The draft report on the project's results examines the potential loss in assistance in the RMI and the potential fiscal responses that the government may need to make if compact transfers end.

<sup>158</sup>Asian Development Bank, *Marshall Islands Pacific Finance Sector Brief* (Sydney, Australia: October 2019).

<sup>159</sup>*Hearing on Sustaining U.S. Pacific Insular Relationships, Before the House Committees on Natural Resources and Foreign Affairs*, 116 Cong. (Sept. 26, 2019) (statement of Gerald M. Zackios, Ambassador of the Republic of the Marshall Islands to the United States).

be a permanent appropriation and adjusted for inflation, as it is an essential part of RMI's education sector.

According to RMI officials, RMI estimates that, because of investment uncertainty, there is a 23 percent chance of the compact trust fund's eventual depletion if the target amount is distributed (subject to the trust fund agreement rules). RMI officials explained that RMI does not currently have a plan for filling the fiscal gap if compact funds are not renewed. Officials also stated that the government is currently working on public finance reform, tax reform, and tax revenue projection. In addition, officials noted that there had been a 7 percent cut across all ministries due to the COVID-19 pandemic and RMI's decrement plan. In August 2020, RMI officials indicated that the timing of disbursements and other compact trust fund changes will require amendments to the trust fund agreement, which the original parties to the agreement expected to address over the next couple of months.

**U.S. officials' statements on grant assistance and the compact trust fund.** As of July 2019, an interagency group comprising representatives of OIA, State, and DOD had begun consulting about possible plans to pay for any extension of financial assistance to RMI.<sup>160</sup> In September 2019, the OIA Director indicated that if grant assistance is allowed to end and is not extended, there is a very real risk of adverse impact on the RMI economy.<sup>161</sup>

Regarding the compact trust fund, the OIA Director also indicated in his September 2019 statement that there is significant concern about the volatility and the size of the disbursements to support RMI's post-FY 2023 budgets. The Director noted that the trust fund committee was analyzing and discussing disbursement policy options to provide more

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<sup>160</sup>*The United States' Interests in the Freely Associated States*, Before the Committee on Energy and Natural Resources, 116th Cong. 116-331 (2019) (statement of Sandra Oudkirk, Deputy Assistant Secretary for Australia, New Zealand, and Pacific Islands, Bureau of East Asian and Pacific Affairs, Department of State, and statement of Douglas Domenech, Assistant Secretary, Insular and International Affairs, Department of the Interior).

<sup>161</sup>*Hearing on Sustaining U.S. Pacific Insular Relationships, Before the House Committees on Natural Resources and Foreign Affairs*, 116 Cong. (Sept. 26, 2019) (statement of Nikolao Pula, Director, Office of Insular Affairs, Department of the Interior).

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consistent disbursements with less volatility and no years of zero distributions.<sup>162</sup>

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<sup>162</sup>Director Pula also noted that disbursement policy options are limited unless the trust fund agreement is amended by the original parties to the agreement.

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## RMI Audits Report Mixed Financial Accountability, while JEMFAC Continues its Oversight

### FY 2015–2019 Audits Indicate Improvement in RMI’s Financial Accountability but Also Identify Shortcomings in Compliance with Grant Agreements

RMI single audits for FYs 2015 through 2019 demonstrated some improvement in accountability for the government’s use of U.S. funds but showed shortcomings in RMI’s compliance with grant requirements.<sup>163</sup> Over the 5-year period, the annual number of single audit findings—that is, material weaknesses or significant deficiencies in internal controls or financial reporting—decreased from 20 to seven.<sup>164</sup> However, certain findings—for example, internal control weaknesses and outstanding questioned costs (i.e., costs that the auditor found lacked sufficient documentation)—remained and in some cases recurred. Also, RMI was not considered a low-risk auditee. An auditee would meet the criteria as a low-risk auditee if the entity, among other things, submitted its audit report within the required time frame in each of the two preceding audit periods.

Table 8 summarizes selected information related to the RMI single audit reports for FYs 2015 through 2019.

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<sup>163</sup>Single audits are a critical element in the federal government’s ability to ensure that federal funds are properly used and that federal agencies have information to fulfill their oversight responsibility for the funds they award to nonfederal entities. Each single audit report includes the following components: the entity’s audited financial statements; the schedule of expenditures of federal awards and the auditor’s opinion on whether the schedule is reported fairly in relation to the financial statements as a whole; the auditor’s opinion (or disclaimer of opinion) regarding the auditee’s compliance with the laws, regulations, and provisions of contracts and grant agreements (such as the compact), which could have a direct and material effect on each major federal program; and a report on findings on internal controls related to federal programs. Auditors issue various types of opinions in audit reports, including unmodified, qualified, disclaimer, and adverse. The audit reports also include any findings—that is, material weaknesses or significant deficiencies in internal controls or financial reporting.

<sup>164</sup>Further, RMI officials told us that prior questioned costs in FYs 2003 and 2004 were approximately \$11 million and \$15 million, respectively.

**Table 8: Selected Information from the RMI Single Audit Reports, Fiscal Years 2015–2019**

Single audit component	Fiscal year				
	2015	2016	2017	2018	2019
Financial reporting (auditor's opinion <sup>a</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Schedule of Expenditures of Federal Awards (auditor's opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor's opinion <sup>c</sup> )	qualified opinion	qualified opinion	qualified opinion	qualified opinion	qualified opinion
Audit findings (total number)	20	12	11	11	7
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	3,520	2,510	2,160	2,519	3,702
Timely submission of single audit package <sup>e</sup>	no	yes	yes	yes	yes
Low-risk auditee <sup>f</sup>	no	no	no	no	no

Source: GAO analysis of Republic of the Marshall Islands (RMI) single audit reports for fiscal years 2015-2019. | GAO-22-104436

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal awards for the period covered by the award recipient's financial statements. This schedule has a number of reporting requirements, including (1) reporting the individual federal programs, by federal agency; (2) providing the total federal awards expended for each individual federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor's opinion is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>A qualified opinion on compliance with requirements of major programs is based on noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards that is material in relation to a type of compliance requirement for a major program identified in the compliance supplement.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost, at the time of the audit, was not supported by adequate documentation; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the entity's fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

The following provides additional information from the RMI single audits for FYs 2015 through 2019.

**Compliance with requirements of major federal programs.** The RMI single audits for FYs 2015 through 2019 reported that use of compact sector grants was not fully compliant with the requirements of federal programs. An opinion on compliance with requirements for major



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programs is based on the extent of the material weaknesses and significant deficiencies observed by the auditors during the course of the audit. The lack of compliance concerned equipment and real-property management requirements. For example, RMI was not performing inventory of its assets and did not have policies and procedures regarding property maintenance.<sup>165</sup>

**Single audit findings.** The single audit report for FY 2015 contained 20 findings and the single audit report for FY 2019 contained seven findings, which indicates improvement. During the 5-year period of our review, the audits identified noncompliance with cash management requirements, allowable cost principles, equipment and real-property management requirements, subrecipient monitoring requirements, and procurement requirements. For example, the single audits reported that RMI improved its compliance with cash management requirements and the Fiscal Procedures Agreement. However, other issues persisted, such as noncompliance with equipment and real-property management requirements and with subrecipient monitoring requirements in FY 2019. For example, one finding in the FY 2019 single audit report included a lack of internal controls over equipment; an inventory of equipment had not been performed at least once in the previous 2 years. Another finding involved a lack of monitoring activities for subrecipients of grants. Further, our analysis of the single audit reports for FYs 2015 through 2019 determined that five findings recurred in all of the 5 years. For example, one of the recurring findings concerned the lack of accountability for equipment.

According to the RMI Office of the Auditor General (OAG), in addition to the single audits of the RMI government conducted by independent auditors, a few performance audits of U.S. grant-funded programs that were performed by state public auditors identified internal control weaknesses. We met with OAG officials to discuss its oversight activities during FYs 2015 through 2019.<sup>166</sup> OAG told GAO that they coordinate the

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<sup>165</sup>According to RMI officials, the Ministry of Finance developed and approved a Fixed Assets Management Procedures Manual in July 2019 that covers procedures to ensure compliance for inventories of assets.

<sup>166</sup>An RMI OAG official told us that the office has invested in its fraud investigation group to ensure it can effectively perform investigations of allegations of fraud, waste, and abuse involving public funds, including U.S. federal funds.

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annual RMI single audit and annual audits of several component units<sup>167</sup> and conducts performance audits.<sup>168</sup> OAG officials told us they performed a review of Pacific Wellness Centers Inc. for FYs 2014 and 2015.<sup>169</sup> The report stated these centers were supported with compact sector grant funds. The OAG reported six findings, including findings that the company had not complied with grant terms and conditions and that expenditures did not have adequate support. The OAG made 13 recommendations. The company's management and the RMI Ministry of Finance concurred with the audit report.

OAG officials reported that RMI compliance with federal award requirements as reflected in single audits has been improving. However, according to the officials, one recurring issue is lack of compliance with procurement requirements in both the education and health sectors, where most of the compact funding is allocated. OAG officials also told us that their office does not have enough resources to conduct additional audits of the health and education programs. OAG officials stated that they have initiated efforts to strengthen its ability to conduct audit and oversight of public funds, including efforts to conduct fraud investigations.<sup>170</sup>

The RMI government is making some progress in its efforts to ensure accountability for the use of U.S. funding, according to OIA officials. OIA officials reported that the RMI government continues to improve the accuracy of its reporting of financial data and its accountability. According to OIA officials who administer and oversee compact grants, OIA's goal related to accountability is for the RMI government to implement and enforce internal controls that will help ensure its use of federal funding

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<sup>167</sup>OAG officials told us these components include the College of the Marshall Islands, Air Marshall Islands, and Majuro Atoll Waste Company, among others.

<sup>168</sup>According to OAG officials, they performed performance audits of non-U.S. funding including an audit of the Passport Program and an audit of procurement sourcing.

<sup>169</sup>Republic of the Marshall Islands, Office of the Auditor-General, *Inspection Report of Pacific Wellness Centers, Inc. Fiscal Years 2014 and 2015*, Report No. 01/17-3581 (Majuro, Republic of the Marshall Islands: Jan. 9, 2018).

<sup>170</sup>OAG officials reported that the office now has two certified fraud investigators to ensure that the office can carry out investigations into all known allegations of fraud, waste and abuse involving public funds, including U.S. federal funds.

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complies with JEMFAC resolutions, the approved budget, and applicable federal and RMI requirements.

For audit purposes, OIA's specific goal is to help the RMI government obtain unmodified opinions in the annual audits of financial reporting, increase compliance with federal grant awards, and have no material internal control findings or questioned costs related to expenditures of federal awards.<sup>171</sup> OIA officials stated that they work closely with RMI government personnel in the Ministry of Finance and the Office of the Auditor General, as necessary, and work directly with RMI government program personnel responsible for the resolution of audit findings. Additionally, OIA officials indicated that the office provides resources for training to help increase the capacity of the RMI government workforce. State officials told us that State's overall objective is to ensure the funds are used for their intended purpose consistent with RMI's obligations under the amended compact as well as the fiscal procedures agreement. An additional objective is the swift resolution of any questioned costs and fewer questioned costs over time.

Both OAG and OIA officials told us that in FY 2017 the RMI compact trust fund was compromised by cyberattacks, resulting in more than \$685,000 in fraudulent withdrawals. After discovery of the fraudulent withdrawals, the custodian bank fully restored the funds and internal controls were enhanced. According to OIA officials, the bank asked the Federal Bureau of Investigation to investigate the cyberattacks. OAG officials told us that, as of September 2021, they had not received any additional information about the results of the investigation.<sup>172</sup>

### JEMFAC Conducts Oversight of Financial Accountability of RMI Compact Grants

JEMFAC is responsible for oversight to help ensure that U.S. compact funds are achieving their intended goals in RMI and that the RMI

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<sup>171</sup>Our performance audits of RMI over the past 20 years have found improvement in the government's progress toward this goal, despite the material weaknesses and outstanding questioned costs identified by the RMI's FY 2019 single audit.

<sup>172</sup>According to RMI officials, the RMI government contacted the Federal Bureau of Investigation directly, pursuant to the compact Mutual Law Enforcement Assistance agreement, to request assistance in investigating the unauthorized withdrawals from compact funds. The officials stated that through RMI's ongoing efforts with State Street Corporation, the custodian bank, RMI successfully recovered all funds that had been taken as a result of the cyberattacks and prevented the theft of further amounts that had been in process at the time.

government has financial internal controls in place to support accountability. Working through JEMFAC, U.S. members, with support from OIA grant managers, have led accountability discussions during joint meetings between the U.S. and RMI governments to improve compact fund accountability and have recommended that JEMFAC take certain actions. For example, at the 2016 annual JEMFAC meeting, RMI and U.S. JEMFAC members reported that they recognized the challenges faced by the RMI government in developing the capacity of the Ministry of Finance. To improve internal controls, resolve questioned costs, and strengthen RMI's ability to effectively use and manage U.S. grant funds, JEMFAC adopted resolutions such as the following:

- The government of RMI needs to strengthen its capacity to provide accurate financial reports and enhance its internal and budgetary controls in compliance with the compact fiscal procedures agreement.<sup>173</sup>
- Effective with the issuance of FY 2018 amended compact budget data, the amount of Section 211 assistance to RMI would be set aside in the amount of questioned costs that remained unresolved after December 31, 2016.<sup>174</sup>
- JEMFAC recognized the need for the government of RMI to improve the reliability of its performance indicators for the health sector.<sup>175</sup> JEMFAC further recognized the need for sustained financial resources to support such efforts by the RMI government and provided additional funding to strengthen the government's ability to provide reliable health performance data. According to State officials,

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<sup>173</sup>JEMFAC further urged the RMI government to adopt a strategy to reduce operational issues within the Ministry of Finance while building capacity. JEMFAC encouraged RMI to submit a proposal to JEMFAC for assistance to strengthen the institutional capacity of the Ministry of Finance.

<sup>174</sup>Specifically, JEMFAC's resolution stated that questioned costs of amended compact sector grant assistance reported in the annual single audits that remained unresolved past December 31, 2016, would be set aside from the total amount of Section 211 assistance that would otherwise be made available to RMI. JEMFAC stated that release of this funding would be contingent on resolution of such questioned costs by the RMI government and accepted through final determination as required by applicable law or as otherwise mutually determined.

<sup>175</sup>In 2013, we recommended that the Director of Insular Affairs, as Chairman of JEMFAC, coordinate with other JEMFAC members to take all necessary steps to ensure that RMI produces reliable indicator data used to track progress in education and health. See GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, [GAO-13-675](#) (Washington, D.C.: Sept. 20, 2013).

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JEMFAC resolved in 2016 that, pending the identification of an appropriate level of financial resources to support a sustained, professionally led performance management effort, the RMI government would, effective in FY 2021 and each year thereafter, include a minimum of \$300,000 of compact sector grant assistance annually with the health sector budget portfolio for the purpose of strengthening the government's ability to systemically produce, gather, and reliably report on health performance indicators and data.

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## Palau: Use and Role of U.S. Funds, Potential Fiscal Effects of Expiring Assistance, and Record of Accountability

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### U.S. Compact Grants, Trust Fund Disbursements, and Other Grants Provide for About One-Quarter of Palau Government Expenditures

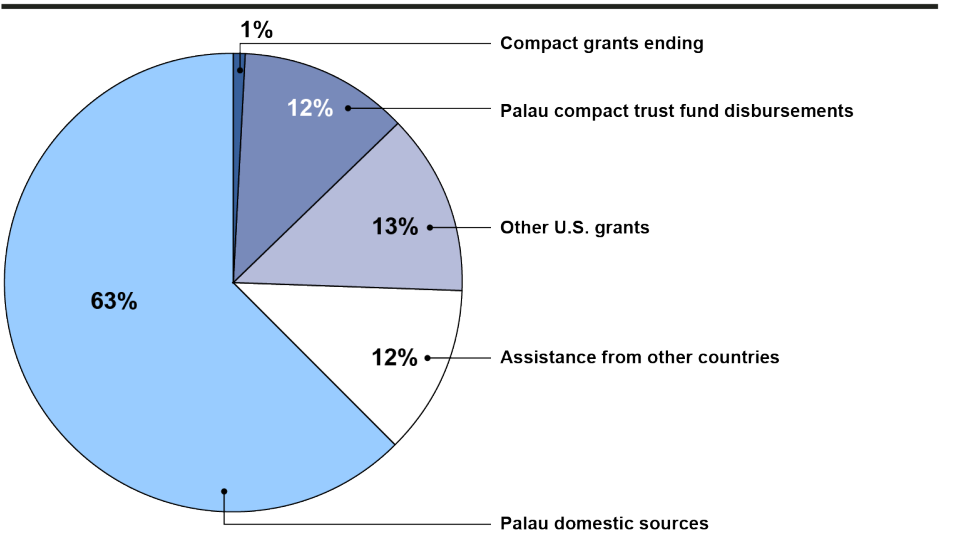
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U.S. assistance, very little of which is scheduled to end, provides a large percentage of the Palau government's budget expenditures for programs.<sup>176</sup> The U.S. has provided assistance primarily through compact grants, compact trust fund disbursements, and other U.S. grants. This assistance—about \$32 million in total—represented one-quarter of Palau's government expenditures in FY 2019. In addition, the Palau government relies on programs and services provided pursuant to the Compact Review Agreement, as amended, that end in 2024 but are not reflected as part of the government's expenditures. Compact grants of over \$1 million supported 1 percent of Palau government's expenditures in FY 2019. Compact trust fund disbursements of \$15 million supported 12 percent of total government expenditures (see fig. 10). Other U.S. grants of about \$16 million for various programs supported an additional 13 percent of government expenditures. (App. III provides additional information, by year, on the U.S. assistance provided to the Palau government, as reflected in the government's expenditures for FYs 2015 through 2019.)

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<sup>176</sup>Throughout this report, we present conclusions about the status of grants and programs under current U.S. law. Changes to the relevant laws before 2024 could alter Palau's eligibility status. The availability of some grants and programs in the future is subject to the availability of appropriations provided for that purpose.

**Figure 10: Total Expenditures of Palau Government, by Source, Fiscal Year 2019**  
FY 2019 total expenditures = \$129.0 million



Source: GAO analysis of Palau single audit for fiscal year 2019. | GAO-22-104436

**Accessible Data Table for Figure 10**

Expenditures	Percent
Compact grant ending	1%
Other U.S. grants	13%
Palau compact trust fund disbursements	12%
Assistance from other countries	12%
Palau domestic sources	63%

Notes: Percentages shown do not sum to 100 because of rounding. Percentages shown do not include government component units, such as the Palau Community College and public utilities. Information depicted does not include programs and services provided in the compact that are scheduled to expire in 2024 but are not reflected as part of the government's expenditures.

**Compact Review Agreement Grants**

For FY 2019, Palau expended over \$1 million for infrastructure projects, including maintenance of roads and structures, mutually agreed on by the U.S. and Palau governments. For the status of all Compact Review Agreement–related grants in Palau, see app. IV.

**Federal Programs and Services**

In addition to receiving the compact assistance provided by the U.S., Palau receives assistance specified in its Federal Programs and Services

Agreements as amended by the Compact Review Agreement. These services are scheduled to expire in 2024 unless the Compact Review Agreement is renewed or extended. The agreement provides for postal, weather, and aviation services carried out by the U.S. Postal Service (USPS), the National Weather Service, and the Federal Aviation Administration (FAA), which incur costs in some cases for the services.<sup>177</sup> These services are not reflected in Palau's government expenditures. Palau government officials stated that USPS and FAA are important partners to enable Palau to carry out services such as maintaining the island's airspace.<sup>178</sup> (See app. IV for additional information about federal programs and services that support the Palau government.)

### Other U.S. Grants

Palau is also eligible for, and receives, funding from a range of other U.S. grants, loans, and in-kind services—known as discretionary programs—to assist in areas such as education, health, infrastructure improvement, and telecommunications.<sup>179</sup> In FY 2019, several U.S. agencies, including the Departments of Commerce, Education, Labor, and Health and Human Services, provided grants and other services worth approximately \$16 million in expenditures for Palau.<sup>180</sup> U.S. programs covering education and health services make up the largest portion of U.S. discretionary

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<sup>177</sup>According to USPS officials, under the current arrangement with the U.S., postage rates for mail from the U.S. to the FAS are maintained at domestic levels, which are lower than international rates. Should the agreements lapse, the USPS would no longer bear the costs of subsidizing shipping and mail prices for the FAS, according to USPS officials.

<sup>178</sup>FEMA officials stated that they have had no role or authority in Palau, in contrast to FSM and RMI, to provide disaster assistance.

<sup>179</sup>In addition to being eligible for the programs provided through the compact, its associated agreements, and the amended compacts' implementing legislation, Palau is eligible for a number of programs under other provisions of current U.S. law, according to U.S. agency officials. These are subject to periodic congressional authorization and annual appropriations.

<sup>180</sup>The Department of Defense accounted for more than \$6 million of Palau's government expenditures of U.S. grants in fiscal year 2019. The expenditure was for financial assistance to Palau with regard to the use of private land needed for designating defense sites. These sites would allow for placement of maritime domain awareness radars, which is intended to increase Palau's air and maritime domain awareness capabilities and improve Palau's security and governance capabilities, according to a State document and State officials.

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funding to Palau (see app. IV for a list and descriptions of U.S. grants for which Palau is eligible).

Interior provided about \$1 million in expenditures for Palau for general economic, health, and infrastructure improvement expenditures, which are covered by the Economic, Social, and Political Development of the Territories grant. The U.S. Department of Education provided grants to both the Palau government and the Palau Community College, an accredited, postsecondary vocational and academic institution.<sup>181</sup> These grants provided funding for a number of education services, including special and adult education programs, teacher training and curriculum development, and postsecondary financial aid. Additionally, students at the Palau Community College receive Pell grants; in FY 2019, the college's distribution of funds for these grants was \$1.8 million. Other U.S. programs extended to Palau include the Department of Education's TRIO programs known as Upward Bound and Talent Search.<sup>182</sup> In FY 2019, the college's distribution of funds for these two programs was almost \$700,000. See appendix IV for compact and other grants related to education provided to Palau.

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## Ending of U.S. Grants Will Cause a Fiscal Gap for Palau, and Risks to Compact Trust Fund Disbursements Exist

According to our projections, the scheduled ending after September 2024 of a U.S. grant of \$2 million for infrastructure maintenance<sup>183</sup> will result in a fiscal gap for Palau's government, leading to shortfalls in the

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<sup>181</sup>Palau Community College is considered a component unit of the Palau national government and is the only postsecondary school in Palau.

<sup>182</sup>TRIO grant-based programs are educational and opportunity outreach programs designed to support students from disadvantaged backgrounds.

<sup>183</sup>The Compact Review Agreement established a trust fund for infrastructure maintenance, consistent with the terms of the agreement. The trust fund is funded by U.S. grants of \$2 million annually through FY 2024, with requirements for Palau to also provide funding. This funding can be used for maintenance of U.S.-financed capital improvement projects such as the road system and airport, according to the Compact Review Agreement. On a case-by-case basis, the funding can also be considered for maintenance use for other U.S. financed capital improvement projects, such as schools and the national hospital, and to mitigate damage and make emergency repairs to capital improvement projects funded by the U.S., when mutually agreed in writing.



government's ability to financially support the nation.<sup>184</sup> In total, an estimated \$4.61 million worth of annual U.S. grants, programs, and services to Palau will end after FY 2024. Disbursements from the Palau compact trust fund are already occurring and are not designed to offset the expiring U.S. assistance. Further, Palau faces a risk of receiving no disbursement from the compact trust fund in some years if the compact trust fund is depleted. Although we project a 0 percent likelihood that Palau will receive no disbursement from the compact trust fund in 1 or more years in FYs 2024 through 2033, that risk increases to 35 percent in FYs 2054 through 2063.<sup>185</sup> In addition to our analysis on this topic, other reports and officials have examined the ending of some U.S. assistance to Palau.<sup>186</sup>

### Estimated \$5 Million of Annual Compact Grants and Other U.S. Assistance to Palau Is Scheduled to End, Resulting in a Fiscal Gap

The U.S. grants and other services related to the compact that will end after September 2024<sup>187</sup> will be worth an estimated \$4.61 million—\$2 million for an annual infrastructure maintenance grant and an estimated \$2.61 million worth of services provided annually.<sup>188</sup> The Palau government will face a fiscal gap due to the ending of the infrastructure

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<sup>184</sup>In this context, “fiscal gap” refers to the projected shortfall in government operational funding that will result from the ending of assistance that could be included in future Palau government expenditures and that future compact trust disbursements will not replace. The ending of U.S. federal programs and services will likely have a further economic effect on Palau.

<sup>185</sup>We used a Monte Carlo simulation model to project outcomes related to the compact trust fund over a 40-year period. A Monte Carlo analysis is a computational technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

<sup>186</sup>For example, we reviewed previous studies of Palau, including the Staff Report for the International Monetary Fund's Article IV Consultation and Graduate School USA's Economic Review.

<sup>187</sup>Certain grants, programs, and services that the U.S. makes available to Palau under the compact will end unless the authority under which they are provided is extended; however, some U.S. agencies may continue to provide other programs and services to Palau under other authorities. See appendix IV for additional details of the status of U.S. grants and programs in Palau after FY 2024.

<sup>188</sup>Several other federal programs and services will also end but are not included in our estimate because of a lack of available data. Therefore, our estimate is likely a lower bound.

maintenance grant, once the infrastructure maintenance trust fund that the grant supports is depleted. The scheduled ending of federal programs and services, which are not reflected in Palau’s government expenditures, will likely have a further economic impact.

- **Grants.** Annual infrastructure maintenance grant assistance of \$2 million will end after FY 2024, contributing to the Palau government’s future fiscal gap once the infrastructure maintenance trust fund that the grant supports is depleted. Disbursements from the compact trust fund, which were not established to replace the grant, are already allowed.
- **Services.** At least \$2.61 million in annual U.S. agency funding for services to Palau, such as postal and weather services, will also end after FY 2024. Past Palau government expenditures did not reflect the value of these services. Several other federal programs and services will also end but are not included in our estimate because of a lack of available data; therefore, our estimate is likely a lower bound.<sup>189</sup>

Table 9 shows the types and estimated amounts of compact-related annual assistance to Palau that will end after FY 2024.

**Table 9: Estimated Compact-Related Annual U.S. Assistance to the Republic of Palau That Will End after Fiscal Year 2024**

Millions of dollars

Type of assistance	Grant or service	Amount
U.S. grant assistance provided to the Palau government.	Infrastructure maintenance grant <sup>a</sup>	2.00
U.S. services provided to Palau, which are not included in past Palau government expenditures.	Postal service	1.75
	Weather service <sup>b</sup>	0.86
	Subtotal	2.61
Total		4.61

Source: GAO analysis of U.S. agency documents, responses, and interviews. | GAO-22-104436

Notes: The amounts shown reflect assistance shown in data provided by various U.S. agencies. If an agency provided an estimated fiscal year (FY) 2024 value, we used that value. Otherwise, we assumed that the FY 2024 value of assistance will be equal to the most recent available estimates that the agencies provided. Federal programs and services provided through an agreement with Palau end on September 30, 2024.

<sup>a</sup>Funds requested by the Palau government for infrastructure projects are subject to U.S. government approval.

<sup>189</sup>These other federal programs and services include civil aviation safety and economic services and related programs and telecommunications services. See appendix IV for additional details on the status of U.S. grants and programs in Palau after FY 2024.

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<sup>b</sup>According to agency officials, one-time capital improvements or major infrastructure projects may increase the funding provided for weather service in some years. Therefore, the estimate shown represents the minimum baseline annual amount.

### Projected Risks to Palau Compact Trust Fund Disbursements in FYs 2024–2043 Are Minimal but Increase over Time because of Risk of Fund Depletion

We found minimal risks to Palau compact trust fund disbursements in FYs 2024 through 2043. However, our projections indicate a growing risk in FYs 2024 through 2063 that the compact trust fund—designed as a sinking fund to last until 2045—will not generate enough returns to provide the Palau government its maximum allowable disbursement in some years.<sup>190</sup> In addition, we project that the average shortfall between the maximum allowable disbursement and potential disbursement will likely increase over time. Furthermore, Palau faces an increasing risk of receiving zero disbursement in some years. Because of the risk of the compact trust fund’s depletion, we found that the Palau compact trust fund faces these risks in spite of likely growth in its projected average yearly balance over time.<sup>191</sup>

We based our projections on the compact trust fund’s \$275.60 million balance at the end of FY 2020 and on current compact trust fund rules. In addition, we assume a 6.5 percent nominal net-of-fees return. (See app. V for the projection results with alternative net returns of 5, 6, 7, and 8 percent.) Our projections also assume that the Palau compact trust fund will disburse \$15 million each year if funds are available. (See app. I for a full description of our methodology.)

- **Disbursement as a percentage of the maximum is projected to decrease over time.** We project an increasing likelihood that the Palau compact trust fund will be unable to provide maximum allowable disbursements in some years.<sup>192</sup> Our projections show that Palau may receive, on average, disbursements equal to 95 percent or

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<sup>190</sup>While our results consider FYs 2024 through 2033 and FYs 2034 through 2043, we anticipate similar findings through FY 2044.

<sup>191</sup>The averages we present are affected by extreme values from the simulated cases. For more information about the distribution of the simulation results for the compact trust fund balance, see appendix V.

<sup>192</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

more of the maximum allowable annual disbursement—\$15 million annually not adjusted for inflation—in FYs 2024 through 2043 (see fig. 11).<sup>193</sup> Specifically, we project that Palau may receive, on average, 100 percent of the maximum allowable annual disbursement in FYs 2024 through 2033. In part because of the risk of depletion of the compact trust fund, we project that Palau may receive, on average, 95 percent of the maximum allowable annual disbursement in FYs 2034 through 2043.

- **The average shortfall is projected to increase over time.** We project that the decrease in the annual disbursement as a percentage of the maximum allowable disbursement will correspond to a likely increasing dollar shortfall between the maximum allowable and projected disbursements.<sup>194</sup> Our projections show a likely average annual shortfall of \$1 million or less between the maximum allowable disbursement and the projected disbursement in FYs 2024 through 2043. Specifically, we project an average shortfall of almost \$3,700 per year in FYs 2024 through 2033, increasing to \$1 million per year in the following decade and higher in subsequent decades.
- **The zero disbursement likelihood is projected to increase over time.** We project that the compact trust fund will likely be unable to disburse any funds in 1 or more years, a risk we project will increase over time in part because of the risk of depletion of the compact trust fund.<sup>195</sup> Our projections indicate a 10 percent or lower likelihood that the Palau compact trust fund—designed as a sinking fund to last until 2045—will be unable to disburse any funds in 1 or more years in FYs 2024 through 2043. Specifically, our projections indicate a 0 percent likelihood that the Palau compact trust fund will be unable to disburse any funds in 1 or more years in FYs 2024 through 2033,<sup>196</sup> rising to 10

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<sup>193</sup>Our projections for Palau cover the same period as those for FSM and RMI. Our results through FY 2044, the year through which the Palau compact trust fund was designed to last, would likely be very similar to those we project for FYs 2024 through 2043.

<sup>194</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>195</sup>This trend is consistent with alternative annual net returns that we considered. For more information, see appendix V.

<sup>196</sup>There is a 100 percent likelihood that the Palau compact trust fund will be able to disburse funds in every year in FYs 2024 through 2033.

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percent in FYs 2034 through 2043 and increasing further in subsequent decades.<sup>197</sup>

- **The compact trust fund balance is projected to increase over time.** We project that, on average, the yearly balance of the compact trust fund may be \$305 million or greater in FYs 2024 through 2043. Specifically, we project an average yearly balance of \$305 million in FYs 2024 through 2033, possibly increasing to \$376 million in FYs 2034 through 2043 and higher in subsequent decades.<sup>198</sup> The risks we project exist in part because of the potential depletion of the compact trust fund, although its balance will likely increase in FYs 2024 through 2063. Our projections present averages over time and over many simulation cases, including cases in which the Palau compact trust fund may be depleted. For those cases where we project the fund's depletion, future years' outcomes reflect that depletion. For example, the simulation cases projecting that the compact trust fund may be depleted show that Palau will receive zero disbursement for all remaining years in those cases.

Figure 11 shows the results of our projections of the Palau compact trust fund's disbursement outcomes and balance for FYs 2024 through 2063.

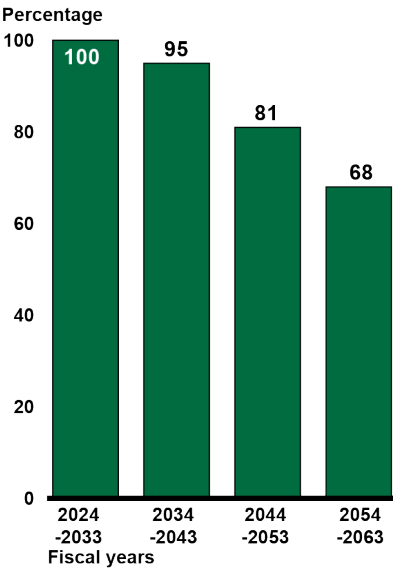
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<sup>197</sup>The 10 percent likelihood can be broken down to a 3 percent likelihood that the Palau compact trust fund will be unable to disburse any funds in 1 or 2 years of the first decade of compact trust fund disbursements and a 6 percent likelihood that it will be unable to disburse any funds in 3 to 10 years (these percentages do not sum to 10 percent because of rounding). For more information about the zero disbursement risk in terms of its distribution of years, see appendix V.

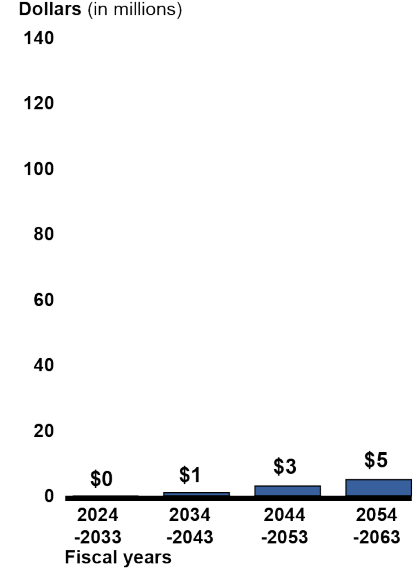
<sup>198</sup>This trend varies with alternative annual net returns that we considered. With an annual net return of 6 percent, 6.5 percent, 7 percent, or 8 percent, we project that, on average, the yearly balance will likely increase over time. With an annual net return of 5 percent, we project that, on average, the yearly balance will likely decrease from FY 2024 through FY 2043 but may increase from FY 2043 through FY 2063. For more information, see appendix V.

**Figure 11: Projected Palau Compact Trust Fund Disbursement Outcomes and Balance, Fiscal Years 2024–2063**

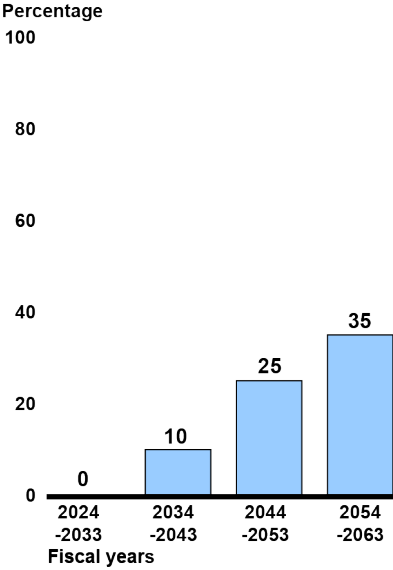
Disbursement: projected average disbursement as a percentage of maximum disbursement



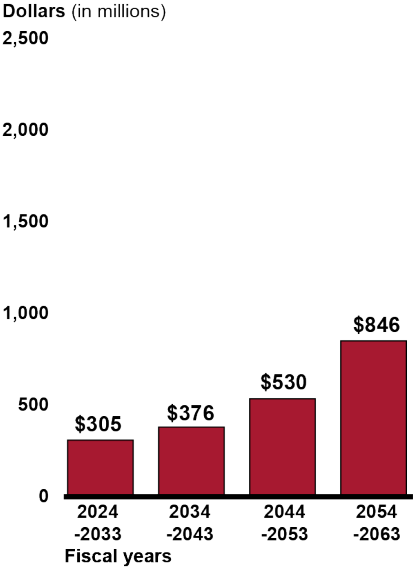
Average shortfall: maximum disbursement less projected disbursement



Zero disbursement: likelihood of one or more years with zero disbursement in a given period



Compact trust fund balance: projected average balance



Source: GAO analysis of Republic of Palau compact trust fund documents. | GAO-22-104436

### Accessible Data Table for Figure 11

	FY24- FY33	FY34- FY43	FY44- FY53	FY54- FY63
Disbursement: projected average disbursement as a percentage of maximum disbursement	100%	95%	81%	68%
Average shortfall: maximum disbursement less projected disbursement	\$0	\$1	\$3	\$5
Compact trust fund balance: projected average balance	\$305	\$376	\$530	\$846
Zero disbursement: likelihood of one or more years with zero disbursement in a given period	0%	10%	25%	35%

Notes: The projections shown are based on the current trust fund rules and the compact trust fund's unaudited balance at the end of fiscal year (FY) 2020. We assumed that the trust fund's annual net return will have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund will disburse \$15 million each year if funds are available. The averages shown are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty. For example, our estimates of the average balances are higher than the medians for each period shown. For more information, as well as additional results based on alternative annual net returns, see GAO-22-104436, appendix V.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases. The projected shortfall in FYs 2024 through 2033 will likely average \$3,662 per year.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

### Reports and Officials Point to Future Fiscal Challenges for Palau

Reports and comments from experts at several institutions, such as IMF and the World Bank, have noted challenges that may confront Palau when U.S. compact assistance ends. Palau and U.S. officials have also identified challenges Palau may face, such as the compact trust fund's inability to cover fiscal gaps and challenges in obtaining additional donor funds.

**IMF report noting uncertainty regarding compact negotiations.** The 2021 IMF Article IV staff report on Palau notes that uncertainty remains regarding the timing and terms of a new compact agreement with the

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U.S.<sup>199</sup> The report also notes that border closure and the suspension of commercial flights curtailed tourist arrivals during the COVID-19 pandemic which put a severe strain on the economy. According to the report, Palau's real GDP contracted by 9.7 percent in FY 2020, notwithstanding policy support, and at the time of analysis was estimated to have contracted further by 17.1 percent in FY 2021.<sup>200</sup> The report indicates that IMF staff welcomed Palau's September 2021 approval of a comprehensive tax reform bill, expected to enter into force in January 2023. Nevertheless, the report recommends a gradual fiscal consolidation, the strategy for which should center on domestic revenue mobilization and expenditure rationalization.

In addition, the report estimates that a gradual fiscal adjustment of 1 percent of GDP per year from FY 2024 through FY 2028 will help safeguard the compact trust fund. The report further estimates that on the basis of historical rates of return, increasing the annual withdrawal from the compact trust fund above \$15 million could endanger the fund's long-term sustainability and compromise its revenue-generating capacity for future generations.

**Graduate School USA report warning of declining revenues and expenditures.** The long-term economic outlook included in Graduate School USA's FY 2018 Economic Review for Palau notes that long-run trends indicate declining revenues and expenditures in proportion to

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<sup>199</sup>International Monetary Fund, *Republic of Palau: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: Nov. 8, 2021). IMF's country surveillance efforts include conducting Article IV consultations, in which an IMF team of economists visits a country to assess economic and financial developments and discuss the country's economic and financial policies with government and central bank officials. IMF conducted Article IV consultations in Palau in 2021, 2018, 2016, 2014, 2012, 2010, 2008, 2005, 2003, and 2001.

<sup>200</sup>Palau does not have any transactions or financial flows with IMF but can access IMF resources if certain conditions are met, according to IMF officials. An IMF debt sustainability analysis included in the 2021 IMF Article IV Staff report concluded that Palau's public debt was sustainable but that a sharp deterioration of the fiscal position due to the COVID-19 pandemic had significantly increased debt sustainability risks. IMF officials noted that COVID-19 related travel restrictions have weighed heavily on tourism in Palau and anticipated that Palau's tourism sector will recover slowly from the COVID-19 pandemic, with arrivals expected to return to prepandemic levels around 2023. In recent years, the number of tourists from China has declined. According to IMF officials, China is one of the key source markets for Palau tourism, and reduced arrivals from China would weigh on economic growth and weaken the fiscal position.



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GDP.<sup>201</sup> Acknowledging that the Palau compact trust fund was not designed to be perpetual, the report examines the costs of shifting to a perpetual fund and states that “the likely level of the compact trust fund in FY 2024 may well be below a level required to provide a sustainable yield to support current levels of government operations in [Palau] thereafter.”

Another Graduate School USA report projects, as a result of the COVID-19 pandemic, that Palau, whose tourism industry collapsed, will experience a 13.8 percent drop in GDP in FY 2020 and a 13.2 percent drop in GDP in FY 2021.<sup>202</sup>

**World Bank report projecting fiscal gaps.** Projections included in a 2016 World Bank report suggest that the scheduled end of compact grants will, absent alternative sources of financial assistance, have a significant adverse effect on the North Pacific economies.<sup>203</sup> The report projects that Palau’s compact trust fund will likely be unable to finance baseline fiscal gaps through 2040 and that the spending required to improve human development outcomes will likely create even greater fiscal pressures. According to the World Bank, Palau could access World Bank trust funds and the World Bank’s International Bank for Reconstruction and Development resources but had not done so as of November 2020.

**ADB officials’ prediction of limited help from other donors.** A 2020 ADB member fact sheet noted that because of the 2018 renewal of the economic assistance terms of the compact, Palau’s compact trust fund is projected to achieve its original objective.<sup>204</sup> However, a 2019 ADB Pacific Finance Sector brief noted that the forthcoming expiration of assistance in 2024 is a major concern for Palau and that considerable uncertainty remains regarding the continuation of various federal programs and

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<sup>201</sup>Graduate School USA, *Economic Review Republic of Palau Fiscal Year 2018* (July 2019). The economic review is an annual report that represents an independent assessment of Palau’s economic performance.

<sup>202</sup>Graduate School USA, *Where Do We Go from Here? Updating the Economic Impact of COVID-19 and Strategies for Mitigation in the Republic of Palau* (August 2020).

<sup>203</sup>World Bank, *Financing Pacific Governments for Pacific Development. Pacific Possible Background Paper No. 7* (Washington, D.C.: 2016).

<sup>204</sup>Asian Development Bank, *Palau Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020).

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services from which Palau currently benefits.<sup>205</sup> In addition, consultants to ADB expressed concerns regarding Palau's debt sustainability in light of the increase in debt and impact on the tourism sector associated with the COVID-19 pandemic.

According to ADB officials, other donors have a limited ability to fill the gap that would result from the end of compact grant assistance. The officials noted that other donors expect the compact grant assistance to be extended and are not actively planning to increase their support.<sup>206</sup> ADB officials also noted that the potential end of compact grant assistance would not change the ADB financing available to Palau.

**Palau officials' statements on assistance, fiscal reforms, and the compact trust fund.** Palau government officials stated that the country's vulnerability to climate change and natural disasters, as well as the COVID-19 pandemic, have changed Palau's development path. According to the officials, Palau faces high risk of debt distress because of its limited ability to obtain concessionary financing, due to its designation as a high-income country, and because of its limited revenue base as a result of its small population. Palau officials noted that these factors make Palau reliant on U.S. assistance, since that assistance does not depend on Palau's income status.

Palau officials also noted that the government has proposed a fiscal responsibility and debt management framework, is working toward tax reform and social security and civil service pension plan structural reforms, and has taken steps to support private sector development. According to Palau officials, Palau intends to change the compact trust fund from a sinking fund to a perpetual fund. The officials also stated that Palau would be unable to cover the gaps that would result from the cessation of support from federal programs and services, such as that provided by FAA.

**U.S. official's statement on grant assistance.** In September 2019, the OIA Director indicated that if grant assistance is allowed to end and is not

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<sup>205</sup>Asian Development Bank, *Palau Pacific Finance Sector Brief* (Sydney, Australia: October 2019).

<sup>206</sup>ADB commissioned a project to examine the economic impacts of the end of compact grant assistance. The draft report on the project's results examines the potential loss in assistance in Palau and the potential fiscal responses that the government may need to make if compact transfers end.

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extended, there is a very real risk of adverse impact on the Palau economy.<sup>207</sup>

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## Palau Government Audits Show Mixed Record of Financial Accountability, while Advisory Group on Economic Reform Has Not Been Established

### Audits for FYs 2015–2019 Show Improvement in Financial Accountability but Shortcomings in Compliance with Grant Agreements

Palau's single audit reports for FYs 2015 through 2019 that we reviewed showed some improvement in accountability but identified shortcomings in compliance in grant agreements remain. One area of improvement over the 5-year period is the overall decrease in audit findings (i.e., material weaknesses or significant deficiencies in internal controls or financial reporting) from 18 to seven. This improvement reflects the resolution of findings of the Palau government's lack of compliance with equipment and real-property management and lack of compliance with procurement requirements in FYs 2015 through 2019. However, our analysis revealed that during the 5-year period, audit findings of noncompliance with cost principles persisted. Also, the Palau government is not considered a low-risk auditee because, among other things, it did not submit its single audit report within required time frames.

Table 10 summarizes our analysis of the Palau single audit reports for FYs 2015 through 2019.

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<sup>207</sup>*Hearing on Sustaining U.S. Pacific Insular Relationships, Before the House Committees on Natural Resources and Foreign Affairs*, 116 Cong. (Sept. 26, 2019) (statement of Nikolao Pula, Director, Office of Insular Affairs, Department of the Interior).

**Table 10: Selected Information from Palau’s Single Audit Reports for Fiscal Years 2015–2019**

Single audit component	Fiscal year				
	2015	2016	2017	2018	2019
Financial reporting (auditors opinion <sup>a</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Schedule of Expenditures of Federal Awards (auditors opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditors opinion <sup>c</sup> )	qualified opinion	qualified opinion	qualified opinion	qualified opinion	qualified opinion
Audit findings (total number)	18	13	13	6	7
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	427	320	262	489	359
Timely submission of single audit package <sup>e</sup>	No	No	No	No	No
Low-risk auditee <sup>f</sup>	No	No	No	No	No

Source: GAO analysis of Palau single audit reports for fiscal years 2015–2019. | GAO-22-104436

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal awards for the period covered by the award recipients’ financial statements. The schedule’s reporting requirements include (1) reporting the individual federal programs, by federal agency; (2) providing the total federal awards expended for each individual federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor’s opinion is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>A qualified opinion on compliance with requirements of major programs is based on noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards that is material in relation to a type of compliance requirement for a major program identified in the compliance supplement.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost, at the time of the audit, was not supported by adequate documentation; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the entity’s fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

The following provides additional information from the Palau single audits for FYs 2015 through 2019.

**Compliance with requirements of major federal programs.** The Palau single audit reports for FYs 2015 through 2019 indicate that the auditor issued a qualified audit opinion with respect to Palau’s compliance with federal program requirements. An opinion on compliance with requirements for major programs is based on the extent of material

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weaknesses and significant deficiencies observed by the auditors during the course of the audit. In FY 2015, the auditors issued a qualified opinion pertaining to Palau's compliance with equipment and real-property requirements for the compact sector grants. The qualified opinion in the FY 2019 single audit was due to lack of compliance with applicable allowable costs and with cost principles related to adequate documentation.

**Single audit findings.** The FY 2015 and FY 2019 single audit reports contained 18 and seven audit findings, respectively. During the 5-year period, the auditors found noncompliance with allowable cost principles, noncompliance with equipment and real-property management requirements, and issues with the lack of matching funds. For example, according to the FY 2019 single audit report, the auditors could not verify that contract expenditures were supported by adequate documentation (e.g., reports) and also identified potential issues regarding funding of the Palau Civil Service Pension Trust Fund. Further, our analysis of the single audit reports for FYs 2015 through 2019 identified three findings that recurred in 4 of the 5 years, including the issues related to the Palau Civil Service Pension Trust Fund.

State public auditors reported capacity limitations to conducting performance audits of programs funded by U.S. grants. Officials in the Palau Office of the Public Auditor (OPA) told us their office outsources its annual single audits and other component audits.<sup>208</sup> Because of its limited capacity, with six professional audit staff, OPA officials reported that they did not perform any performance audits of compact sector or non-compact sector U.S. federal funding, including the compact trust fund, during FYs 2015 through FY 2019. However, the office conducted several other performance audits of non-U.S. funding sources—such as ADB's Asian Pacific Disaster Response Fund and the Ministry of Finance—Preparedness for Implementation of Sustainable Development Grants—as well as performance audits of the state governments and found some issues.

The Palau government is making some progress in its efforts to ensure accountability for the use of U.S. funding, according to OIA officials. OIA officials reported that their analysis showed the Palau government continues to improve the accuracy of reporting financial data and

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<sup>208</sup>Palau component units include the Palau Social Security Retirement Fund, the National Development Bank of Palau, and the Palau Visitor's Center.

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accountability in the use of federal funds. According to OIA officials who administer and oversee compact grants, OIA's goal related to accountability for the Palau government is to help it implement and enforce internal controls to ensure the use of federal funding in compliance with the approved budget and applicable federal and Palau requirements. For audit purposes, OIA's specific goal is to help the Palau government obtain unmodified opinions on the annual audits of financial reporting, increase compliance with federal grant awards, and have no material internal control findings or questioned costs related to expenditures of federal awards.

OIA officials stated that they work closely with Palau government personnel in the Ministry of Finance and the Office of the Public Auditor and, as necessary, work directly with Palau government program personnel responsible for resolution of audit findings. Additionally, OIA provides resources for training to help increase the capacity of the Palau government workforce, according to OIA officials.<sup>209</sup> Officials in the Office of the Public Auditor told us they had no concerns regarding the use and monitoring of compact funds provided to Palau.

#### Palau Advisory Group on Economic Reform Has Not Been Established

Palau's Compact Review Agreement, which entered into force in 2018, includes a provision to establish an advisory group on economic reform, with members appointed by the U.S. government and Palau; however, as

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<sup>209</sup>According to State officials, State's overall objective is to ensure that Palau's use of U.S. funds is consistent with the Compact Review Agreement, as amended, and that any questioned costs are resolved quickly. The officials said that State also seeks to ensure that Palau continues to work with partners, including the Pacific Financial Technical Assistance Center, to strengthen its overall financial management and accountability.

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of August 2021, this advisory group had not been established.<sup>210</sup> The stated purpose of the advisory group is to contribute to Palau's long-term economic sustainability by recommending economic, financial, and management reforms and a schedule for implementing these reforms. Although with a different scope and the possibility of a different composition than other FAS oversight bodies, this committee can provide information to the U.S. and Palau governments about the impact of the economic assistance the U.S. provides to Palau and accountability for the use of the funds.<sup>211</sup>

The advisory group is also required to provide input on the government of Palau's progress in implementing reforms recommended by the group or initiated by the government before annual bilateral economic consultations between the U.S. and Palau governments. If the U.S. determines that the government of Palau has failed to make significant progress in implementing meaningful reforms, it can delay payment of direct economic assistance. Palau's Compact Review Agreement states that, unless otherwise agreed by the two governments, the advisory group shall terminate at the end of FY 2023.

The membership of the advisory group has not been fully constituted. As of August 2021, two Palau members, originally designated in 2019, still remained designated, according to Palau officials. However, until January

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<sup>210</sup>*Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review*, September 2018. The agreement states: "In recognition of the ties that were developed between the United States of America and Palau during World War Two and the subsequent half century of the United States administration and Palau and the continuing close relationship between the Governments of the United States and Palau ....shall consider the overall nature and development of their relationship." The agreement states that the Advisory Group shall be composed of five members, two of whom shall be designated by the President of Palau and two of whom shall be designated by the U.S. and the fifth shall be chosen from a list of not fewer than three persons not residents of Palau and submitted by the President of Palau; the fifth member shall be chosen by the U.S. government. Should the U.S. reject the persons enumerated in the list submitted by the President of Palau, then the fifth member shall be chosen by the President of Palau from a list of not fewer than three persons submitted by the U.S. government.

<sup>211</sup>FSM and RMI have the JEMCO and JEMFAC oversight bodies to strengthen their financial accountability and promote the effectiveness of compact funds and to strengthen the management and accountability and promote effective use of compact funds provided to FSM and RMI. JEMCO and JEMFAC are empowered to make decisions, according to State officials. For additional information, see GAO, *Compacts of Free Association: Micronesia and the Marshall Islands Continue to Face Challenges Measuring Progress and Ensuring Accountability*, [GAO-13-675](#) (Washington, D.C.: Sept. 20, 2013).

2022, the President of Palau had not submitted a list of at least three candidates for the fifth member, as required by the Compact Review Agreement, and that position had not been filled. Instead, Palau provided the name of one candidate for this position because of challenges associated with finding three available qualified candidates, according to Palau officials. According to these officials, in January 2020, Palau proposed a procedural change that would allow the U.S. to accept or reject this nominee and, if the U.S. rejected the nominee, would allow Palau to identify, in serial fashion, up to two additional persons for consideration.<sup>212</sup> However, this procedure has not been adopted. Palau officials told us in September 2021 that the U.S. government had not formally responded to its January 2020 proposal.

State officials told us in August 2021 that the U.S. government designated two members in 2019 and the selection of a fifth member had not yet occurred.<sup>213</sup> In addition, State officials told us that there is no timetable for selection of the fifth member, which depends on Palau's nomination of candidates. State officials also told us that several coordination issues had delayed the formation of the advisory group but that State planned to continue its discussion with the Palau government to establish the group in coordination with Interior. For example, State officials cited Palau administration changes and the COVID-19 pandemic as factors causing delays.

In January 2022, after reviewing a draft version of this report, Palau submitted the names of three candidates, in a letter to the U.S. President, for consideration as the fifth member of the advisory group. We asked State officials about their awareness of, and views on, Palau's letter. The officials indicated that they had not yet received the official letter but understood its substance and would proceed as needed after receiving it.

The U.S. government (i.e., State and Interior) has not set any official timeframes or milestones for finalizing the members of the advisory group so that the group can be established and carry out its duties, consistent

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<sup>212</sup>The Compact Review Agreement states that "any alternation to the terms of this compact or its related agreements shall be made by mutual agreement." The government of Palau indicated that it had a candidate who had confirmed interest and availability. The government added that it also identified another person who may be a potential nominee but at a later time.

<sup>213</sup>No different members have been designated by the U.S., which could choose to retain the same members or select new members, according to State officials.



with the Compact Review Agreement, before the group's scheduled termination in 2023. According to Standards for Internal Control in the Federal Government, management should design control activities, such as milestones and timeframes, to achieve objectives and respond to risks.<sup>214</sup> Palau officials said that they believed the advisory group's establishment would benefit their government.

Table 11 shows a timetable of the actions taken by the U.S. and Palau governments regarding the formation of the advisory group on economic reform.

**Table 11: Timeline Related to Formation of the Palau Advisory Group on Economic Reform**

Action	Date
The Compact Review Agreement, which entered into force in September 2018, includes a provision to establish the Palau Advisory Group on Economic Reform.	September 2018
U.S. designates its two resident members.	June 2019
Palau designates its two resident members.	June 2019
Palau requests a procedural change from the Compact Review Agreement and submits one candidate to the U.S. Ambassador, rather than the required three candidates, as the fifth nonresident member and requests a response from the U.S. <sup>a</sup>	January 2020
Palau officials indicate that the U.S. government has not responded to their procedural change request.	As of September 2021
U.S. and Palau have not established a timetable to select the fifth member.	As of August 2021
Palau submits the names of three candidates for consideration as the fifth nonresident member.	January 2022
The advisory group is scheduled to terminate unless otherwise agreed by the Palau and U.S. governments.	September 2023

Source: GAO analysis based on information from State and Palau officials and documents. | GAO-22-104436

<sup>a</sup>Palau proposed a procedural change that would allow the U.S. to accept or reject this nominee and proposed that if the U.S. rejected the nominee, Palau would identify in serial fashion up to two additional persons for consideration. According to Palau and State officials, the U.S. government has not responded to Palau's request for a procedural change and its submission of one candidate as the fifth member.

The advisory group is expected to provide a report annually on the government of Palau's progress in implementing reforms prior to annual bilateral economic consultations, according to the Compact Review Agreement.<sup>215</sup> According to State officials, these bilateral economic consultations have not been held over the last few years. Without the Palau advisory group's input at these annual consultations, the Palau

<sup>214</sup>GAO-14-704G.

<sup>215</sup>The Compact Review Agreement states that "the two governments are committed to these annual economic consultations being meaningful, substantive, and comprehensive."

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government might not have the necessary information for its decision-making. Additionally, without an effective mechanism such as the Palau advisory group, the U.S. and Palau governments may be lacking insight into potential economic, financial, and management issues, including the impact of U.S. economic assistance to Palau, Palau's progress in making reforms, and its accountability for the use of the U.S. funds.

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## Conclusions

The U.S. compacts of free association with the FSM, RMI, and Palau provided frameworks for the U.S. and the three FAS to work toward, among other things, the goal of assisting the FSM, RMI, and Palau in their efforts to achieve economic development and self-sufficiency. The ending of U.S. compact sector grants after fiscal year 2023 for FSM and RMI and the beginning of disbursements from the compact trust funds in fiscal year 2024 will mark a key transition in these ongoing efforts. The countries' transition to relying on income from the compact trust funds will likely require significant budgetary choices.

We found that the current structural restrictions governing disbursements under the FSM and RMI compact trust fund agreements will likely reduce the amounts available to be distributed from the funds. This may result in 1 or more years of zero distributions in the first decade after U.S. compact assistance ends, even if the compact trust funds have substantial balances. For example, we project that although the average yearly balance of FSM's compact trust fund in the first 10 years of disbursements may be \$905 million, FSM may, on average, receive 85 percent of the maximum allowable disbursement and face a 36 percent likelihood of receiving no disbursement in 1 or more years.

In addition, no entity has been established to advise Palau—unlike FSM and RMI—regarding economic and financial issues.<sup>216</sup> Palau's Compact Review Agreement, which entered into force in September 2018, provides for the establishment of a U.S.–Palau Advisory Group on Economic Reform. According to the agreement, this group is to contribute to Palau's long-term economic sustainability by recommending economic, financial, and management reforms. However, as of September 2021, the advisory group had not been constituted because of a number of factors.

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<sup>216</sup>The amended compacts' implementing legislation and their subsidiary fiscal procedures agreements for FSM and RMI established committees to oversee compact grants to each country—JEMCO for the FSM and JEMFAC for the RMI.

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Additionally, the parties have not set timeframes for selecting members. Without the Palau advisory group as an advisory mechanism, the Palau government may lack information necessary for its decision-making and the U.S. may lack insight into potential economic, financial, and management issues, including the impact of the economic assistance the U.S. provides to Palau.

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## Recommendation for Executive Action

The Secretary of State, working with the Department of the Interior, should establish timeframes with milestones to constitute the Palau Advisory Group on Economic Reform before its 2023 termination date. (Recommendation 1)

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## Agency Comments and Our Evaluation

We provided a draft of this report to the Departments of Agriculture (USDA), Commerce, Defense, Education, Energy, Health and Human Services, the Interior, Labor, State, Treasury, and Transportation; the Federal Deposit Insurance Corporation; the Federal Emergency Management Agency; the Institute of Museum and Library Services; the National Science Foundation; the Small Business Administration; the U.S. Agency for International Development (USAID); the U.S. Postal Service (USPS); and the FSM, RMI, and Palau governments.

State, USAID, USDA, USPS, the FSM government, and the RMI government provided comments that we have reproduced in appendixes VII through XI with, where relevant, our responses. The Departments of Agriculture, Commerce, Education, State, and Transportation; the Federal Deposit Insurance Corporation; and the FSM and RMI governments provided technical comments that we incorporated as appropriate.

The following summarizes comments from the Department of State, U.S. Agency for International Development, U.S. Department of Agriculture, and USPS.

- State concurred with our recommendation and stated that it will seek to establish a timeframe, in coordination with the Department of the Interior, with the government of Palau to constitute the Palau Advisory Group on Economic Reform, consistent with the Compact Review Agreement, as amended.

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- USAID stated that, although the compact programs and services agreements with FSM, RMI, and Palau will end in 2024, current U.S. law enables USAID to provide foreign disaster assistance to the three countries under the same terms as it provides this assistance to other countries under the Foreign Assistance Act.
  - USDA Natural Resources Conservation Service stated that it agreed with the information presented in the report and characterized its understanding of the status of the technical assistance provided to the FSM, RMI, and Palau, should financial provisions of the compact not be renewed.
  - USPS stated that it appreciates the report's findings insofar as the provision of postal services is concerned. USPS pointed out that it has incurred losses since 2002 by providing service to the FAS under the current compact agreements. It added that the mounting costs of providing service without sufficient compensation are unsustainable.

The FSM government stated its belief that the compact trust fund's corpus will not be adequate to secure FSM's long-term viability without additional contributions to the trust fund from the U.S. The FSM government also stated its belief that mandatory appropriations are a fundamental part of U.S. assistance to FSM, and suggested that our report include a recommendation that mandatory appropriations be maintained into the next compact period. While we acknowledge FSM's perspective on mandatory appropriations and understand that this an important consideration for parties involved in the negotiations, we make no such recommendation in this report because this issue was not part of our review. In addition, the FSM government stated that our report does not reflect positive developments in FSM audits and advances in the professionalism and competence of FSM authorities to manage foreign assistance funds, particularly over the last 20 years. The information we provide on FSM's accountability record is accurate. It includes single audit results only for the period included in the scope of our work, which covers fiscal years 2015 through 2019. Our report also includes a discussion of improvements made in FSM's accountability over use of funds. In addition, the FSM government made several additional technical comments; see appendix XI for our response.

The RMI government stated that our and other reviews inform the RMI trust fund committee of the fund's viability and status and that these reviews should continue. The RMI government also noted that the trust fund cannot guarantee sustainable and stable distributions and that a discussion of distribution policy should take place alongside compact negotiations and should include discussion of the trust fund committee's

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structure and governance. Further, the RMI government stated that there have been significant improvements in its audit results since fiscal year 2003 and that the RMI Audit Office has been strengthened to carry out its audit and oversight role over funds. While the information we provide on RMI's accountability record is accurate, we have added additional information in a footnote to acknowledge some of the initiatives that RMI's Audit Office has implemented. In addition, the RMI government provided several technical comments regarding terminology and presentation of data in our report; see appendix XII for our response.

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We are sending copies of this report to the appropriate congressional committee and to the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security (the Federal Emergency Management Agency), the Interior, Labor, State, the Treasury, and Transportation; the Federal Deposit Insurance Corporation; the Institute of Museum and Library Services; the National Science Foundation; the Small Business Administration; USAID; USPS; and the Ambassadors of FSM, RMI, and Palau. In addition, the report will be available at no charge on GAO's website at <http://www.gao.gov>.

If you or your staff have questions about this report, please contact me at (202) 512-4409 or [LoveL@gao.gov](mailto:LoveL@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix XIII.

A handwritten signature in black ink that reads "Latesha Love". The signature is written in a cursive style with a large, stylized initial "L".

Latesha Love  
Director, International Affairs and Trade

## Appendix I: Objectives, Scope, and Methodology

This report examines, for the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Republic of Palau, (1) the use and role of U.S. funds and programs in the country's budget, (2) the projected fiscal effects of the ending of compact grants and certain programs and services, and (3) the record of accountability for the use of U.S. funds.

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### Use and Role of U.S. Funds and Programs

To identify the use and role of U.S. funds and programs in the three countries' budgets, we reviewed relevant documents and interviewed knowledgeable U.S., FSM, RMI, and Palau officials. For FSM and RMI, we reviewed the amended compact and associated Federal Programs and Services Agreement and Military Use and Operating Rights Agreement (MUORA) between the U.S. and each of the two countries. For Palau, we reviewed its compact, and the Compact Review Agreement, as amended, including its appendices such as the revised Programs and Services Agreement. We also reviewed FSM's, RMI's, and Palau's single audit reports for FYs 2015 through 2019.<sup>1</sup>

We analyzed expenditure and funding data in FSM, RMI, and Palau single audit reports, including each country's Schedule of Expenditures of Federal Awards, to identify the sources of funds expended by the FSM national and state governments,<sup>2</sup> the RMI national government, and the

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<sup>1</sup>We chose to review single audit reports for fiscal years 2015 through 2019 because data for fiscal year 2019 were the most recent available for all three countries and because our report's intended scope was 5 years.

<sup>2</sup>The governments of FSM's four semiautonomous state governments (Chuuk, Kosrae, Pohnpei, and Yap) receive a large proportion of the U.S. funding provided to the FSM national government.

Palau national government.<sup>3</sup> We also identified U.S. funds flowing to components of those governments. We calculated federal funds as a percentage of each entity's total expenditures. We also reviewed the single audit reports. We concluded that these data were sufficiently reliable for estimating the role and use of U.S. assistance in the FSM, RMI, and Palau budgets.

To determine the legal status of U.S. grants and certain programs and services after FY 2023 for FSM and RMI and after FY 2024 for Palau,<sup>4</sup> when these grants, programs, and services are scheduled to end, we relied on information provided by agency officials to determine whether, under current law, they would remain available. We prepared a preliminary list of the programs and funding sources we identified from the Schedule of Expenditures of Federal Awards. The final list did not capture all U.S. grants and programs provided in FSM, RMI, and Palau or all those for which the countries may be eligible. For example, the list excluded cooperative agreements; grants that agencies reported had expired for a variety of non-compact-related reasons; grants and programs that were not provided directly to the FAS governments; and grants and programs that covered emerging issues, such as the COVID-19 pandemic, which occurred after our review's scope of FYs 2015 through 2019.

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<sup>3</sup>We used the same approach to gather and analyze data from the Schedule of Expenditures of Federal Awards for FSM, RMI, and Palau as we used to gather and analyze such data for our May 2018 report *Compacts of Free Association: Actions Needed to Prepare for the Transition of Micronesia and the Marshall Islands to Trust Fund Income* (GAO-18-415). Specifically, we used the same guidelines and processes to extract summary and program data from the Schedule of Expenditures of Federal Awards in the single audit reports as we used for GAO-18-415. For each country table, we included the program's name, Catalogue of Federal Domestic Assistance number, issuing agency, and dollar amount. We extracted summary information from both the Independent Auditor's Report and the Report on the Financial Statements. For FSM, we extracted the total summary information by adding together the summary information for the national government and each of the states. Our portrayal of the role of U.S. funds in the government budgets does not capture the value of any noncash goods and services that do not appear in the single audit reports. In addition, it does not capture benefits that some programs provide to individuals, such as U.S. Department of Agriculture rural housing loans and Federal Deposit Insurance Corporation insurance that benefits depositors at the Bank of the Federated States of Micronesia.

<sup>4</sup>The countries may continue to receive some grant funding after the provisions of law authorizing the grants expire at the end of FY 2023 for FSM and RMI and at the end of FY 2024 for Palau. Funding may flow to FSM, RMI, and Palau pursuant to a grant for several years after the grant ends. Federal programs and services provided through compact agreements with each country end at various specific dates in 2023 for FSM and 2024 for RMI and Palau.



We asked agency officials to review and comment on the accuracy of the list as well as the eligibility status of the programs after FYs 2023 and 2024. We contacted officials from the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, the Interior, Labor, State, Homeland Security, and Transportation; the Federal Deposit Insurance Corporation; the National Science Foundation; the U.S. Agency for International Development; the Small Business Administration; the Institute of Museum and Library Sciences; and the U.S. Postal Service (USPS). We incorporated comments from these officials into our analysis, and we again asked for their technical comments before we completed our draft report. In some cases, on the basis of information we derived from the compacts, compact implementing legislation, related agreements, and various provisions of U.S. law authorizing program grants, we asked these officials to clarify or confirm their responses. Our presentation of the status of grants and programs is based on information provided by these agencies and officials.

Any changes in the applicable law after our report's publication but before the end of FY 2023 for FSM and RMI or the end of FY 2024 for Palau may affect the countries' eligibility for U.S. programs and funding. In addition, the availability of some programs depends on appropriations made for that purpose.

We also provide information about the economic context for each of the countries.

- To understand the contribution of U.S. grants to FSM's, RMI's, and Palau's national government revenue, we analyzed government finance statistics in Graduate School USA's statistical appendices for each country.<sup>5</sup> We use data for the longest time series available for each of the countries, FYs 2004 through 2018.<sup>6</sup> To describe U.S. contributions to the respective compact trust funds, we used data from

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<sup>5</sup>See Graduate School USA, *Federated States of Micronesia Fiscal Year 2018 Statistical Appendices* (Honolulu: August 2019); *Republic of the Marshall Islands Fiscal Year 2018 Statistical Appendices* (Honolulu: August 2019); *Republic of Palau Fiscal Year 2019 Statistical Appendices (Preliminary)* (Honolulu: March 2020).

<sup>6</sup>The data for RMI and FSM cover FYs 2004 through 2018. The data for Palau cover FYs 2000 through 2019.

FSM's and RMI's official compact trust websites and the Graduate School USA data on Palau.

- To describe the characteristics of FSM's, RMI's, and Palau's economies, we reviewed publications pertaining to each of the three countries and small-island developing states.<sup>7</sup> We reported some of the key characteristics that the publications we reviewed discussed as being relevant regarding the development opportunities and challenges faced by FSM, RMI, and Palau. We determined that these data were sufficiently reliable for the purposes of our analyses.
- To describe the leading donors to the FSM, RMI, and Palau, we used data from the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC). Since the DAC does not include aid from all countries, we used the data on contributions from RMI's single audit and reporting from the FSM national government.

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## Projected Fiscal Effects of Ending of Compacts Grants and Certain Programs and Services

To examine the projected fiscal effects of the scheduled ending of compact grants and certain programs and services in FSM, RMI, and Palau, we reviewed compact documents; the Compact Review Agreement for Palau; and other governance and reporting documents, such as the compact trust funds' investment policy statements, audits, and annual reports as well as regularly recurring publications. In addition, we interviewed or corresponded with U.S. agency officials; FSM, RMI, and Palau officials; and the FSM and RMI compact trust funds'

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<sup>7</sup>We reviewed reports from multilateral organizations. See Chris Becker, *Small Island States in the Pacific: The Tyranny of Distance*. IMF Working Paper No. 12/223 (September 2012); Organisation for Economic Co-operation and Development, *Making Development Co-operation Work for Small Island Developing States* (Paris: 2018); Virginia Becker, *Public Sectors in the Islands: Are They 'Too Big' and Do They 'Crowd Out' the Private Sector?* World Bank Policy Research Working Paper Series, No. 7102 (Washington, D.C.: December 2016); United Nations Convention on Trade and Development, *Small Island Developing States: Challenges in Transport and Trade Logistics* (Geneva: September 2014). We also reviewed publications from the Asian Development Bank and the International Monetary Fund.

administrator. We also built a Monte Carlo simulation model to project outcomes related to the compact trust funds.<sup>8</sup>

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## Projection of Amount of Compact Grants and Certain Programs and Services That Are Scheduled to End

To project the amounts of compact grant assistance and certain programs and services that are scheduled to end for each country, we first contacted the relevant U.S. government agencies and asked them to indicate the eligibility status of compact assistance provided to the FAS.

We assumed that the FY 2023 and FY 2024 values of the grants and certain programs and services that are scheduled to end will be equal to the most recent available estimates or average of estimates that the agencies provided.<sup>9</sup> For two services—disaster assistance and postal service—we made the following additional assumptions:

- To estimate the value of disaster services for U.S. presidential disaster declarations for FSM and RMI, we calculated an annual average of the cost of disaster services in FYs 2008 through 2020 and assumed that the FY 2023 value of those services would be equal to that average.<sup>10</sup>
- Our estimate of the value of expiring postal service in the FAS represents USPS's net shortfall and the value of assistance that the

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<sup>8</sup>A Monte Carlo analysis is a problem-solving technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

<sup>9</sup>These estimates reflect assistance provided by the U.S. agencies. If an agency provided an estimated value for FY 2023 or FY 2024, we used that value; otherwise, we used the most recent available value. In two cases, for disaster and postal services, we averaged multiple years of recent agency data.

<sup>10</sup>In FYs 2008 through 2020, there were three U.S. presidential disaster declarations for FSM and two for RMI.

Interior reimburses to USPS.<sup>11</sup> For postal service for each country, our estimates reflect the USPS expenses<sup>12</sup> net of revenue offset<sup>13</sup> but including an estimate of the amount that Interior reimbursed.<sup>14</sup> Specifically, we assumed that the values of postal service in FY 2023 and FY 2024 would be equal to the average of the cost of service in FYs 2017 through 2019 less an estimated average amount of the revenue offset that USPS receives.<sup>15</sup> According to technical comments that USPS officials provided, USPS's view is that the total assistance for the postal sector should consist of the total expenditures that USPS incurs in providing service to the FAS, without subtracting the amount of the revenue offset.

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## Assumptions for Projections of the Compact Trust Funds

To project the compact trust funds' likely income at their current value and under current trust fund rules, we built a Monte Carlo simulation model and performed 10,000 trial runs of projected returns and disbursements over a 4-decade period, using random values of future rate of return from assumed return distributions.<sup>16</sup> All estimates account for projected future inflation and are presented in nominal dollar terms.

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<sup>11</sup>In total for the FAS in FYs 2017 through 2019, USPS incurred total expenses of \$37,572,561; received \$3,813,664 in revenue offsets; and received \$6,715,077 in reimbursements from Interior. USPS considers its net shortfall for the FAS over this period to be \$27,043,820, equal to its expenses minus the revenue offset and minus the amount received from Interior.

<sup>12</sup>USPS's expenses include air transportation, surface transportation, supplies, and accounting, according to agency officials.

<sup>13</sup>The revenue offsets represent the additional revenue USPS receives for a good traveling from the U.S. (other than Hawaii) to the FAS as compared with a good traveling from the U.S. to Hawaii, according to agency officials.

<sup>14</sup>Although USPS provided the amount of the total Interior reimbursement for FYs 2017 through 2019, this amount is included in our estimate to reflect the U.S. government's cost of providing postal service.

<sup>15</sup>USPS provided an estimate of the FAS revenue offset in total for FY 2017 through FY 2019. In addition, USPS provided the yearly cost allocations breakdowns for the three countries. We assumed that the average cost allocation breakdown would apply to the revenue offset, and we used the average cost allocation for each country to calculate the average annual revenue offset.

<sup>16</sup>We previously reported on potential strategies for improving the outlook of FSM's and RMI's compact trust funds, including reducing disbursements, making additional contributions, and changing disbursement policies. See [GAO-18-415](#).

We used the following key assumptions in our compact trust fund analysis:<sup>17</sup>

**Current compact trust fund rules.** Our projections are based on current compact trust fund rules.

**Compact trust fund balance.** We used FY 2020 year-end compact trust fund balances from FSM's and RMI's FY 2020 compact trust fund annual reports and Palau's Bureau of National Treasury fourth-quarter FY 2020 report.<sup>18</sup> We assumed that these balances reflected the FY 2021 beginning balance before annual contributions.

**Buffer (C) account balance.** For FSM and RMI, we used the FY 2020 year-end balance in the compact trust funds' buffer (C) accounts from the countries' FY 2020 compact trust fund annual reports.<sup>19</sup> We assumed that these balances reflected the FY 2021 beginning balance before annual contributions.<sup>20</sup> The size of the buffer (C) account is capped at three times the amount of the estimated compact annual grant assistance in FY 2023.<sup>21</sup> The buffer (C) account is partially adjusted for inflation according to a formula set forth in section 217 of the FSM compact and section 218 of the RMI compact, using the inflation rate after fiscal year 2023. According to the FY 2020 compact trust fund annual reports, FSM's buffer (C) account was not yet at its full value but RMI's was at its full value.

**Amount of future compact trust fund contributions.** We based the amounts of future annual U.S. contributions to the compact trust funds on

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<sup>17</sup>The model approximates a projection based on our set of assumptions and may differ with varying conditions.

<sup>18</sup>At the end of FY 2020, FSM's compact trust fund had a balance of \$783.9 million, RMI's compact trust fund had a balance of \$514.4 million, and Palau's compact trust fund had a balance of \$275.6 million.

<sup>19</sup>At the end of FY 2020, FSM's compact trust fund's buffer (C) account had a balance of \$154.48 million and RMI's compact trust fund's buffer (C) account had a balance of \$79.2 million.

<sup>20</sup>Our simulations assumed that the buffer (C) account balance will not fluctuate automatically on the basis of investment return. That is, we assumed that the buffer (C) account balance will not change before disbursement, even if negative investment return occurs, and that the corpus (A) account balance will instead decrease.

<sup>21</sup>As of the end of FY 2020, the balance in the buffer (C) account represented 1.92 times the estimated compact sector grant assistance that expires in FY 2023 for FSM and was at the maximum value for RMI.

future amounts estimated in Interior's Office of Insular Affairs' (OIA) "Budget Justifications and Performance Information, Fiscal Year 2022." For RMI, we assumed that Taiwan would, as it had previously committed, continue to contribute \$2.4 million per year through FY 2023 to the compact trust fund's corpus (A) account.<sup>22</sup> Additionally for RMI, we included the \$5 million the U.S. provided to RMI as compensation for tax and trade provisions in FY 2021, which was deposited into the RMI compact trust fund's corpus (A) account as a RMI government contribution.<sup>23</sup>

#### Annual maximum disbursement amount

- For FSM and RMI, we assumed that the annual maximum disbursement amount was the full inflation-adjusted value, using the inflation rate after fiscal year 2023, of the compact annual grant assistance in FY 2023. We also assumed that the trust fund committees would choose to disburse the maximum allowable amount each year if sufficient funds are available. We based our estimates of FY 2023 assistance on the inflation-adjusted amounts estimated in OIA's "Budget Justifications and Performance Information, Fiscal Year 2022." OIA estimated that FSM would receive \$81.4 million in annual compact sector grant assistance in FY 2023 and that RMI would receive \$36.0 million, including Kwajalein-related assistance. In keeping with the RMI compact trust fund agreement, we excluded from our analysis grants provided to RMI under compact section 211(b) for Kwajalein-related assistance, resulting in an estimated \$26.7 million in grant assistance to the RMI under compact section 211 in FY 2023.
- For Palau, the annual maximum disbursement amount is \$15.0 million.

**Net rate of return.** In the report, we present results based on a 6.5 percent nominal rate of return after fees are deducted. To select and assess the reasonability of this projected net rate of return, we reviewed the capital market assumptions and projections included in the investment

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<sup>22</sup>Contributions from Taiwan are normally made in March and May, but for purposes of the simulation we assumed that the contributions are received at the beginning of the fiscal year.

<sup>23</sup>Although the contribution was received in April 2021, for purposes of the simulation we assumed that the contribution was received at the beginning of the fiscal year. An additional \$5 million is included in the budget justification for FY 2022, but we did not include this amount in our simulations because that budget had not been enacted.

policy statements<sup>24</sup> used by the money managers for the compact trust funds as well as historical market rates of return.<sup>25</sup> However, because using the current portfolio and economic assumptions to project the funds' long-term performance has limitations, we also used additional nominal values for the net returns—5, 6, 7, and 8 percent<sup>26</sup>—in each case using a standard deviation of 13 percent (see app. V).<sup>27</sup> We assumed a normal distribution for the return, but we tested the reported results with a t-distribution. In addition, we tested the reported results with a normal distribution with a lower bound.

**Inflation rate after fiscal year 2023.** For FSM and RMI, we applied the 2.1 percent long-term inflation rate projected by the Congressional Budget Office.

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## Presentation of Simulation Results for Compact Trust Funds

To summarize and compare our simulation results, we analyzed for each country the average disbursements in nominal dollars, the average disbursements as a percentage of maximum allowable disbursements, the average shortfall in nominal dollars, the likelihood of 1 or more years with zero disbursement, and the average balance in nominal dollars.

- We calculated the average disbursement in the given time periods by averaging simulated disbursements over 10-year periods (averaging first over 10 years and then over 10,000 simulated cases).
- We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging the ratio of each simulated disbursement to the maximum inflation-adjusted allowable

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<sup>24</sup>The investment policy statements we reviewed were dated February 2020 for Palau and June 2020 for FSM and RMI—immediately before and during the COVID-19 pandemic, respectively. Forecasts and capital market assumptions could be significantly affected by continued market uncertainty related to COVID-19.

<sup>25</sup>For more details on our selection of the rate of return, see appendix V.

<sup>26</sup>We previously conducted analyses for the FSM and RMI compact trust funds using 5, 6, 7, and 8 percent rates of return and standard deviation of 13 percent. See [GAO-18-415](#).

<sup>27</sup>This standard deviation is the approximate average of the standard deviations for the FSM and RMI compact trust funds expected by the compact trust fund money managers. We also used this standard deviation for Palau and conducted a sensitivity test for Palau with a standard deviation as suggested by the investment policy statement.

disbursement in the given period (averaging first over 10 years and then over 10,000 simulated cases).

- We calculated the average shortfall by averaging the difference between the estimated maximum disbursement and the simulated disbursement over 10-year periods (averaging first over 10 years and then over 10,000 simulated cases).
- We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement among the 10,000 simulated cases in each 10-year period.
- We calculated the average compact trust balance in the given time periods by averaging simulated balances over 10-year periods (averaging first over 10 years and then over 10,000 simulated cases).

We report the results averaged by decade for 40 years of compact trust fund disbursements—FYs 2024 through 2033, FYs 2034 through 2043, FYs 2044 through 2053, and FYs 2054 through 2063—to summarize the overall trends. However, depending on market volatility, disbursements during these decades are likely to fluctuate from year to year. Although the projected per-decade averages can show long-term trends in the funds' disbursements and sustainability, the projected averages do not provide information about the volatility of changes in annual disbursement.

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## Reports and Interviews Relating to the FAS

To report the perspectives of institutions, FAS officials, and U.S. officials on the challenges that the FAS may face, we reviewed previous studies of the FAS, including the staff reports of the International Monetary Fund's Article IV Consultations, Graduate School USA's Economic



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Reviews, and reports produced by the FAS.<sup>28</sup> In addition, we interviewed or corresponded with FSM, RMI, and Palau officials and representatives of Graduate School USA, the International Monetary Fund, the World Bank, and the Asian Development Bank. The information about foreign law contained in this report is not the product of our original analysis but is derived from interviews and secondary sources.

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## Accountability Record

To examine the record of accountability for the use of U.S. funds provided to FSM, RMI, and Palau, we reviewed the single audit reports for the FSM, RMI, and Palau national governments and the FSM states for fiscal years 2015 through 2019. Our review of the single audit reports included identifying the type of financial statement audit opinions issued, the type of audit opinion issued on the Schedule of Expenditures of Federal Awards, and the type of audit opinion issued on compliance with requirements for major federal programs. Further, we reviewed findings that included material weaknesses and significant deficiencies, internal controls over financial reporting, and internal controls over compliance with federal awards, as applicable. We reported on selected information from the audit reports and summarized information about audit findings, which we deemed sufficient for the purposes of this report. We did not independently assess the quality of the audits or the reliability of the audit findings. We determined the timeliness of the FAS governments' submissions of the single audit reports by using the Federal Audit

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<sup>28</sup>We reviewed the staff reports associated with the International Monetary Fund's Article IV consultations. See International Monetary Fund, *Federated States of Micronesia: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: Oct. 5, 2021); *Federated States of Micronesia: Staff Report for the 2019 Article IV Consultation* (Washington, D.C.: July 30, 2019); *Republic of the Marshall Islands: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: May 6, 2021); and *Republic of Palau: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: Nov. 8, 2021). In addition, we reviewed Graduate School USA's annual economic reviews. See Graduate School USA, *Economic Review Federated States of Micronesia Fiscal Year 2018* (March 2020); Graduate School USA, *Economic Review Republic of the Marshall Islands Fiscal Year 2018* (November 2019); and Graduate School USA, *Economic Review Republic of Palau Fiscal Year 2018* (November 2019). We also reviewed publications from the Asian Development Bank. See Asian Development Bank, *Federated States of Micronesia Pacific Finance Sector Brief* (Sydney, Australia: October 2019); *Federated States of Micronesia Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020); *Marshall Islands Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020); *Marshall Islands Pacific Finance Sector Brief* (Sydney, Australia: October 2019); *Palau Asian Development Bank Member Fact Sheet* (Manila, Philippines: May 2020); and *Palau Pacific Finance Sector Brief* (Sydney, Australia: October 2019).

Clearinghouse's "form date," which is the most recent date that the clearinghouse received the required SF-SAC data collection form.

We interviewed officials in FSM's, RMI's, and Palau's finance ministries or other offices who oversee and address single audit findings regarding their corrective action plans to resolve their audit findings as well as questioned costs. In addition, we interviewed OIA officials and officials from the FSM Office of National Public Auditor, Marshall Islands Office of Auditor General, and Palau Office of the Public Auditor to determine the extent of their oversight and their perspectives on accountability in their countries. We also reviewed resolutions of the Joint Economic Management Committee for FSM and the Joint Economic Management and Financial Accountability Committee for RMI. We asked the Palau and U.S. governments about the status of the Palau Advisory Group on Economic Reform, which was to be established in accordance with terms in the Compact Review Agreement.

We conducted this performance audit from July 2020 to February 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Appendix II: Economic Overview of the Freely Associated States

This appendix highlights distinctive characteristics of the Freely Associated States (FAS): the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), and the Republic of Palau. Specifically, this appendix provides information about the population, trade, and natural resources in the FAS; the contribution of population growth to gross domestic product (GDP) per capita growth; and the contribution of U.S. grants to FAS governments' revenue.

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### Population, Trade, and Natural Resources in the FAS

The FAS have small and dispersed populations, which can inhibit economic activity and lead to higher costs for public service delivery, according to research.<sup>1</sup> The FAS have an estimated combined population of 176,395 dispersed over 517 square miles and a 2.2 million square mile exclusive economic zone (EEZ).<sup>2</sup> In comparison, the U.S. population of 331 million is spread across 3.8 million square miles and a 4.5 million-square-mile EEZ.

The FAS are relatively dependent on trade, particularly imports of goods,<sup>3</sup> but their remoteness from global markets leads to higher transport costs,

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<sup>1</sup>Chris Becker, *Small Island States in the Pacific: The Tyranny of Distance*, IMF Working Paper No. 12/223 (September 2012); Organisation for Economic Co-operation and Development, *Making Development Cooperation Work for Small Island Developing States* (Paris: OECD Publishing, 2018); Virginia Horscroft, *Public Sectors in the Islands: Are They 'Too Big' and Do They 'Crowd Out' the Private Sector?* World Bank Policy Research Working Paper Series No. 7102 (Washington, D.C.: World Bank, December 2016).

<sup>2</sup>An EEZ is the area in which a coastal nation has jurisdiction over the exploration and exploitation of marine resources in its adjacent section of the continental shelf, taken to be a band extending up to 200 nautical miles from the shore. The extent of the country's coastline or geographical dispersion also determines the size of an EEZ.

<sup>3</sup>In 2018, imports of goods exceeded exports of goods by 273 percent for FSM, 100 percent for RMI, and 1,002 percent for Palau, according to Graduate School USA. The 2018 trade-to-GDP ratios of the FAS exceeded 100, compared with a global average of 57.8 and a U.S. ratio of 27.5, according to the World Bank.

according to the United Nations Conference on Trade and Development.<sup>4</sup> For instance, using a measure of connectedness to global shipping networks for 2015, the Organisation for Economic Co-operation and Development estimated that the FAS were among the least well-connected small-island developing states, a group that is generally less connected than other developing countries.<sup>5</sup>

Fishing is a significant resource for FSM and RMI, as fishing royalties account for 10 percent of each country’s GDP. In contrast, fishing royalties make up less than 2 percent of GDP for Palau. The three countries lack other revenue-producing resources such as oil, gas, coal, or timber.

Table 12 presents information about population, trade, and natural resources of the FAS.

Table 12: Population, Trade, and Natural Resources in FSM, RMI, and Palau in 2018

	FSM	RMI	Palau
Population	104,286	54,566	17,543
Land area (square miles)	270	69	178
Exclusive economic zone (square miles)	1,149,811	822,783	242,858
GDP (millions of dollars) <sup>a</sup>	401.9	221.3	280.4
Connectedness to global shipping networks (maximum value in 2004 = 100)	4.5	7.5	3.6
Fishing (percent of GDP)	10.0	10.7	1.6
Total natural resource rents (percent of GDP)	0.02	0.00	0.00

Legend: FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands, GDP = gross domestic product.

Source: GAO analysis of Graduate School USA’s Pacific Island Training Initiatives data, World Bank World Development Indicators, and the University of Hawaii’s Pacific Islands Ocean Observing System. | GAO-22-104436

Note: Total natural resource rents equals the sum of rents from coal, timber, mineral, natural gas, and oil, where rent is the difference between the price of a commodity and the average cost of producing it. Trade is the sum of exports and imports of goods and services.

<sup>a</sup>GDP estimates for FSM are based on interim data.

<sup>4</sup>United Nations Convention on Trade and Development, *Small Island Developing States: Challenges in Transport and Trade Logistics* (Geneva: September 2014).

<sup>5</sup>Organisation for Economic Co-operation and Development, *Making Development Cooperation Work for Small Island Developing States*.

## GDP and Population Growth

Changes in population levels affected growth of GDP per capita, a proxy for the average living standard, in fiscal years (FY) 2004 through 2018. Population levels decreased in FSM and Palau, as shown in table 2. Consequently, GDP per capita grew faster than the overall economy (i.e., GDP) in both countries. This was especially true in Palau, where almost half of the GDP per capita growth came from decreasing population levels rather than economic growth.<sup>6</sup> In contrast, growth in RMI's population during this period diluted the effect of its GDP growth, which was the highest in the FAS during the period. RMI's annual GDP per capita growth of 0.7 percent was roughly half of the annual 1.2 percent GDP growth.

**Table 13: Annual Growth Rates of FAS's Real GDP, Real GDP per Capita, and Estimated Population, Fiscal Years 2004–2018**

Country	GDP annual growth rate (percent)	Estimated population annual growth rate (percent)	Real GDP per capita annual growth rate (percent)
Federated States of Micronesia	0.3	-0.1	0.4
Republic of Marshall Islands	1.3	0.6	0.7
Republic of Palau	0.6	-0.8	1.5

Legend: FAS = freely associated states, GDP = gross domestic product.

Source: GAO analysis of Graduate School USA's Pacific Islands Training Initiatives data. | GAO-22-104436

Note: GDP estimates for the Federated States of Micronesia for fiscal year 2018 are based on interim data.

The FAS have experienced high levels of migration, particularly to the U.S. In 2020, we reported on the number of compact migrants residing in the U.S. in 2013 through 2017.<sup>7</sup> Specifically, we estimated that 25,555

<sup>6</sup>According to analysts from Graduate School USA, the declining population levels have had less relevance to GDP growth in the past decade. These analysts indicated that the population drop following the end of the compact road construction is also relevant and that GDP per capita does not capture the implications of the age structure. Specifically, the Graduate School USA analysts note that Palau's population will include a higher proportion of working-age people than FSM's and RMI's populations, which have higher proportions of younger people.

<sup>7</sup>GAO, *Compacts of Free Association: Populations in U.S. Areas Have Grown, with Varying Reported Effects*, [GAO-20-491](#) (Washington, D.C.: June 15, 2020). The number of compact migrants residing in the U.S. includes migrants to Puerto Rico but not migrants to U.S. territories.

migrants from FSM, 20,545 migrants from RMI, and 3,435 migrants from Palau were residing in the U.S.<sup>8</sup>

## Employment Shares and Growth in the FAS

Employment grew in the FAS during the period from FY 2014 through FY 2018, ranging from 3 percent in FSM and 4 percent in RMI to 20 percent in Palau over the 5-year interval. Employment growth varied greatly among the FAS and across sectors.

## Employment Growth Sectors in FSM

Employment growth in FSM varied greatly across leading employment sectors. Public administration was the largest employment sector in FSM, nearly twice as large as the next largest sector. During the period from FYs 2014 through 2018, public administration and construction represented the near totality of lost employment.<sup>9</sup> In contrast, the second largest overall employer, the wholesale and retail trade and repairs sector, was the leading source of new employment during the period. Table 14 presents the FSM's leading sectors' size and contribution to employment growth during the period from FYs 2014 through 2018.

**Table 14: Average Size and Contributions to Employment Growth by Leading Industrial Sectors in FSM, Fiscal Years 2014–2018**

Sector	Average number of employees (persons)	Share of average employment (percentage)	Change in employment (number of positions)	Contribution to employment growth (percentage)
Largest sectors by average employment				
Public administration	6,150	39.8	-96	-25.2
Wholesale and retail trade and repairs	3,414	21.9	185	48.2
Transport, storage, and communications	1,031	6.6	100	26.1

<sup>8</sup>In comparison, the 2018 populations of the FAS were 104,286 for FSM, 54,566 for RMI, and 17,543 for Palau.

<sup>9</sup>Agriculture, hunting, and forestry was the only other sector that lost employees during the period from FYs 2014 through 2018. Losses in the sector (-5 positions) were substantially smaller than losses in the public administration (-96 positions), and construction (-281 positions) sectors.

**Appendix II: Economic Overview of the Freely Associated States**

Construction	908	6.2	-281	-73.4
Education	834	5.4	8	2.1
Largest sectors by contribution to employment growth				
Wholesale and retail trade and repairs	3,414	21.9	185	48.2
Real estate, renting, business activities	456	2.8	118	30.9
Other community, social, personal services	594	3.8	113	29.5
Transport, storage, and communications	1,031	6.6	100	26.1
Electricity, gas, and water supply	388	2.4	64	16.7

Legend: FSM = Federated States of Micronesia.

Source: GAO analysis of Graduate School USA's Pacific Islands Training Initiatives data. | GAO-22-104436

Note: Employment includes both full and part time. Public administration sector employees include state and national government workers in the education and health sectors.

## Employment Growth Sectors in RMI

Public administration, which had 3,775 employees on average between FY 2014 and 2018, was both the largest employer and the largest source of new employment in RMI (see table 15). The Kwajalein base, which had 1,011 employees on average, was the only other sector to appear among the five largest sectors in both categories. The other leading employment sectors lost jobs during the period. Declines in manufacturing were particularly notable, as employment levels decreased by 35 percent over the period.

**Table 15: Average Size and Contributions to Employment Growth by Leading Industrial Sectors in RMI, Fiscal Years 2014–2018**

Sector	Average number of employees (persons)	Share of average employment (percentage)	Change in employment (number of positions)	Contribution to employment growth (percentage)
Largest sectors by average employment				
Public administration	3,775	34.3	258	67.2
Wholesale and retail trade; repair of motor vehicles and motorcycles	1,773	16.1	-64	-16.7
Kwajalein base	1,011	9.2	151	39.3
Transportation and storage	751	6.8	-22	-5.8
Manufacturing	663	6.0	-340	-88.7
Largest sectors by contribution to employment growth				
Public administration	3,775	34.3	258	67.2
Construction	607	5.5	186	48.4
Kwajalein base	1,011	9.2	151	39.3
Financial intermediation	284	2.6	67	17.5
Other service activities	203	1.8	59	15.3

Legend: RMI = Republic of the Marshall Islands.

Source: GAO analysis of Graduate School USA's Pacific and Virgin Islands Training Initiatives data. | GAO-22-104436

Note: Employment includes both full and part time. Public administration sector employees include state and national government workers in the education and health sectors.

## Employment Growth Sectors in Palau

In contrast to FSM and RMI, Palau's largest employment sectors also experienced the greatest employment growth during the period from FYs 2014 through 2018. The only exception was the transportation sector, which was not one of the leading sources of new employment. More broadly, only the mining and quarrying sector and the education sector lost positions during the period. However, these job losses were outweighed by the employment gains of other sectors, -62 and 1,950 positions, respectively. Table 16 shows the size and contribution to employment growth of the leading sectors in Palau during the period from FYs 2014 through 2018.



**Table 16: Average Size and Contributions to Employment Growth by Leading Industrial Sectors in Palau, Fiscal Years 2014–2018**

Sectors	Average number of employees (persons)	Share of average employment (percentage)	Change in employment (number of positions)	Contribution to employment growth (percentage)
Largest sectors by average employment				
Public administration and defense, compulsory social security	3,140	31.0	165	8.7
Accommodation and food service activities	1,777	17.5	281	14.9
Wholesale and retail trade; repair of motor vehicles and motorcycles	1,595	15.7	261	13.8
Construction	902	8.9	459	24.3
Transportation and storage	797	7.9	14	0.7
Largest sectors by contribution to employment growth				
Construction	902	8.9	459	24.3
Accommodation and food service activities	1,777	17.5	281	14.9
Wholesale and retail trade; repair of motor vehicles and motorcycles	1,595	15.7	261	13.8
Administrative and support service activities	366	3.6	225	11.9
Public administration and defense; compulsory social security	3,140	31.0	165	8.7

Source: GAO analysis of Graduate School USA's Pacific Islands Training Initiatives data. | GAO-22-104436

Note: Employment includes both full and part time. Public administration sector employees include state and national government workers in the education and health sectors.

## Contribution of U.S. Grants to Government Revenue

Figures 12 through 14 show the sources of government revenue for the FAS in FYs 2004 through 2018. Government revenue increased during this period in each of the FAS, with growth ranging from 74 percent in Palau to over 100 percent in FSM. According to data from Graduate School USA, the increases in government revenue outstripped expenses and shifted fiscal balance deficits into surpluses for each of the FAS.

During this time period, U.S. grants to the FAS also increased.<sup>10</sup> Grants to FSM increased from \$73 million to \$89 million, while grants to RMI increased from \$31 million to \$51 million.<sup>11</sup> Grants to Palau increased by the smallest magnitude, from \$26 million to \$34 million.<sup>12</sup> Even with the increasing grant amounts, the percentage of government revenue from U.S. grants decreased as revenue from other sources grew faster (see figs. 12 through 14). In FSM, the percentages of revenue from royalties from fishing rights and taxes from corporations increased more than the percentages of revenue from other sources.<sup>13</sup> RMI experienced a similar increase in the percentage of revenue from royalties from fishing rights. In Palau, the percentage of revenue from taxes increased more than the percentage of revenue from other sources during the period.

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<sup>10</sup>The grant amounts shown in figures 12 through 14 and discussed here do not include contributions by the U.S. to the compact trust funds, because these contributions are not part of FAS government revenue, according to Graduate School USA.

<sup>11</sup>During the same period, the U.S. contributed \$340 million and \$178 million to the compact trust funds of FSM and RMI, respectively.

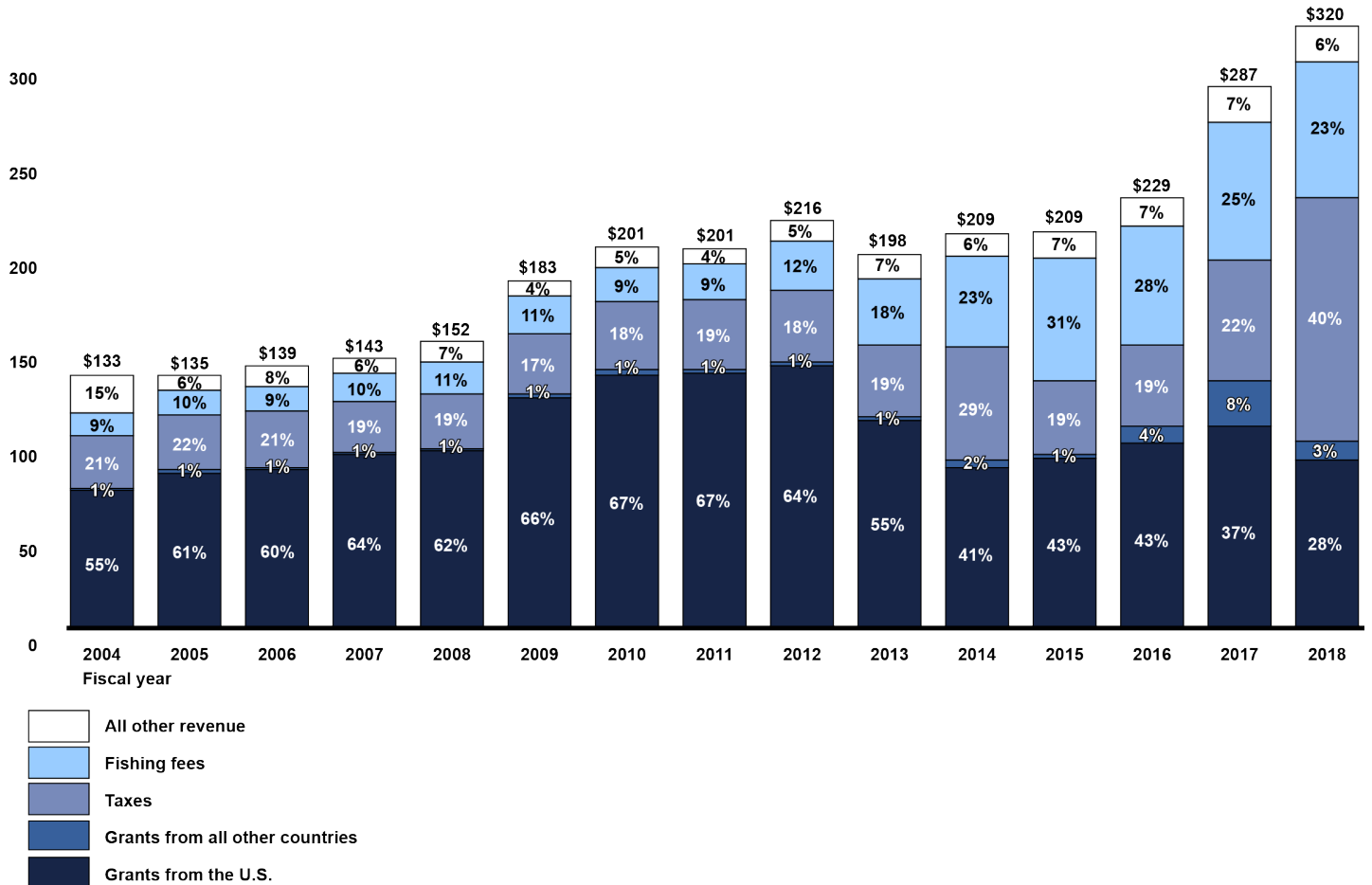
<sup>12</sup>During the same period, the U.S. contributed \$65 million to the compact trust fund of Palau.

<sup>13</sup>Graduate School USA notes that the tax revenue for FSM is periodically affected by unusually large receipts of capital gains, particularly FYs 2014, 2017, and 2018. According to Graduate School USA, the \$77 million receipt of capital gains from an individual Japanese organization in FY 2018 was exceptional among these years.

Appendix II: Economic Overview of the Freely Associated States

Figure 12: Sources of Government Revenue for the Federated States of Micronesia, Fiscal Years 2004–2018

Dollars in millions  
350



Source: GAO analysis of the Graduate School USA's Pacific Islands Training Initiatives data. | GAO-22-104436

**Appendix II: Economic Overview of the Freely  
Associated States**

**Accessible Data Table for Figure 12**

<b>Fiscal Year</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Grants from the United States	73	82	84	92	94	122	134	135	139	110	85	90	98	107	89
Grants from other countries	1	2	1	1	1	2	3	2	2	2	4	2	9	24	10
Taxes	28	29	30	27	29	32	36	37	38	38	60	39	43	64	129
Fishing Fees	12	13	13	15	17	20	18	19	26	35	48	65	63	73	72
All other revenue	20	8	11	8	11	8	11	8	11	13	12	14	15	19	19
<b>Total Revenue</b>	<b>133</b>	<b>135</b>	<b>139</b>	<b>143</b>	<b>152</b>	<b>183</b>	<b>201</b>	<b>201</b>	<b>216</b>	<b>198</b>	<b>209</b>	<b>209</b>	<b>229</b>	<b>287</b>	<b>320</b>
Grants from the United States	55%	61%	60%	64%	62%	66%	67%	67%	64%	55%	41%	43%	43%	37%	28%
Grants from other countries	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	2%	1%	4%	8%	3%
Taxes	21%	22%	21%	19%	19%	17%	18%	19%	18%	19%	29%	19%	19%	22%	40%
Fishing Fees	9%	10%	9%	10%	11%	11%	9%	9%	12%	18%	23%	31%	28%	25%	23%
All other revenue	15%	6%	8%	6%	7%	4%	5%	4%	5%	7%	6%	7%	7%	7%	6%

Notes: "All other revenue" comprises all revenue not included in the other categories shown.

"Taxes" comprises taxes on nonresident corporations.

"Grants from all other countries" comprises any grants from foreign governments not included in "Grants from the U.S."

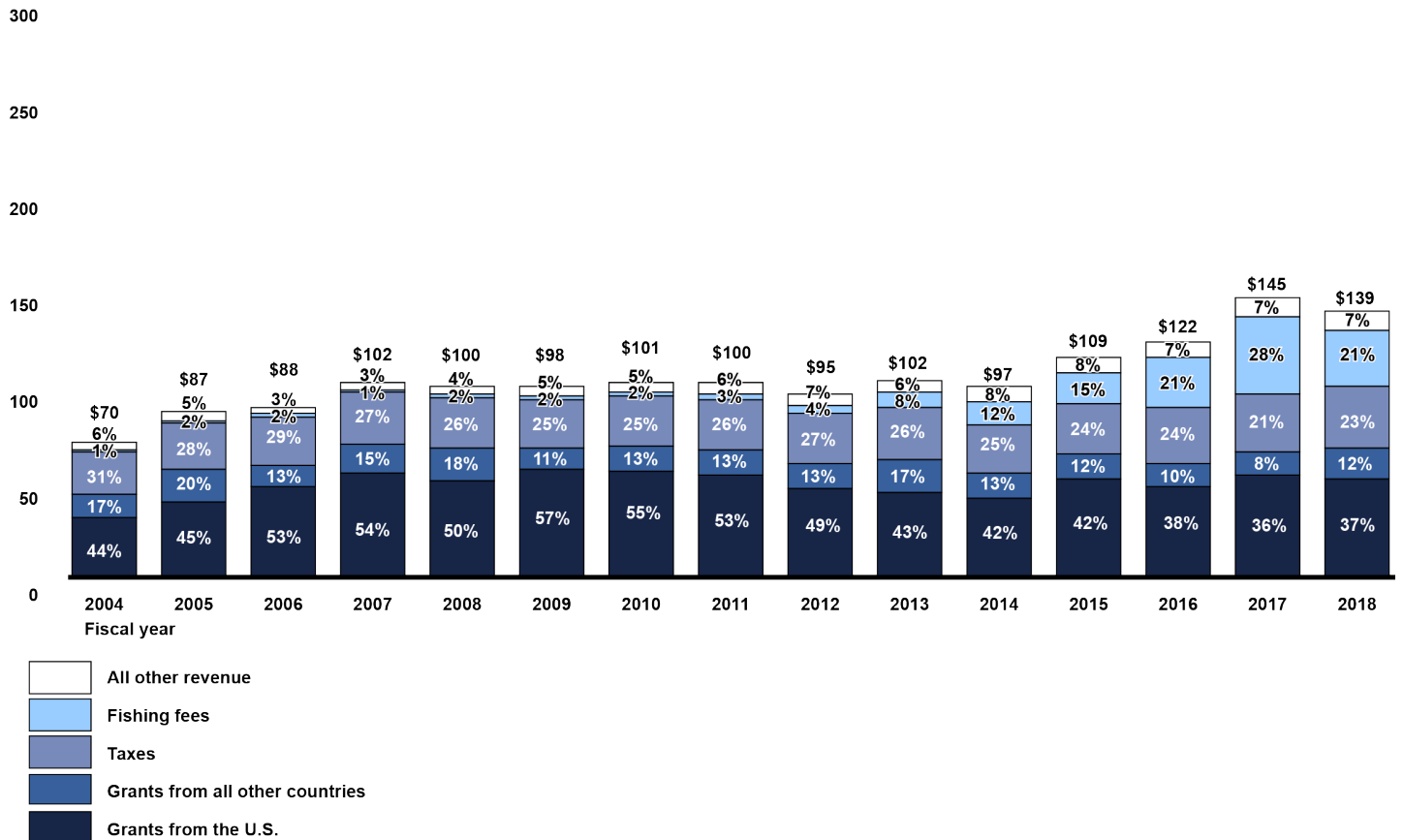
"Grants from the U.S." comprises grants that Graduate School USA labeled "Compact" and "Federal Programs and other U.S."

Revenue does not include U.S. contributions to the compact trust fund.

Appendix II: Economic Overview of the Freely Associated States

Figure 13: Sources of Government Revenue for the Republic of the Marshall Islands, Fiscal Years 2004–2018

Dollars in millions  
350



Source: GAO analysis of the Graduate School USA's Pacific Islands Training Initiatives data. | GAO-22-104436

**Appendix II: Economic Overview of the Freely  
Associated States**

**Accessible Data Table for Figure 13**

<b>Fiscal Year</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Grants from the United States	31	39	47	54	50	56	55	53	46	44	41	46	47	53	51
Grants from other countries	12	17	11	15	17	11	13	13	13	17	13	13	12	12	16
Taxes	22	24	25	27	26	25	26	26	26	27	25	26	29	30	32
Fishing Fees	1	1	2	1	2	2	2	3	4	8	12	16	26	40	29
All other revenue	4	5	3	4	4	5	5	6	6	6	8	8	8	10	10
<b>Total Revenue</b>	<b>70</b>	<b>87</b>	<b>88</b>	<b>102</b>	<b>100</b>	<b>98</b>	<b>101</b>	<b>100</b>	<b>95</b>	<b>102</b>	<b>97</b>	<b>109</b>	<b>122</b>	<b>145</b>	<b>139</b>
Grants from the United States	44%	45%	53%	54%	50%	57%	55%	53%	49%	43%	42%	42%	38%	36%	37%
Grants from other countries	17%	20%	13%	15%	18%	11%	13%	13%	13%	17%	13%	12%	10%	8%	12%
Taxes	31%	28%	29%	27%	26%	25%	25%	26%	27%	26%	25%	24%	24%	21%	23%
Fishing Fees	1%	2%	2%	1%	2%	2%	2%	3%	4%	8%	12%	15%	21%	28%	21%
All other revenue	6%	5%	3%	3%	4%	5%	5%	6%	7%	6%	8%	8%	7%	7%	7%

Notes: "All other revenue" comprises all revenue not included in the other categories shown.

"Grants from all other countries" comprises any grants from foreign governments not included in "Grants from the U.S."

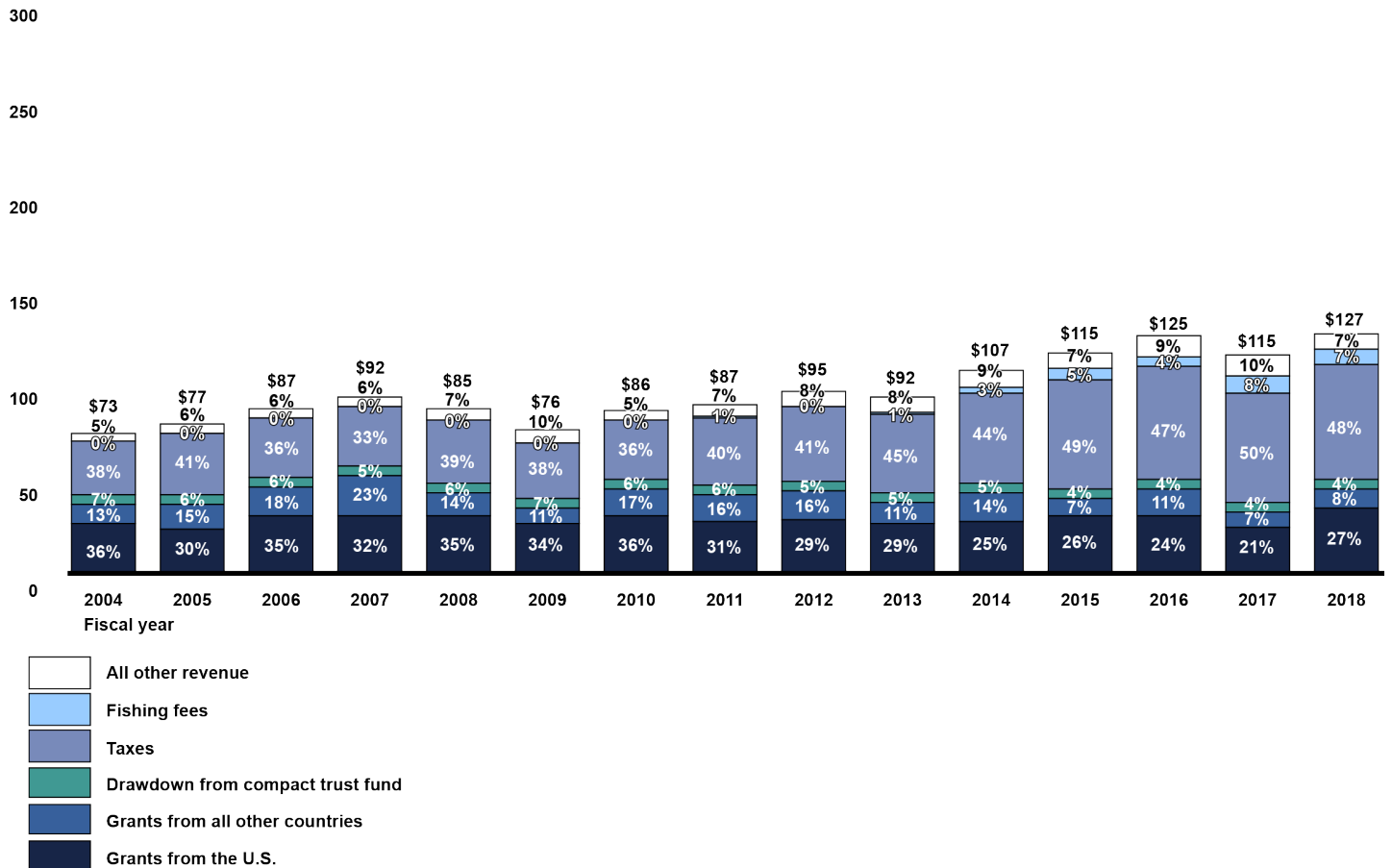
"Grants from the U.S." comprises grants that Graduate School USA labeled "U.S. Compact" and "U.S. Federal Programs and other."

Revenue does not include U.S. contributions to the compact trust fund.

Appendix II: Economic Overview of the Freely Associated States

Figure 14: Sources of Government Revenue for the Republic of Palau, Fiscal Years 2004-2018

Dollars in millions  
350



Source: GAO, based on data from the Graduate School USA, Pacific Islands Training Initiative. | GAO-22-104436

**Appendix II: Economic Overview of the Freely  
Associated States**

**Accessible Data Table for Figure 14**

<b>Fiscal Year</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Grants from the United States	26	23	30	30	29	26	30	27	28	26	27	30	30	24	34
Grants from other countries	10	13	15	21	12	8	14	14	15	11	15	9	14	8	10
Drawdown from compact trust fund	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
Taxes	28	32	31	31	33	29	31	35	39	41	47	57	59	57	60
Fishing Fees	0	0	0	0	0	0	0	1	0	1	3	6	5	9	8
All other revenue	4	5	5	5	6	7	5	6	8	8	9	8	11	11	8
<b>Total Revenue</b>	<b>73</b>	<b>77</b>	<b>87</b>	<b>92</b>	<b>85</b>	<b>76</b>	<b>86</b>	<b>87</b>	<b>95</b>	<b>92</b>	<b>107</b>	<b>115</b>	<b>125</b>	<b>115</b>	<b>127</b>
Grants from the United States	36%	30%	35%	32%	35%	34%	36%	31%	29%	29%	25%	26%	24%	21%	27%
Grants from other countries	13%	16%	18%	23%	14%	11%	17%	16%	16%	11%	14%	7%	11%	7%	8%
Drawdown from Compact Trust Fund	7%	6%	6%	5%	6%	7%	6%	6%	5%	5%	5%	4%	4%	4%	4%
Taxes	38%	41%	36%	33%	39%	38%	36%	40%	41%	45%	44%	49%	47%	50%	48%
Fishing Fees	0%	0%	0%	0%	0%	0%	0%	1%	0%	1%	3%	5%	4%	8%	7%
All other revenue	5%	6%	6%	6%	7%	10%	5%	7%	8%	8%	9%	7%	9%	10%	7%

Notes: "All other revenue" comprises all revenue not included in the other categories shown.

"Fishing fees" comprises both royalties from fishing rights and fees from fishing vessel day schemes.

"Grants from all other countries" comprises any grants from foreign governments not included in "Grants from the U.S."

"Grants from the U.S." comprises grants that Graduate School USA labeled "Compact" and "Federal Programs and other U.S."

Revenue does not include U.S. contributions to the compact trust fund.



# Appendix III: U.S. Assistance Totals by Expenditures of the Freely Associated States, Fiscal Years 2015-2019

The U.S. provides a variety of assistance to the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), and the Republic of Palau. Table 17 shows information about the U.S. assistance provided to the FSM national and state governments, as reflected in the governments' expenditures for fiscal years (FY) 2015 through 2019.<sup>1</sup>

**Table 17: U.S. Assistance to the FSM National Government and State Governments as Reflected in the Governments' Expenditures, by Source, Fiscal Years 2015–2019**

Dollars in millions

Fiscal year	Compact and supplemental education grants ending in fiscal year 2023	Other U.S. grants	Total
2015	69.26	20.18	89.44
2016	68.42	30.23	98.65
2017	71.73	34.87	106.6
2018	70.89	23.05	93.94
2019	64.93	17.72	82.65

Source: GAO analysis of the Federated States of Micronesia (FSM) national and state government single audit reports for fiscal years 2015–2019. | GAO-22-104436

Notes: The amounts shown do not include expenditures by government component units, such as the College of Micronesia and public utilities.

For purposes of this report, “compact grants” refers to the compact sector grants provided to FSM and RMI pursuant to Section 211 of their respective compacts, Kwajalein impact and use grants provided pursuant to Section 212 of the RMI compact, and grants provided to Palau under Article I of its compact and under the compact review agreement, as amended, between the U.S. and Palau that entered into force on September 19, 2018.

<sup>1</sup>U.S. contributions to the FSM compact trust fund are not recorded as an FSM government expenditure.

Appendix III: U.S. Assistance Totals by  
Expenditures of the Freely Associated States,  
Fiscal Years 2015-2019

Table 18 shows information about the U.S. assistance provided to RMI, as reflected in the government's expenditures for FYs 2015 through 2019.<sup>2</sup>

**Table 18: Total U.S. Assistance to the RMI Government as Reflected in the Government's Expenditures, by Source, Fiscal Years 2015–2019**

Dollars in millions

Fiscal year	Compact sector and supplemental education grants ending in fiscal year 2023	Compact Kwajalein-related grants that do not end in 2023	Other U.S. grants	Total
2015	29.61	6.69	9.74	46.04
2016	30.33	3.25	10.36	43.94
2017	36.70	7.73	9.71	54.14
2018	33.06	7.64	10.34	51.04
2019	33.98	11.15	11.27	56.40

Source: GAO analysis of the Republic of the Marshall Islands (RMI) single audit reports for fiscal years 2015–2019. | GAO-22-104436

Note: The amounts shown do not include expenditures by government component units, such as the College of the Marshall Islands and public utilities.

<sup>2</sup>U.S. contributions to the RMI compact trust fund are not recorded as an RMI government expenditure.

Appendix III: U.S. Assistance Totals by  
Expenditures of the Freely Associated States,  
Fiscal Years 2015-2019

Table 19 provides information about the U.S. assistance provided to Palau, as reflected in the governments’ expenditures for FYs 2015-2019.<sup>3</sup>

**Table 19: Total U.S. Assistance to the Palau Government as Reflected in the Government’s Expenditures, by Source, Fiscal Years 2015–2019**

Dollars in millions

Fiscal year	Compact grants ending in fiscal year 2024	Compact trust fund disbursements	Other U.S. grants	Total
2015	13.15	5.00	17.04	35.19
2016	13.15	5.00	17.12	35.27
2017	13.15	5.00	11.32	29.47
2018	26.57	5.00	10.28	41.85
2019	1.09	15.00	16.20	32.29

Source: GAO analysis of the Republic of Palau single audit reports for fiscal years 2015–2019. | GAO-22-104436

Notes: The amounts shown do not include expenditures by government component units, such as the Palau Community College and public utilities.

For purposes of this report, “compact grants” refers to the compact sector grants provided to FSM and RMI pursuant to Section 211 of their respective compacts, Kwajalein impact and use grants provided pursuant to Section 212 of the RMI compact, and grants provided to Palau under Article I of its compact and under the compact review agreement, as amended, between the U.S. and Palau that entered into force on September 19, 2018.

<sup>3</sup>U.S. contributions to the Palau compact trust fund in fiscal year 2018 are not recorded as a Palau government expenditure.

## Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024

This appendix provides information about the status of compact grants, education-related grants and programs, programs and services mentioned in the Federal Programs and Services Agreements with the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Palau, as applicable, and of programs mentioned in the compacts' implementing legislation under current law as of the end of fiscal years (FY) 2023 or 2024, according to agency officials. In addition, this appendix provides information about grants, loans, and other programs for which FSM, RMI, and Palau are eligible and about the status of these grants, loans, and programs under current law as of the end of fiscal years 2023 or 2024, according to agency officials.

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### Status of Compact Grants to FSM, RMI, and Palau

Under current law, compact sector grants provided to FSM and RMI under sections 211(a) of their compacts are scheduled to end in 2023.<sup>1</sup> However, RMI is scheduled to continue to receive \$7.2 million, partially adjusted for inflation, related to the U.S. military base in Kwajalein Atoll, consistent with section 211(b) of its compact and the RMI Military Use and Operating Rights Agreement (MUORA). Under the terms of the RMI MUORA, the U.S. agreed to provide these Kwajalein-related grants for as long as the MUORA remains in effect. The MUORA continues until 2066 and may be extended at the discretion of the U.S. until 2086. The amended RMI compact provides for \$18 million, partially adjusted for

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<sup>1</sup>The countries may continue to receive some grant funding after the provisions of law authorizing the grants expire at the end of FY 2023 for FSM and RMI and at the end of FY 2024 for Palau. Funding may flow to FSM, RMI, and Palau pursuant to the grant for several years after the grant ends. Federal programs and services provided through compact agreements with each country end at various specific dates in 2023 for FSM and 2024 for RMI and Palau.

inflation, in annual payments to the RMI government to compensate for impacts from the U.S. Army Garrison–Kwajalein Atoll. These payments will continue for as long as the MUORA is in effect.

Annual compact grants of up to \$500,000 (not adjusted for inflation) to FSM and RMI to pay for required annual audits of compact grants are scheduled to end in 2023. The Palau Compact Review Agreement established a trust fund for infrastructure maintenance, consistent with the terms of the agreement. The trust fund is funded by annual U.S. grants of \$2 million through FY 2024, with requirements for Palau to also provide funding.

Table 20 summarizes the status under current law of compact sector, Kwajalein-related, and audit grants to FSM and RMI after FY 2023 and of compact-related grants to Palau after FY 2024.

Table 20: Status after Fiscal Year 2023 under Current Law of Compact Sector, Kwajalein-Related, and Other Compact Grants to FSM and RMI Made Pursuant to Their Compacts or Subsidiary Agreements and Status after Fiscal Year 2024 under Current Law of Grants to Palau Made Pursuant to Its Compact Review Agreement

Country receiving assistance	Reference and compact grant name	Status after end of FY 2023 for FSM and RMI and 2024 for Palau under current law
FSM and RMI	Section 211 (a)—all compact sector grants <sup>a</sup>	Grants will end.
FSM and RMI	Section 212(b) (FSM) Audit Section 213(b) (RMI) Audit	Grants will end.
RMI	Section 211(b)(1) Ebeye Special Needs (infrastructure)	Grants will continue as long as the MUORA is in effect.
RMI	Section 211(b)(2) Ebeye Special Needs (emphasis on landowners)	Grants will continue as long as the MUORA is in effect.
RMI	Section 211(b)(3) Kwajalein Environmental Grants	Grants will continue as long as the MUORA is in effect.
RMI	Section 212 Kwajalein Impact and Use	Grants will continue as long as the MUORA is in effect.
Palau	Compact Review Agreement, Infrastructure Maintenance Grant	Grant will end.

Legend: FSM = Federated States of Micronesia, FY = fiscal year, RMI = Republic of the Marshall Islands, MUORA = Military Use and Operating Rights Agreement.

Sources: Department of Interior officials and GAO review of compact agreements. | GAO-22-104436

Note: The Palau Compact Review Agreement consists of an agreement signed in Honolulu in 2010, with appendices, as amended by an agreement signed at Koror, Palau, in 2018. The agreement entered into force on September 19, 2018. Treaties and Other International Acts Series (T.I.A.S.) 18-919.2.

<sup>a</sup>Economic assistance directed to specific sectors, with a focus on health and education. The base amount of the grants generally declines yearly in fiscal years 2004 through 2023.

## Programs Replaced by the Supplemental Education Grant

The supplemental education grant (SEG) authorized by the FSM and RMI amended compacts' implementing legislation will end in FY 2023, according to agency officials; under current law, FSM and RMI will not be eligible for most programs that the SEG replaced. The amended compacts' implementing legislation also extended eligibility for programs replaced by the SEG to Palau.<sup>2</sup> Absent changes to current law, FSM and RMI will not be eligible after FY 2023 and Palau will not be eligible after FY 2024 for job training programs and Head Start early education programs, according to agency officials. See table 21.

**Table 21: U.S. Agencies' Assessment of FSM's, RMI's, and Palau's Eligibility under Current Law after FY 2023 or FY 2024 for Programs Replaced by the Supplemental Education Grant Provided in the FSM and RMI Amended Compacts' Implementing Legislation, Pub. L. No. 108-188**

Agency	Program description	Eligibility as of end of FY 2023 for FSM and RMI and FY 2024 for Palau <sup>a</sup> under current law <sup>b</sup>
Department of Education	Supplemental Education Grant (SEG)  Authorization of appropriations of \$12.23 million for the Federated States of Micronesia (FSM) and \$6.1 million to the Republic of the Marshall Islands (RMI), partially adjusted for inflation for each of fiscal years 2005 through 2023 in lieu of eligibility for the various education, health, and labor programs listed below.	SEG ends.  Eligibility varies for programs replaced by the SEG after 2023.  See below for FSM, RMI, and Palau eligibility for programs replaced by the SEG for FSM and RMI.
<b>Programs replaced by the SEG, fiscal years 2005-2023</b>		
Department of Education	Part A of title I of the Elementary and Secondary Education Act of 1965 (Improving Basic Programs Operated by Local Educational Agencies).	FSM and RMI are not eligible; Palau remains eligible.

<sup>2</sup>See Pub. L. No. 108-188, § 105(f)(1)(B)(ix), 117 Stat. 2720, 2751 (Dec. 17, 2003). Congress subsequently extended Palau's eligibility for programs replaced by the SEG through fiscal year 2024. Pub. L. No. 115-91, § 1259C(c), 131 Stat. 1283, 1687. These provisions of law are codified at 48 U.S.C. § 1921d(f)(1)(B)(ix).

**Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024**

<b>Agency</b>	<b>Program description</b>	<b>Eligibility as of end of FY 2023 for FSM and RMI and FY 2024 for Palau<sup>a</sup> under current law<sup>b</sup></b>
Department of Education	The Carl D. Perkins Career and Technical Education Act of 2006, as amended by the Strengthening Career and Technical Education for the 21st Century Act, formerly Title I of the Carl D. Perkins Vocational and Technical Education Act of 1998 (Career and Technical Education)	FSM and RMI are not eligible; Palau remains eligible.
Department of Education	Subpart 3 of part A of title IV of the Higher Education Act of 1965 (Federal Supplemental Educational Opportunity Grants).	All three countries remain eligible.
Department of Education	Part C of title IV of the Higher Education Act of 1965 (Federal Work-Study Programs)	All three countries remain eligible.
Department of Education	Title II of the Workforce Innovation and Opportunity Act of 2014. <sup>c</sup>  (Adult Education and Literacy programs.)	FSM and RMI are not eligible; Palau remains eligible.
Department of Health and Human Services	Head Start Act (early childhood education, health, and nutrition services for low-income children and their families.)	None of the countries are eligible.
Department of Labor	Title I of the Workforce Innovation and Opportunity Act of 2014. <sup>b</sup>  (Statewide and local workforce investment systems, Job Corps, and various national programs such as Native American, migrant, and veterans programs.)	FSM and RMI are not eligible; Palau remains eligible.

Legend: FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands.

Sources: Department of Education, Labor, and Health and Human Services officials and GAO analysis of Pub. L. No. 108-188, 117 Stat. 2720 (Dec. 17, 2003). | GAO-22-104436

<sup>a</sup>The amended compacts' implementing legislation granted Palau eligibility for programs replaced by the SEG as well as for the education-related program grants described in table 22 of GAO 22-104436. Section 1259C of the National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91, 131 Stat. 1283, 1687 (2017), extended Palau's eligibility for these programs until the end of FY 2024. See 48 U.S.C. § 1921d(f)(1)(B)(ix).

<sup>b</sup>Eligibility was determined by agency officials on the basis of current law. The availability of grants and programs in the future is subject to the availability of appropriations provided for that purpose.

<sup>c</sup>The relevant provision of law concerning workforce investment replaced by SEG grants was titled the Workforce Investment Act of 1998. This act was repealed and replaced by the Workforce Innovation and Opportunity Act of 2014, Pub. L. No. 113-128, 128 Stat. 1425.

## Status of Education-Related Grants and Programs for FSM, RMI, and Palau

Table 22 summarizes information about compact and other education-related grants to FSM, RMI, and Palau, according to agency officials. Pursuant to section 105(f)(1)(B)(ix) of the Compact of Free Association Amendments Act of 2003, Pub. L. No. 108-188, Palau was made eligible

for appropriations and to receive grants under the Individuals with Disabilities Education Act as well as Pell grants. This eligibility was extended through FY 2024 by section 1259C(c) of the National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91.



Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024

Table 22: Department of Education Assessment of Eligibility under Current Law after FY 2023 and FY 2024 of Education-Related Programs Currently Provided to FSM, RMI, and Palau Pursuant to Compact Agreements, Related Agreements, or Implementing Legislation

Country receiving assistance	Compact grant name and reference	Description	Status under current law as of end of FY 2023 for FSM and RMI and 2024 for Palau <sup>a</sup>
FSM, RMI, and Palau	Special Education Cluster–Part B of the Individuals with Disabilities Education Act: Special Education-Grants to States	Grants to states to assist them in providing special education and related services to eligible children with disabilities.	Eligible
FSM, RMI, and Palau	Pell grants	Financial need–based grants to qualifying students for postsecondary education expenses	Eligible <sup>b</sup>

Legend: FSM = Federated States of Micronesia, FY = fiscal year, RMI = Republic of the Marshall Islands.

Sources: Department of Education officials and GAO analysis of the Compact Agreements. | GAO-22-104436

<sup>a</sup>The amended compacts' implementing legislation granted Palau eligibility for these education-related grants as well as certain programs replaced by the Special Education Grant described in Table 21 of GAO-22-104436. Section 1259C of the National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91, 131 Stat. 1283, 1687 (2017), extended Palau's eligibility for these programs until the end of FY 2024. See 48 U.S.C. § 1921d(f)(1)(B)(ix).

<sup>b</sup>Representatives of one of the freely associated states noted that the Department of Education's determination that its citizens would remain eligible for Pell grants was based on language in the Code of Federal Regulations (34 C.F.R. § 668.33(b)) that may not be supported by the statute authorizing this program. See 20 U.S.C. § 1091(a)(5). They suggested that this issue should be addressed as part of current negotiations to extend their compact assistance.

Description and Status of Programs and Services in the Compact Programs and Services Agreements for FSM, RMI, and Palau

The compact programs and services agreements with FSM, RMI, and Palau<sup>3</sup> will end in 2023 or 2024. However, according to agency officials, current U.S. law enables U.S. agencies to continue providing some

<sup>3</sup>The U.S. and Palau concluded an agreement on programs and services pursuant to sections 221 and 232 of the Palau compact that addressed postal services, weather services, and civil aviation. A separate agreement concluded pursuant to sections 131 and 132 of the compact addressed telecommunications services. We include programs provided pursuant to the sections 131 and 132 agreement with those provided pursuant to the programs and services agreements.

programs and services now provided under those agreements.<sup>4</sup> According to agency officials, no current provisions of U.S. law will enable the Federal Emergency Management Agency (FEMA) to provide disaster response funding, enable the Federal Deposit Insurance Corporation to provide deposit insurance to foreign chartered institutions, or enable the U.S. Postal Service to provide services, as currently structured, to FSM, RMI, and Palau after the expiration of the provisions of the Federal Programs and Services Agreements relating to those services. However, officials noted that the National Weather Service, the U.S. Department of Transportation's (DOT) Federal Aviation Administration (FAA), and the U.S. Agency for International Development (USAID) could, under other legal authorities, provide services similar to those they now provide under the programs and services agreements.

**National Weather Service.** The programs and services agreements authorize the National Weather Service to fund the operations of weather stations in FSM, RMI, and Palau, which it can continue to fund under other authorities after the end of the agreements, according to a Department of Commerce official.<sup>5</sup>

**DOT FAA.** The existing safety-related programs and services agreements authorize DOT's FAA to provide technical assistance in FSM, RMI, and Palau. After the agreements expire, FAA could continue to provide technical assistance under other provisions of current U.S. law, according to DOT officials. However, DOT officials stated that FAA would require new bilateral agreements with FSM, RMI, and Palau in order for the countries to continue to receive the civil aviation safety services that FAA currently provides under the programs and services agreements. FAA would also seek reimbursement for any technical assistance it provides to FSM, RMI, and Palau, according to DOT officials. With regard to the civil aviation economic services of the programs and services agreements,

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<sup>4</sup>The agreement with FSM ends on September 30, 2023; the agreement with RMI ends on April 30, 2024; and the agreement with Palau ends on September 30, 2024. The Palau section 131 telecommunications agreement remains in force as long as the Palau compact remains in force. Certain provisions of the section 132 telecommunications agreement remain in force while the Palau MUORA remains in force, while other provisions expire on September 30, 2024.

<sup>5</sup>The weather stations are in Pohnpei, Chuuk, and Yap states in FSM; in Majuro in RMI; and in Airai in Palau, according to a Department of Commerce official.

DOT officials stated that FSM, RMI, and Palau airlines will no longer have the legal right to operate between certain U.S. destinations.

**USAID.** The programs and services agreements authorize FSM and RMI to request an annual grant of up to \$50,000 from the U.S. for disaster preparedness programs. After a U.S. presidential disaster declaration, FEMA provides the funding for disaster relief and reconstruction for FSM and RMI, which USAID programs.<sup>6</sup> According to FEMA officials, under current law, FEMA funds will no longer be available for this purpose after the relevant provisions of the agreements expire. However, these officials stated that USAID will be able to provide foreign disaster assistance funding to FSM RMI, and Palau under the same terms as it provides this assistance to other countries. After the programs and services agreements end, FEMA will be able to support disaster relief efforts only if USAID or the countries request it on a reimbursable basis, according to FEMA officials.

In addition, according to officials of the Department of the Interior, telecommunications-related services that the agency provides to FSM and RMI under the programs and services agreements will continue as long as the FSM and RMI governments provide appropriate authorization for such services. The separate agreement relating to provision of telecommunications services to Palau does not fully expire until 2044; however, certain provisions of that agreement concerning provision of telecommunications services in support of the Palau programs and services agreement expire on September 30, 2024. Table 23 shows agency officials' assessment of the status, after fiscal year 2023, of programs and services currently provided to the FSM, RMI, and Palau under the agreements.

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<sup>6</sup>In recent years, USAID has programmed FEMA-provided funds for disaster response and reconstruction in the FSM states of Chuuk, Pohnpei, and Yap to meet immediate humanitarian needs and facilitate recovery from the impact of Typhoon Wutip in February 2019 and to address flooding and damage to critical infrastructure in Pohnpei resulting from Tropical Depression Jelawat in March 2018. In addition, USAID programmed FEMA-provided funds for disaster assistance in RMI in response to prolonged drought conditions in 2015 and 2016.

**Appendix IV: Status of U.S. Grants and  
Programs in FSM and RMI after 2023 and in  
Palau after 2024**

**Table 23: U.S. Agencies' Assessment of Status under Current Law of Programs and Services Identified in U.S.–FSM, U.S.–RMI, and U.S.–Palau Amended Compacts' Programs and Services Agreements after the Agreements Expire**

<b>Countries receiving assistance</b>	<b>U.S. agency providing assistance</b>	<b>Programs and services</b>	<b>Description</b>	<b>Status under current law after programs and services agreements end</b>
Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Republic of Palau	Department of Commerce National Weather Service (NWS)	Weather services and related programs	NWS provides funding for the operation of weather stations in the FSM states of Pohnpei, Chuuk, and Yap; in Majuro, RMI; and in Airai, Palau.	The Secretary of Commerce may continue funding to maintain services in FSM, RMI, and Palau because the services are essential to proper execution of Commerce Department duties, including the provision of critical observations for NWS forecasting capabilities in the Pacific.
FSM, RMI, and Palau	Department of the Interior and Department of State	Telecommunications services and related programs	Operation of telecommunications services of the U.S. government necessary to fulfill its obligations under the amended compacts.	Services will end for FSM and RMI. Certain provisions of the Palau Compact Section 132 Agreement Regarding the Operation of Telecommunications Services will remain in force while the Palau Military Use and Operating Rights Agreement remains in force. <sup>a</sup>
FSM	Federal Deposit Insurance Corporation (FDIC)	Federal deposit insurance	The Federal Deposit Insurance Corporation insures deposits of the Bank of the FSM.	Upon expiration of relevant provisions of the Federal Programs and Services Agreement, the FDIC will no longer have authority to insure a foreign-chartered institution in the FSM.
FSM and RMI	Federal Emergency Management Agency (FEMA) and U.S. Agency for International Development (USAID)	Disaster relief assistance	In the event of a U.S. Presidential Disaster Declaration, USAID provides direct relief and reconstruction services to FSM and RMI, which is funded by FEMA.	If FSM's and RMI's programs and services agreements are not renewed, FEMA will no longer have authority after FY 2023 to provide funding to USAID to provide these services to either country.  FSM and RMI will remain eligible to receive assistance from USAID on the same terms as other foreign countries, including Palau, pursuant to the Foreign Assistance Act.

**Appendix IV: Status of U.S. Grants and  
Programs in FSM and RMI after 2023 and in  
Palau after 2024**

<b>Countries receiving assistance</b>	<b>U.S. agency providing assistance</b>	<b>Programs and services</b>	<b>Description</b>	<b>Status under current law after programs and services agreements end</b>
FSM and RMI	USAID	Disaster resilience/preparedness	In addition to receiving regular assistance funding from USAID for this activity, FSM and RMI receive enhanced assistance for disaster preparedness from USAID and FEMA under the terms of their respective compacts.	If FSM's and RMI's programs and services agreements are not renewed, FEMA and USAID will no longer have the authority after FY 2023 to provide enhanced funding under the compact. FSM and RMI will remain eligible to receive assistance from USAID on the same terms as other foreign countries pursuant to the Foreign Assistance Act.
FSM, RMI, and Palau	U.S. Postal Service (USPS)	Postal services and related programs	USPS provides postal services to the Freely Associated States (FAS). USPS conducts the exchange of FAS-origin outbound international mail with other foreign postal operators and dispatches to the FAS inbound foreign-origin mail addressed to recipients in the FAS. USPS further procures and provides for transportation of mail to and from each FAS, as well as certain air transportation within and among the FAS, as well as technical assistance, supplies, and training.	Services will expire.
FSM, RMI, and Palau <sup>b</sup>	USPS	Law enforcement assistance	Technical and training assistance, including training and equipment for postal inspection of illicit drugs and other contraband.	Assistance will expire for FSM and Palau; may continue for RMI if mutually agreed.
FSM, RMI, and Palau	Department of Transportation (DOT) Federal Aviation Administration (FAA)	Civil aviation safety services and related programs	FAA provides assistance with airport navigational and safety services.	After FY 2023 (for FSM and RMI) and FY 2024 (for Palau), new bilateral agreements will be required in order for FAA to provide this assistance.

**Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024**

Countries receiving assistance	U.S. agency providing assistance	Programs and services	Description	Status under current law after programs and services agreements end
FSM, RMI, and Palau	DOT	Civil aviation economic services and related programs	Provides FSM, RMI, and Palau airlines with legal rights to operate between certain U.S. destinations and for U.S. carriers to serve points within FSM, RMI, and Palau. Provides technical assistance to FSM with respect to economic regulation of air service.	After FY 2023 (for FSM and RMI) and FY 2024 (for Palau), FSM, RMI, and Palau airlines will no longer be permitted to operate between certain U.S. destinations. After FY 2023 (for FSM and RMI) and FY 2024 (for Palau), technical assistance may be provided under various DOT authorities, but DOT would seek reimbursement for those services.

Legend: FSM = Federated States of Micronesia, FY = fiscal year, RMI = Republic of the Marshall Islands.

Sources: U.S. agency officials and GAO review of the compacts' programs and services agreements. | GAO-22-104436

<sup>a</sup>The Palau Military Use and Operating Rights Agreement remains in effect until 2044. Provisions of the Palau Telecommunications Agreement addressing provision of telecommunications services in support of the Palau programs and services agreement expire on September 30, 2024.

<sup>b</sup>The technical assistance is provided pursuant to section 221 of the Palau compact and the Palau programs and services agreement as amended pursuant to the compact review agreement.

## Programs Identified in the Amended Compacts' Implementing Legislation

Additional grants provided to FSM and RMI under the amended compacts' implementing legislation will end in FY 2023, but, according to agency officials, the countries' eligibility for programs now provided under that legislation will generally continue under current U.S. law.<sup>7</sup> Grants provided under the amended compacts' implementing legislation for (1) judicial training in FSM and RMI and (2) agricultural and planting programs on the RMI's nuclear-affected Enewetak Atoll are scheduled to end (see table 24). However, under current U.S. law, agency officials stated that legal authorities permitting the operation of other programs would remain available to FSM and RMI after FY 2023. Eligibility for these programs continues either because the amended compacts' implementing legislation does not specify an ending date or because

<sup>7</sup>The countries may continue to receive some grant funding after the provisions of law authorizing the grants expire at the end of FY 2023 for FSM and RMI and at the end of FY 2024 for Palau. Funding may flow to FSM, RMI, and Palau pursuant to the grant for several years after the grant ends. Federal programs and services provided through compact agreements with each country end at various specific dates in 2023 or 2024 for FSM, RMI, and Palau.

**Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024**

other provisions in current U.S. law make FSM and RMI eligible for these programs, according to agency officials.

**Table 24: U.S. Agencies' Assessment of Status under Current Law after Fiscal Year 2023 of Programs and Grants Provided in the U.S.–FSM and U.S.–RMI Amended Compacts' Implementing Legislation, Pub. L. No. 108-188**

Country receiving assistance	Compact grant name and reference	Description	Status under current law after end of FY 2023 or 2024
FSM and RMI	Judicial training grants	\$300,000 annually, partially adjusted for inflation, for each fiscal year from 2004 through 2023 for the training of judges and officials of the judiciary.	Grants will end.
RMI	Radiological Health Care Program	Medical care and logistical support thereto for the remaining members of the population exposed to radiation by U.S. nuclear testing.	Program will continue.
RMI	Runit Island Environment Monitoring	Monitoring at least every 4 years of the containment structure and groundwater of Runit island in the nuclear-affected Enewetak atoll.	Program will continue.
RMI <sup>a</sup>	Environmental Monitoring Program	Periodic monitoring of the four nuclear-affected atolls—Bikini, Enewetak, Rongelap and Utrik.	Program will continue.
RMI	Four Atoll Health Care	Health care for nuclear-affected areas.	Program will continue.
RMI	Planting and Agricultural Maintenance Program on Enewetak	\$1.3 million, partially adjusted for inflation, for each fiscal year from 2004 through 2023 to restore vegetation on Enewetak, a nuclear-affected atoll.	Program will end.
FSM, RMI, and Palau <sup>b</sup>	Rural Utilities Service grants and loans	The U.S. Department of Agriculture Rural Utilities Service provides financing and grants to support infrastructure development such as electricity, telecommunications, and water and wastewater systems.	Eligibility will continue.

Legend: FSM = Federated States of Micronesia, FY = fiscal year, RMI = Republic of the Marshall Islands.

Sources: U.S. agency officials and GAO review of the compacts legislation. | GAO-22-104436

<sup>a</sup>This program was authorized by the original RMI compact implementing legislation. See Pub. L. No. 99-239, § 177(b).

<sup>b</sup>The grant for Palau is provided pursuant to the authorization for the Rural Electrification Administration codified at 7 U.S.C. §§ 901 et seq.

## List and Description of U.S. Grants and Programs That Have Been Made Available to, and Used by, FSM, RMI, and Palau

In addition to being eligible for the programs provided through the compacts, associated agreements, and their implementing legislation, FSM and RMI are also eligible for a number of programs, according to U.S. agency officials. Table 25 provides information about grants, loans, and other programs that FSM, RMI, and Palau are eligible to receive and their status under current law as of the end of fiscal year 2023 or 2024, according to agency officials.

**Table 25: U.S. Agencies’ Assessment of FSM, RMI, and Palau Eligibility under Current Law after Fiscal Year 2023 or 2024 for Other U.S. Grants and Programs That Have Been Made Available**

Country receiving assistance	U.S. agency	Type of grant or program	Description	Status of eligibility under current law after end of fiscal year 2023 for FSM and RMI and 2024 for Palau
FSM, RMI, and Palau	Department of Agriculture	Cooperative Forest Health Protection	To protect and improve the health of Pacific Island forests by preventing, eradicating, suppressing or controlling insects, diseases, and invasive plants.	Eligible
FSM, RMI, and Palau	Department of Agriculture	Urban and Community Forestry Program	To plan for, establish, manage, and protect trees, forests, green spaces, and related natural resources in and adjacent to cities and town.	Eligible
FSM, RMI, and Palau	Department of Agriculture	Forest Stewardship Program	To promote and enable the long-term active management of nonindustrial private and other nonfederal forest land to sustain the multiple values and uses that depend on such lands.	Eligible
FSM, RMI, and Palau	Department of Agriculture	Landscape Scale Restoration	Competitive funding program. Successful proposals integrate programs to address watershed-scale or community-scale projects, especially multi-island collaborations.	Eligible
FSM and Palau	Department of Agriculture	National Fire Capacity	In cooperation with state/island foresters and public safety agencies, develop systems and methods for fire prevention, control, suppression, and fire risk reduction activities; includes financial, technical, and related assistance.	Eligible
Palau	Department of Agriculture	Community Facilities loans and grants	To construct, enlarge, extend, or otherwise improve community facilities providing essential services to rural residents.	Eligible



**Appendix IV: Status of U.S. Grants and  
Programs in FSM and RMI after 2023 and in  
Palau after 2024**

<b>Country receiving assistance</b>	<b>U.S. agency</b>	<b>Type of grant or program</b>	<b>Description</b>	<b>Status of eligibility under current law after end of fiscal year 2023 for FSM and RMI and 2024 for Palau</b>
FSM and RMI	Department of Agriculture	Mutual Self-Help Technical Assistance Grant	To assist lower-income families in rural areas in building their own homes. Funding is provided to an entity that must give technical assistance.	Eligible
FSM and RMI	Department of Agriculture	Section 502 Single Family Housing Loan and Guaranteed Loan Programs	To assist low-income applicants in obtaining decent, safe, and sanitary housing in eligible rural areas.	Eligible
FSM and RMI	Department of Agriculture	Section 504 Housing Repair and Rehabilitation Loans and Grants	To assist very low-income applicants 62 years or older in removing health and safety hazards or repair their homes in rural areas with populations of 20,000 or fewer.	Eligible
FSM, RMI, and Palau	Department of Commerce National Weather Service	Special Oceanic and Atmospheric Projects	To strengthen the communication and improve the impact of hurricane, flood, and wildfire forecast modeling through the use of state-of-the-art and emerging research and technologies within the National Environmental Satellite, Data and Information Service National Weather Service, Oceanic and Atmospheric Research, and National Ocean Service, including unmanned ocean observing platforms and data assimilation.	Eligible
FSM,RMI, and Palau	Department of Education	TRIO Talent Search and TRIO Upward Bound	Outreach and student services programs designed to identify and provide services for individuals from disadvantaged backgrounds, such as low-income individuals, first-generation college students, and individuals with disabilities.	Eligible
FSM, RMI, and Palau	Department of Health and Human Services	Multiple programs authorized by the Public Health Services Act	Public health, medical, and disease control and prevention grants.	Eligible
FSM, RMI, and Palau	Department of Health and Human Services	Consolidated Health Centers	To improve the health of the nation's underserved communities and vulnerable populations by assuring continued access to comprehensive, culturally competent, quality primary health care services to communities and populations served by the Health Center Program. Individual health center grant mechanisms: (1) Community Health Centers; (2) Migrant Health Centers; (3) Health Care for the Homeless; and (4) Public Housing Primary Care Program.	Eligible

**Appendix IV: Status of U.S. Grants and  
Programs in FSM and RMI after 2023 and in  
Palau after 2024**

<b>Country receiving assistance</b>	<b>U.S. agency</b>	<b>Type of grant or program</b>	<b>Description</b>	<b>Status of eligibility under current law after end of fiscal year 2023 for FSM and RMI and 2024 for Palau</b>
FSM, RMI, and Palau	Department of Health and Human Services	Block Grant for Community Mental Health Services	To provide financial assistance to states and territories to enable them to carry out the state's plan for providing comprehensive community mental health services to adults with a serious mental illness and to children with a serious emotional disturbance; monitor the progress in implementing a comprehensive community based mental health system, among other things.	Eligible
FSM, RMI, and Palau	Department of Health and Human Services	Maternal and Child Health Services Block Grant to the States	To enable states to improve the health and well- being of the Nation's mothers, children, and families by supporting and promoting the development and coordination of systems of care for the maternal and child health population, particularly vulnerable populations who do not have access to adequate health care.	Eligible
FSM	Institute of Museum and Library Services	Grants to States	The Grants to States Program provides funds to State Library Administrative Agencies (SLAAs) using a population-based formula. SLAAs may use federal funds to support statewide initiatives and services; they also may distribute the funds through subgrant competitions or cooperative agreements to public, academic, research, school, and special libraries in their state.	Eligible
Palau	Department of the Interior	Economic, Social, and Political Development of the Territories	The Office of Insular Affairs will pursue the department's mission of fulfilling trust and insular responsibilities by executing activities that bolster health care capacity, strengthen island economies, and fulfill U.S. compact obligations.	Grant will end.
FSM and RMI	Department of the Interior	Historic Preservation Fund Grants-In-Aid	To provide formula grants to states, tribes, territories, the Freely Associated States, the District of Columbia, certified local governments, and other applicants as defined by Congress, to assist in the identification, evaluation, and protection of historic properties by such means as education, survey, planning, technical assistance, preservation, documentation, and financial incentives such as grants and tax credits available for historic properties. To provide PROJECT grants to eligible grantees for the identification, evaluation, and protection of historic properties as defined by Congress.	Eligibility will continue.

**Appendix IV: Status of U.S. Grants and  
Programs in FSM and RMI after 2023 and in  
Palau after 2024**

<b>Country receiving assistance</b>	<b>U.S. agency</b>	<b>Type of grant or program</b>	<b>Description</b>	<b>Status of eligibility under current law after end of fiscal year 2023 for FSM and RMI and 2024 for Palau</b>
FSM and RMI	National Science Foundation	Grants to improve science, technology, inventory, and math education	Advancing Informal Science Learning/Geo-literacy Education in Micronesia and Advanced Technological Education/Partnership for Advanced Marine and Environmental Science Training for Pacific Islanders.	Eligibility will continue.
RMI	National Science Foundation	Grant to conduct research and train students and faculty	The project investigates the condition of reefs around the Republic of the Marshall Islands. Scientists from the University of Hawaii at Hilo and the College of the Marshall Islands will perform the research.	Eligibility will continue.
RMI and Palau	Department of State	Humanitarian demining	The program increases civilian security by protecting lives and property through the survey and clearance of U.S.-origin explosive remnants from World War II and returns land to productive use.	Eligibility will continue.
FSM, RMI, and Palau	Department of State	U.S.-Forum Fisheries Agency Economic Assistance Agreement	The U.S. provides \$21 million in Economic Support Funds annually to the Pacific Island region under an Economic Assistance Agreement associated with the 1987 Treaty on Fisheries between the Governments of Certain Pacific Island States and the Government of the United States. The funds provided to the Pacific Islands Forum Fisheries Agency support economic development as well as administration of the treaty and related objectives under the agreement.	The current agreement expires in 2023.
FSM, RMI, and Palau	Department of Transportation/Federal Aviation Administration (FAA)	Airport Improvement Program	To assist sponsors, owners, or operators of public-use airports in the development of a nationwide system of airports adequate to meet the needs of civil aeronautics. The purpose of the law includes the investment in transportation, environmental protection, and airport infrastructure that will support long-term economic benefits.	Eligibility will continue.
FSM, RMI, and Palau	U.S. Agency for International Development (USAID)	Pacific American Fund (replaced the Pacific-American Climate Fund)	This activity will strengthen the capacity of locally established civil society organizations to address second-order impacts of COVID-19. Subgrants will be multisectoral and offer communities increased resilience to disasters and climate risks, enhanced livelihoods, increased food security, access to water, improved health and education, better governance, and more sustainable natural resources management and biodiversity conservation.	Ends August 2025.

Appendix IV: Status of U.S. Grants and Programs in FSM and RMI after 2023 and in Palau after 2024

Country receiving assistance	U.S. agency	Type of grant or program	Description	Status of eligibility under current law after end of fiscal year 2023 for FSM and RMI and 2024 for Palau
Palau	USAID	Palau Submarine Cable	The Palau Submarine Cable project will support the development of a submarine cable branch system connecting Palau to a proposed new submarine information and communication technology cable between southeast Asia and the U.S.—the Echo Cable—to increase redundancy of internet access. USAID’s \$3 million contribution is a component of a larger, \$30 million multidonor effort.	USAID’s contribution was obligated in September 2020, and the development of the submarine cable branch system may take up to 5 years.

Legend: FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands.

Source: U.S. agency officials. | GAO-22-104436

Note: The grants, loans, and programs shown do not represent an exhaustive list of grants, loans, and programs available to FSM, RMI, and Palau. Agency officials determined eligibility and provided the grant and program descriptions.

## Appendix V: Additional Details of Compact Trust Fund Projections

This appendix explains our selection decision for the annual net-of-fees rate of return used in our projections of disbursement outcomes and balances for the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI), and Republic of Palau compact trust funds. For each country, we include additional information related to our projection outcomes: (1) results for the compact trust funds' disbursement outcomes and balances, calculated with varying return assumptions; (2) detailed projection results for the compact trust fund balance; and (3) the distribution of the zero disbursement likelihood across years. For FSM and RMI, we also provide examples of how the compact trust funds' buffer (C) accounts could be exhausted.

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### Selection of Rates of Return Used in Projections of Compact Trust Funds

To test the sensitivity of our compact trust fund projections to assumptions about future rates of return, we performed a Monte Carlo analysis using alternate rates of return.<sup>1</sup> We projected the compact trust fund disbursements and balance under current compact trust fund rules on the basis of a 6.5 percent annual net return, which we present in the body of this report. This rate of return is nominal and does not account for inflation. We also estimated outcomes for the trust funds on the basis of 5, 6, 7, and 8 percent annual net returns. To help determine the range of net rates of return for our simulations, we reviewed the FSM, RMI, and Palau compact trust funds' Investment Policy Statements and historical

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<sup>1</sup>A Monte Carlo analysis is a problem-solving technique that approximates the probability of certain outcomes by performing multiple trial runs, or simulations, using random variables. The simulations capture the volatility of market returns and reflect that volatility in the projection of future earnings.

investment returns and also reviewed returns that other institutions used in their simulations.<sup>2</sup>

Table 26 presents annual investment return information for the FSM, RMI, and Palau compact trust funds for fiscal years (FY) 2006 through 2020.<sup>3</sup> For FSM and RMI, the annual investment returns correspond to the annual weighted investment return after discounting for contributions, fees, and expenses. For Palau, the annual investment return corresponds to the rate of return net of fees. In FYs 2006 through 2020, the FSM compact trust fund's average yearly investment return was 6.5 percent, with a high return of 18 percent and a low return of -17.2 percent. The RMI compact trust fund's average yearly investment return was 6.5 percent, with a high return of 18.5 percent and a low return of -19.2 percent. The Palau compact trust fund's average yearly investment return was 6.1 percent, with a high return of 19.4 percent and a low return of -13.7 percent.<sup>4</sup>

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<sup>2</sup>The simulations for the FSM and RMI compact trust funds included in the International Monetary Fund's Article IV staff report for each country used a nominal rate of return of 5 percent. A report that Graduate School USA produced on the compact trust fund projections stated that the long-term projected nominal rate of return of the FSM and RMI compact trust funds is 7 percent. See International Monetary Fund, *Federated States of Micronesia: Staff Report for the 2019 Article IV Consultation* (Washington, D.C.: July 30, 2019); International Monetary Fund, *Republic of the Marshall Islands: Staff Report for the 2021 Article IV Consultation* (Washington, D.C.: May 6, 2021); Graduate School USA, *Compact Trust Funds in the Freely Associated States: Mechanics and Stochastic Projections* (April 2018).

<sup>3</sup>In October 2004, FSM and the U.S. made initial contributions to FSM's compact trust fund that were deposited in money market accounts. Contributions to RMI's compact trust fund were initially deposited in money market accounts for FY 2004 and FY 2005.

<sup>4</sup>In FYs 1995 through 2020, the Palau compact trust fund's average yearly investment return was 7.5 percent; the highest return was 24.0 percent and the low was -16.6 percent.

**Table 26: Annual and Average Investment Returns for FSM, RMI, and Palau Compact Trust Funds, Fiscal Years (FY) 2006–2020**

Percentages

Annual investment return <sup>a</sup>	FSM	RMI	Palau
FY 2020	8.4	11.6	3.2
FY 2019	3.2	2.8	1.4
FY 2018	6.8	7.0	6.4
FY 2017	13.8	14.1	14.5
FY 2016	9.7	10.4	9.9
FY 2015	-2.6	-4.1	-5.3
FY 2014	9.1	8.0	7.7
FY 2013	14.4	13.9	14.5
FY 2012	16.0	18.5	19.4
FY 2011	-0.6	-1.6	0.7
FY 2010	11.0	8.6	8.6
FY 2009	-0.3	1.1	1.8
FY 2008	-17.2	-19.2	-13.7
FY 2007	18.0	15.3	15.6
FY 2006	7.2	11.6	6.2
<b>Average investment return</b>	<b>6.5</b>	<b>6.5</b>	<b>6.1</b>

Source: GAO analysis of compact trust fund documents. | GAO-22-104436

<sup>a</sup>For the Federated States of Micronesia (FSM) and Republic of the Marshall Islands (RMI), the annual investment return corresponds to the annual weighted investment return after discounting for contributions, fees, and expenses, which is included in the compact trust funds' FY 2020 annual reports. For the Republic of Palau, the annual investment return corresponds to the rate of return, net of fees, from Raymond James's comparative performance analysis.

## Additional Projection Results for FSM Compact Trust Fund and Example of Exhaustion of Buffer (C) Account

### Projection Results for FSM Compact Trust Fund under Additional Return Assumptions

Table 27 contains the results of our Monte Carlo analysis for the FSM compact trust fund using additional annual rates of return, where higher rates of return would improve the fund's outlook. Because of structural

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rules for the compact trust fund, our projections indicate, even with higher rates of return, a growing risk during the period from FY 2024 through FY 2063 that the fund will not generate enough returns to provide the FSM government its maximum allowable disbursement during some years. This outcome corresponds to a likely increase in the average shortfall between the maximum allowable disbursement and potential disbursement over time. We also find a likely increasing risk of zero disbursement in some years. Our findings related to the projected compact trust fund balance vary depending on the annual net returns we considered. With an annual net return of 5 percent, 6 percent, or 6.5 percent, we project that the yearly balance will likely decrease on average over time. With an annual net return of 7 percent, we project that the yearly balance will likely decrease on average during the period from FY 2024 through FY 2053 but may increase during the period from FY 2053 through FY 2063. With an annual net return of 8 percent, we project that the yearly balance will likely increase on average over time.

**Table 27: FSM Compact Trust Fund Outcomes Calculated with Varying Return Assumptions, Fiscal Years 2024–2063**

Mean net rate of return	Projected average compact trust fund disbursement as a percentage of maximum disbursement				Projected average shortfall between maximum allowable disbursement and projected disbursement (dollars in millions)				Likelihood of 1 or more years with zero disbursement in the given 10-fiscal-year period (percentage)				Projected compact trust fund balance (dollars in millions)			
	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063
5 percent	79	43	25	15	20	65	104	145	51	87	95	97	802	590	452	352
6 percent	83	50	32	21	16	56	94	134	41	79	90	94	868	706	607	562
6.5 percent	85	55	37	25	14	51	88	128	36	73	87	92	905	772	687	668
7 percent	87	59	41	29	12	46	82	121	32	68	82	88	944	860	842	942
8 percent	90	68	52	40	9	36	67	103	24	56	71	78	1,036	1,088	1,275	1,755

Source: GAO analysis of Federated States of Micronesia (FSM) compact trust fund documents. | GAO-22-104436

Notes: The projections shown are based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available. The averages we present are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum



disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

## Detailed Projection Results for FSM Compact Trust Fund Balance

In this report, we present averages of the FSM compact trust fund balance across 10-year intervals for all 10,000 simulated cases, including those cases whose outcomes are relatively low and relatively high. Table 28 presents additional simulation details—that is, the distribution of simulated cases over time for the balance. Specifically, table 28 includes the following percentiles from across the 10,000 simulations: 5th, 25th, 50th (median), 75th, and 95th. For example, for FY 2024, our projection results for the compact trust fund balance found that the 5th percentile across the 10,000 simulations corresponded to a balance of \$651 million, suggesting that the lowest 5 percent of the 10,000 simulation cases had balances of \$651 million or less. The 50th percentile (median) was \$976 million, suggesting that the lowest 50 percent of the 10,000 simulation cases had balances of \$976 million or less. The 95th percentile was about \$1.4 billion, suggesting that the lowest 95 percent of the 10,000 simulation cases had balances of about \$1.4 billion or less. Over time, the standard deviation of the projections increases because of increased uncertainty.

Table 28: Detailed Projection Results for FSM Compact Trust Fund Balance, Fiscal Years 2022–2063

Dollars in millions

Fiscal year	5th percentile	25th percentile	50th percentile	75th percentile	95th percentile
2022	698	803	874	943	1,048
2023	709	856	965	1,075	1,249
2024	651	835	976	1,130	1,375
2025	576	779	947	1,131	1,441
2026	509	723	914	1,134	1,516
2027	471	674	881	1,130	1,571
2028	439	627	838	1,114	1,622
2029	413	596	805	1,102	1,669
2030	393	571	767	1,086	1,714

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<b>Fiscal year</b>	<b>5th percentile</b>	<b>25th percentile</b>	<b>50th percentile</b>	<b>75th percentile</b>	<b>95th percentile</b>
2031	377	543	732	1,061	1,761
2032	363	524	698	1,036	1,804
2033	348	503	672	1,004	1,853
2034	333	486	647	976	1,899
2035	323	470	624	946	1,925
2036	311	454	605	925	1,972
2037	300	439	583	892	1,985
2038	286	425	564	866	2,027
2039	276	412	547	835	2,049
2040	264	399	531	806	2,068
2041	256	386	516	779	2,074
2042	246	376	500	752	2,087
2043	238	364	488	726	2,106
2044	230	353	476	701	2,156
2045	223	342	462	681	2,133
2046	216	332	449	656	2,160
2047	208	323	436	641	2,123
2048	201	312	424	622	2,154
2049	195	303	412	610	2,141
2050	189	294	403	592	2,147
2051	182	286	392	578	2,134
2052	177	277	382	562	2,191
2053	171	268	373	548	2,182
2054	164	259	363	537	2,179
2055	158	252	354	522	2,164
2056	153	244	344	510	2,185
2057	147	236	334	501	2,138
2058	142	231	325	488	2,115
2059	138	222	317	478	2,096
2060	134	216	309	467	2,004
2061	129	210	301	455	2,035
2062	125	203	293	444	1,981
2063	120	198	285	434	1,890

Source: GAO analysis of Federated States of Micronesia (FSM) compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available.

## Likelihood of Zero Disbursement from FSM Compact Trust Fund across Years

Table 29 provides additional details related to the likelihood of zero disbursement. Specifically, the table shows the proportion of simulation cases with a zero disbursement across the various numbers of years and across the 10,000 simulations. For example, during the first decade of disbursements, for FY 2024 through FY 2033, we project

- a 64 percent likelihood that the FSM compact trust fund will be able to disburse funds in every year,
- a 19 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 1 year,
- an 11 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 2 years,
- a 4 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 3 years,
- a 1 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 4 years, and
- a 0 percent likelihood that the FSM compact trust fund will be unable to disburse any funds in 5 or 6 years.

**Table 29: Proportion of FSM Compact Trust Fund Simulation Cases with a Zero Disbursement across Years during 10-Year Periods, Fiscal Years 2024–2063**

Percentages

Number of years	Fiscal years			
	2024–2033	2034–2043	2044–2053	2054–2063
0	64	27	13	8
1	19	19	15	13
2	11	19	21	22
3	4	17	22	24
4	1	10	16	18
5	0	5	8	10
6	0	2	3	4
7	–	0	1	1
8	–	0	0	0
9	–	0	–	0

Appendix V: Additional Details of Compact Trust Fund Projections

Total <sup>a</sup>	100	100	100	100
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Legend: – = None of the simulations had the given number of years in the period with a zero disbursement.

Source: GAO analysis of Federated States of Micronesia (FSM) compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund’s audited balance at the end of fiscal year 2020. We assumed that the trust fund’s annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available. We calculated the likelihood of zero disbursement by counting the number of cases with zero disbursement across the number of years shown for each of the given periods over 10,000 simulated cases.

<sup>a</sup>The percentages in each column may not sum to 100 because of rounding.

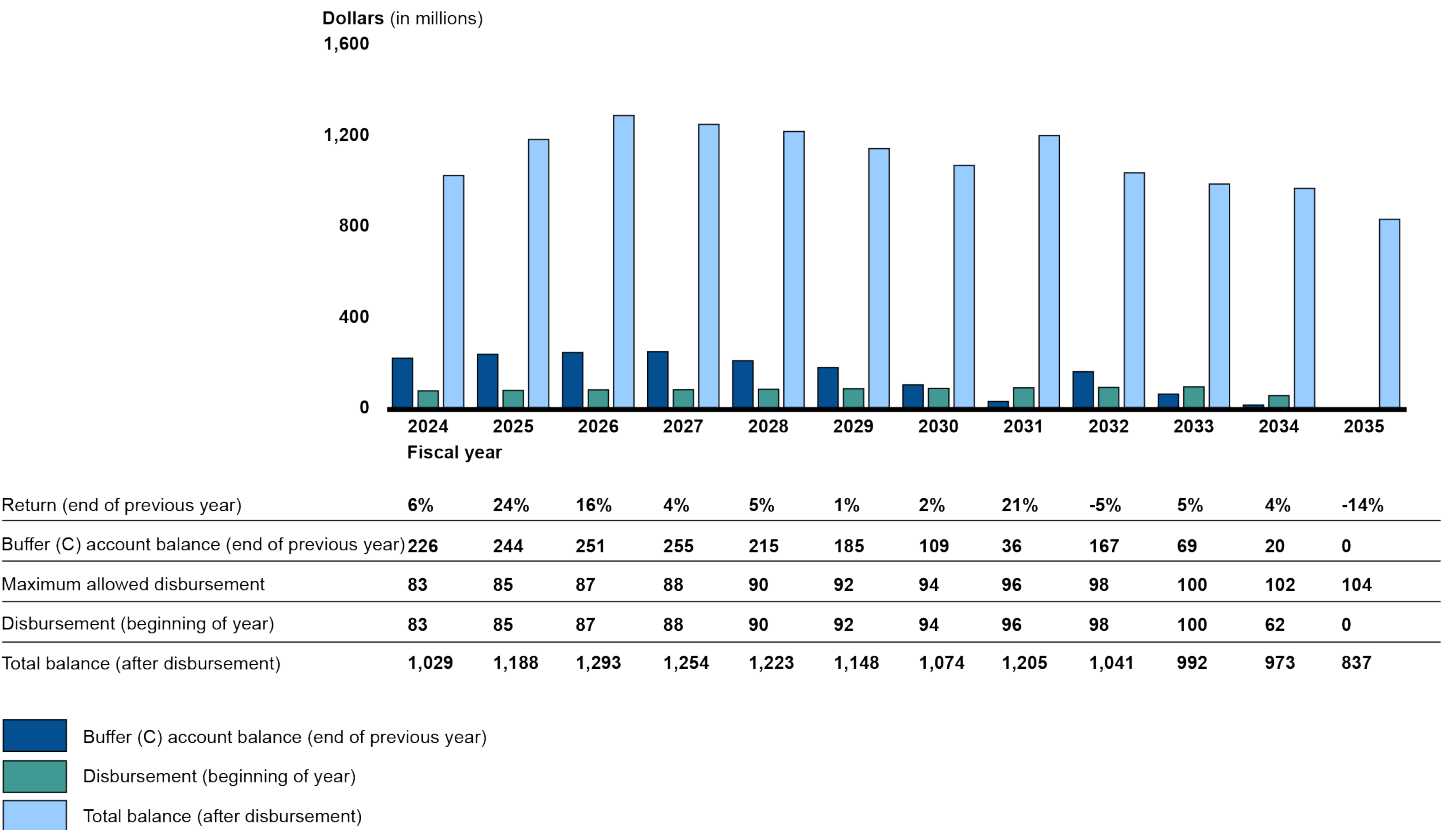
Example Showing Exhaustion of FSM Compact Trust Fund’s Buffer (C) Account

Figure 15 provides an example of how the FSM compact trust fund’s buffer (C) account could be exhausted, leading to a year with zero disbursement.<sup>5</sup> The example represents one of the 10,000 simulation cases we analyzed as part of our projections for the compact trust fund. This example illustrates how a series of years with low or negative returns could exhaust the compact trust fund’s buffer (C) account. During the 12 years shown in this example, the FSM compact trust fund has negative annual net returns in 2 years and has positive returns equal to 5 percent or less in 6 years. In this example, the buffer (C) account is exhausted at the end of FY 2034, and FSM receives less than the maximum allowed disbursement that year. The exhaustion of the buffer (C) account, combined with the negative return in FY 2035, results in no disbursement for FSM that year despite a projected balance of \$837 million in the compact trust fund.

<sup>5</sup>According to the FY 2020 compact trust fund annual report, FSM’s buffer (C) account was not yet at its full value.

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Figure 15: Example of How FSM Compact Trust Fund’s Buffer (C) Account Could Be Exhausted



Source: GAO analysis of Federated States of Micronesia (FSM) compact trust fund documents. | GAO-22-104436

**Accessible Data Table for Figure 15**

Year	Return (end of previous year)	C account balance (end of previous year)	Maximum allowed disbursement	Distribution (beginning of year)	Total balance (after distribution)
2024	6%	226	83	83	1,029
2025	24%	244	85	85	1,188
2026	16%	251	87	87	1,293
2027	4%	255	88	88	1,254
2028	5%	215	90	90	1,223
2029	1%	185	92	92	1,148
2030	2%	109	94	94	1,074
2031	21%	36	96	96	1,205
2032	-5%	167	98	98	1,041
2033	5%	69	100	100	992
2034	4%	20	102	62	973
2035	-14%	0	104	0	837

Note: This example represents one of the 10,000 simulation cases we analyzed as part of our projections for the FSM compact trust fund. The projection example shown is based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available.

## Additional Projection Results for RMI Compact Trust Fund and Example of Exhaustion of Buffer (C) Account

### Projection Results for RMI Compact Trust Fund under Additional Return Assumptions

Table 30 contains the results of our Monte Carlo analysis for the RMI compact trust fund using additional annual rates of return, where higher rates of return would improve the fund's outlook. Because of structural rules for the compact trust fund, our projections indicate, even with higher rates of return, a growing risk during the period from FY 2024 through FY 2063 that the fund will not generate enough returns to provide the RMI government its maximum allowable disbursement during some years. This outcome corresponds to a likely increase in the average shortfall between the maximum allowable disbursement and potential disbursement over time. We also find a likely increasing risk of zero

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disbursement in some years. For all of the annual net returns we considered, we project that the yearly balance of the compact trust fund will likely increase on average over time.

**Table 30: RMI Compact Trust Fund Outcomes Calculated with Varying Return Assumptions, Fiscal Years 2024–2063**

	Projected average compact trust fund disbursement as a percentage of maximum disbursement				Projected average shortfall between maximum allowable disbursement and projected disbursement (dollars in millions)				Likelihood of 1 or more years with zero disbursement in the given 10-fiscal-year period (percentage)				Projected compact trust fund balance (dollars in millions)			
Mean net rate of return	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063
5 percent	94	82	68	53	2	7	15	26	19	42	58	70	673	727	796	910
6 percent	96	87	78	67	1	5	10	19	14	30	43	54	730	910	1,176	1,609
6.5 percent	96	90	81	72	1	4	9	16	12	26	36	46	758	997	1,403	2,110
7 percent	97	92	86	79	1	3	6	12	10	20	29	37	794	1,134	1,720	2,798
8 percent	98	95	92	87	1	2	4	7	6	14	18	23	858	1,373	2,404	4,528

Source: GAO analysis of Republic of the Marshall Islands (RMI) compact trust fund documents. | GAO-22-104436

Notes: The projections shown are based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available. The averages we present are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

## Detailed Projection Results for RMI Compact Trust Fund Balance

In this report, we present averages of the RMI compact trust fund balance across 10-year intervals for all 10,000 simulated cases, including those cases whose outcomes are relatively low and relatively high. Table 31

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presents additional simulation details, the distribution of simulated cases over time for the balance. Specifically, table 31 includes the following percentiles from across the 10,000 simulations: 5th, 25th, 50th (median), 75th, and 95th. For example, for FY 2024, our projection results for the compact trust fund balance found that the 5th percentile across the 10,000 simulations corresponded to a balance of \$459 million, suggesting that the lowest 5 percent of the 10,000 simulation cases had balances of \$459 million or less. The 50th percentile (median) was \$669 million, suggesting that the lowest 50 percent of the 10,000 simulation cases had balances of \$669 million or less. The 95th percentile was \$924 million, suggesting that the lowest 95 percent of the 10,000 simulation cases had balances of \$924 million or less. Over time, the standard deviation of the projections increases because of increased uncertainty.

**Table 31: Detailed Projection Results for RMI Compact Trust Fund Balance, Fiscal Years 2022–2063**

Dollars in millions

Fiscal year	5th percentile	25th percentile	50th percentile	75th percentile	95th percentile
2022	460	529	576	624	693
2023	468	564	635	709	823
2024	459	578	669	771	924
2025	428	568	677	807	1,006
2026	403	556	688	834	1,093
2027	384	549	699	866	1,164
2028	364	541	709	903	1,268
2029	350	536	717	933	1,341
2030	337	529	727	969	1,446
2031	324	526	731	1,009	1,528
2032	311	519	744	1,045	1,635
2033	298	512	747	1,080	1,751
2034	288	503	759	1,115	1,852
2035	277	493	766	1,148	1,961
2036	262	486	776	1,193	2,068
2037	250	480	782	1,224	2,211
2038	241	470	790	1,269	2,369
2039	231	458	802	1,315	2,520
2040	223	447	807	1,369	2,668
2041	215	436	814	1,419	2,817
2042	205	423	826	1,455	2,997
2043	198	416	828	1,504	3,161



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<b>Fiscal year</b>	<b>5th percentile</b>	<b>25th percentile</b>	<b>50th percentile</b>	<b>75th percentile</b>	<b>95th percentile</b>
2044	191	406	828	1,570	3,365
2045	187	390	838	1,636	3,606
2046	178	380	844	1,691	3,815
2047	173	367	851	1,758	4,014
2048	168	355	859	1,819	4,306
2049	162	341	861	1,893	4,557
2050	157	331	862	1,963	4,853
2051	151	322	872	2,018	5,101
2052	146	309	876	2,095	5,435
2053	142	298	870	2,175	5,760
2054	137	290	866	2,261	6,074
2055	132	280	864	2,330	6,464
2056	129	269	875	2,429	6,979
2057	124	262	873	2,503	7,387
2058	120	254	871	2,575	7,815
2059	117	246	863	2,698	8,184
2060	113	239	857	2,760	8,719
2061	109	233	860	2,887	9,264
2062	106	227	850	2,987	9,818
2063	103	220	834	3,123	10,484

Source: GAO analysis of Republic of the Marshall Islands (RMI) compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available.

## Likelihood of Zero Disbursement from RMI Compact Trust Fund across Years

Table 32 provides additional details related to the likelihood of zero disbursement. Specifically, the table shows the proportion of simulation cases with a zero disbursement across the various numbers of years and across the 10,000 simulations. For example, during the first decade of disbursements, for FY 2024 through FY 2033, we project

- an 88 percent likelihood that the RMI compact trust fund will be able to disburse funds in every year,
- an 8 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 1 year,

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- a 3 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 2 years,
- a 1 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 3 years, and
- a 0 percent likelihood that the RMI compact trust fund will be unable to disburse any funds in 4, 5, or 6 years.

**Table 32: Proportion of RMI Compact Trust Fund Simulation Cases with a Zero Disbursement across Years during 10-Year Periods, Fiscal Years 2024–2063**

Percentages

Number of years	Fiscal years			
	2024–2033	2034–2043	2044–2053	2054–2063
0	88	74	64	54
1	8	13	14	14
2	3	6	10	11
3	1	4	6	10
4	0	2	4	7
5	0	1	2	3
6	0	0	1	1
7	None of the simulations had the given number of years in the period with a zero disbursement		0	0
8	None of the simulations had the given number of years in the period with a zero disbursement		0	0
9	None of the simulations had the given number of years in the period with a zero disbursement		None of the simulations had the given number of years in the period with a zero disbursement	
Total <sup>a</sup>		100	100	100

Source: GAO analysis of Republic of the Marshall Islands (RMI) compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund’s audited balance at the end of fiscal year 2020. We assumed that the trust fund’s annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available. We calculated the likelihood of zero disbursement by counting the number of cases with zero disbursement across the number of years shown for each of the given periods over 10,000 simulated cases.

<sup>a</sup>The percentages in each column may not sum to 100 because of rounding.

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## Example Showing Exhaustion of RMI Compact Trust Fund's Buffer (C) Account

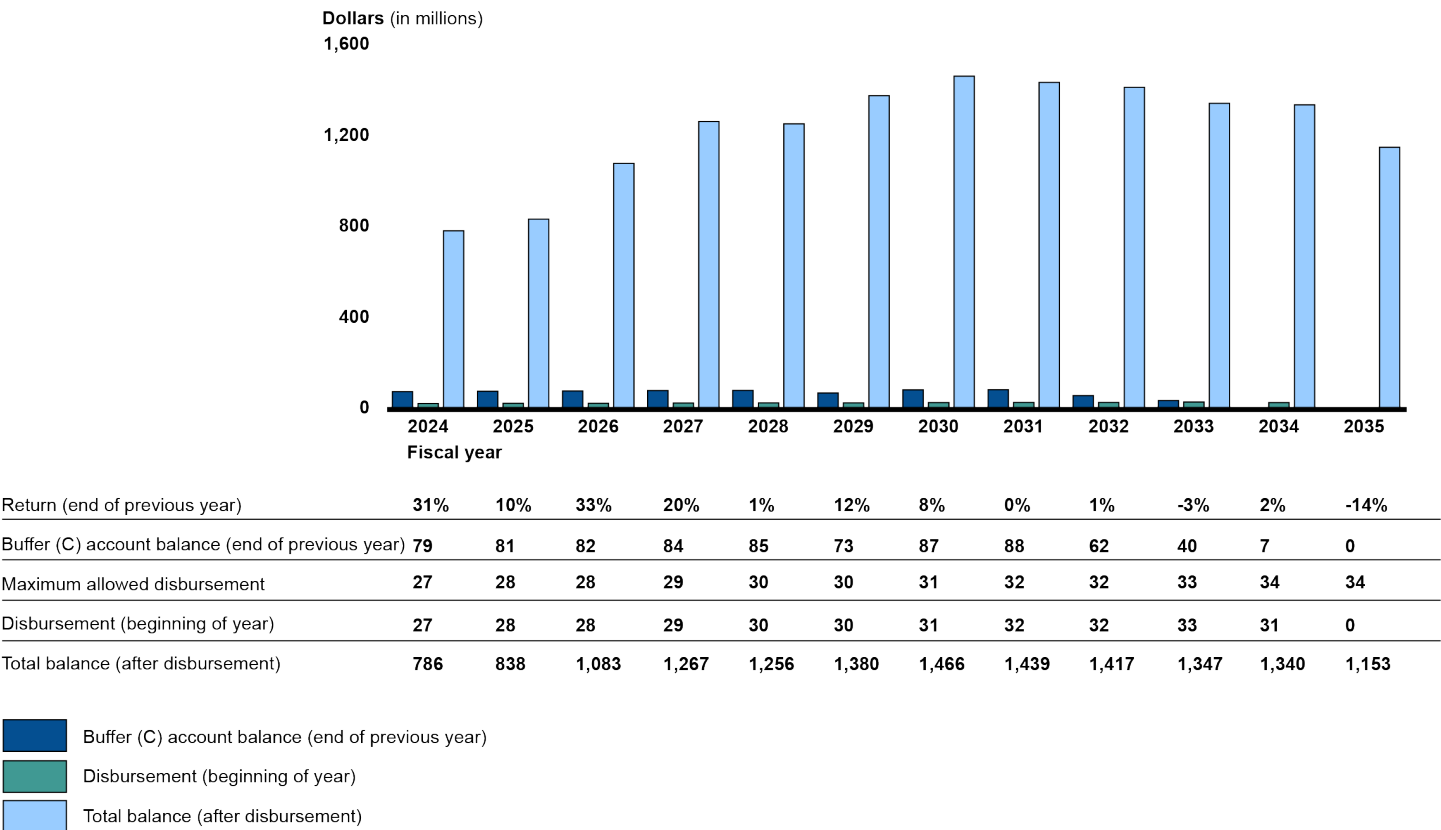
Figure 16 provides an example of how the RMI compact trust fund's buffer (C) account could be exhausted, leading to a year with zero disbursement.<sup>6</sup> The example represents one of the 10,000 simulation cases we analyzed as part of our projections for the compact trust fund. This example illustrates how a series of years with low or negative returns could exhaust the compact trust fund's buffer (C) account. During the 12 years shown in this example, the RMI compact trust fund has negative annual net returns in 2 years and has positive returns equal to 5 percent or less in 4 years. In this example, the buffer (C) account is exhausted at the end of FY 2034, and RMI receives less than the maximum allowed disbursement that year. The exhaustion of the buffer (C) account, combined with the negative return in FY 2035, results in no disbursement for RMI that year despite a projected balance of \$1.2 billion in the compact trust fund.

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<sup>6</sup>As of the FY 2020 compact trust fund annual report, RMI's buffer (C) account was at its full allowable value.

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Figure 16: Example of How RMI Compact Trust Fund’s Buffer (C) Account Could Be Exhausted



Source: GAO analysis of Republic of Marshall Islands (RMI) compact trust fund documents. | GAO-22-104436

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Accessible Data Table for Figure 16

FY	Return (end of previous year)	C account balance (end of previous year)	Maximum allowed disbursement	Distribution (beginning of year)	Total balance (after distribution)
2024	31%	79	27	27	786
2025	10%	81	28	28	838
2026	33%	82	28	28	1,083
2027	20%	84	29	29	1,267
2028	1%	85	30	30	1,256
2029	12%	73	30	30	1,380
2030	8%	87	31	31	1,466
2031	0%	88	32	32	1,439
2032	1%	62	32	32	1,417
2033	-3%	40	33	33	1,347
2034	2%	7	34	31	1,340
2035	-14%	0	34	0	1,153

Note: This example represents one of the 10,000 simulation cases we analyzed as part of our projections for the RMI compact trust fund. The projection example shown is based on the current rules for the compact trust fund and on the fund's audited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the trust fund committee would choose to disburse the maximum allowable amount each year if funds were available.

## Additional Projection Results for Palau Compact Trust Fund

### Projection Results for Palau Compact Trust Fund under Additional Return Assumptions

The Palau compact trust fund was designed as a sinking fund to last until FY 2045. However, because of the risk of the fund's depletion, our projections indicate, even with higher rates of return, a growing risk during the period from FY 2024 through FY 2043 that the compact trust fund will not generate enough returns to provide the Palau government its maximum allowable disbursement during some years. This outcome corresponds to a likely increase in the average shortfall between the maximum allowable disbursement and potential disbursement during that period. We also found a likely increasing risk of zero disbursement in some years, and these risks increase further in subsequent decades.

Our findings related to the projected compact trust fund balance vary depending on the annual net returns we considered. With an annual net

return of 6 percent, 6.5 percent, 7 percent, or 8 percent, we project that the yearly balance will likely increase on average over time. With an annual net return of 5 percent, we project that the yearly balance will likely decrease on average during the period from FY 2024 through FY 2043 but may increase during the period from FY 2043 through FY 2063.

Table 33 shows the results of our Monte Carlo analysis for the Palau compact trust fund using additional annual rates of return, where higher rates of return would improve the fund's outlook.

Appendix V: Additional Details of Compact  
Trust Fund Projections

Table 33: Palau Compact Trust Fund Outcomes Calculated with Varying Return Assumptions, Fiscal Years 2024–2063

	Projected average compact trust fund disbursement as a percentage of maximum disbursement				Projected average shortfall between maximum allowable disbursement and projected disbursement (dollars in millions)				Likelihood of 1 or more years with zero disbursement in the given 10-fiscal-year period (percentage)				Projected compact trust fund balance (dollars in millions)			
Mean net rate of return	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063	2024-2033	2034-2043	2044-2053	2054-2063
5 percent	100	90	64	46	0	2	5	8	0	20	45	58	264	250	262	319
6 percent	100	94	76	61	0	1	4	6	0	12	31	43	292	330	427	624
6.5 percent	100	95	81	68	0	1	3	5	0	10	25	35	305	376	530	846
7 percent	100	97	85	74	0	1	2	4	0	7	20	29	319	422	642	1,088
8 percent	100	98	91	84	0	0	1	2	0	4	12	18	349	533	942	1,817

Source: GAO analysis of Republic of Palau compact trust fund documents. | GAO-22-104436

Notes: The projections shown are based on the current rules for the compact trust fund and on the fund's unaudited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution and a standard deviation of 13 percent. We also assumed that the Palau compact trust fund would disburse \$15 million each year if funds were available. The averages we present are affected by extreme values from the simulated cases, and the standard deviation of the projections increases over time because of increased uncertainty.

We calculated the average disbursement as a percentage of the maximum allowable disbursement by averaging, over each 10-year period and over 10,000 simulated cases, the ratio of simulated disbursement to the maximum inflation-adjusted allowable disbursement in the given period.

We calculated the average shortfall (i.e., the maximum disbursement minus the average disbursement) in the given periods by averaging the difference between the estimated maximum disbursement and the simulated disbursement over each 10-year period and over 10,000 simulated cases.

We calculated the likelihood of zero disbursement by counting cases with 1 or more years of zero disbursement in each of the given periods over 10,000 simulated cases.

We calculated the average compact trust balance in the given periods by averaging simulated balances over each 10-year period and over 10,000 simulated cases.

## Detailed Projection Results for Palau Compact Trust Fund Balance

In this report, we present averages of the Palau compact trust fund balance across 10-year intervals for all 10,000 simulated cases, including those cases whose outcomes are relatively low and relatively high. Table 34 presents additional simulation details, the distribution of simulated cases over time for the balance. Specifically, table 34 includes the following percentiles from across the 10,000 simulations: 5th, 25th, 50th (median), 75th, and 95th. For example, for FY 2025, our projection results for the compact trust fund balance found that the 5th percentile across the

**Appendix V: Additional Details of Compact  
Trust Fund Projections**

10,000 simulations corresponded to a balance of \$171 million, suggesting that the lowest 5 percent of the 10,000 simulation cases had balances of \$171 million or less. The 50th percentile (median) was \$282 million, suggesting that the lowest 50 percent of the 10,000 simulation cases had balances of \$282 million or less. The 95th percentile was \$434 million, suggesting that the lowest 95 percent of the 10,000 simulation cases had balances of \$434 million or less. Over time, the standard deviation of the projections increases because of increased uncertainty. The 5th percentile results reflect the risk of depletion of the Palau compact trust fund, because starting in FY 2039, the lowest 5 percent of the 10,000 simulation cases for each year had balances of \$0. This risk exists even while the 50th percentile (median) results generally increase over time.

**Table 34: Detailed Projection Results for Palau Compact Trust Fund Balance, Fiscal Years 2022–2063**

Dollars in millions

<b>Fiscal year</b>	<b>5th percentile</b>	<b>25th percentile</b>	<b>50th percentile</b>	<b>75th percentile</b>	<b>95th percentile</b>
2022	222	255	279	303	338
2023	200	245	280	315	371
2024	184	237	280	326	404
2025	171	232	282	338	434
2026	158	226	283	350	465
2027	145	220	283	360	496
2028	135	214	285	371	527
2029	123	208	285	382	555
2030	111	202	287	393	586
2031	101	196	289	404	627
2032	90	189	289	419	672
2033	78	184	292	432	709
2034	65	179	292	443	756
2035	53	172	292	456	800
2036	40	165	294	474	851
2037	26	158	297	485	911
2038	12	149	298	506	958
2039	0	143	299	521	1,017
2040	0	134	301	537	1,085
2041	0	126	300	549	1,149
2042	0	116	304	571	1,199
2043	0	106	306	595	1,285



**Appendix V: Additional Details of Compact  
Trust Fund Projections**

<b>Fiscal year</b>	<b>5th percentile</b>	<b>25th percentile</b>	<b>50th percentile</b>	<b>75th percentile</b>	<b>95th percentile</b>
2044	0	96	307	617	1,375
2045	0	85	306	637	1,456
2046	0	74	310	661	1,578
2047	0	62	310	688	1,657
2048	0	50	313	721	1,759
2049	0	38	315	747	1,881
2050	0	24	317	778	1,989
2051	0	11	315	802	2,128
2052	0	0	317	834	2,232
2053	0	0	323	870	2,399
2054	0	0	326	904	2,515
2055	0	0	324	940	2,677
2056	0	0	323	983	2,863
2057	0	0	328	1,030	3,027
2058	0	0	329	1,073	3,236
2059	0	0	329	1,120	3,417
2060	0	0	336	1,164	3,649
2061	0	0	335	1,226	3,900
2062	0	0	337	1,287	4,172
2063	0	0	341	1,330	4,478

Source: GAO analysis of Republic of Palau compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund's unaudited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the Palau compact trust fund would disburse \$15 million each year if funds were available.

## Likelihood of Zero Disbursement from Palau Compact Trust Fund across Years

Table 35 provides additional details related to the likelihood of zero disbursement. Specifically, the table shows the proportion of simulation cases with a zero disbursement across the various numbers of years and across the 10,000 simulations. For example, for FYs 2024 through 2033, we project

- a 100 percent likelihood that the Palau compact trust fund will be able to disburse funds in every year and

**Appendix V: Additional Details of Compact  
Trust Fund Projections**

- a 0 percent likelihood that the Palau compact trust fund will be unable to disburse any funds in 1, 2, or 3 years.

**Table 35: Proportion of Palau Compact Trust Fund Simulation Cases with a Zero Disbursement across Years during 10-Year Periods, Fiscal Years 2024–2063**

Percentage

Number of years	Fiscal years			
	2024–2033	2034–2043	2044–2053	2054–2063
0	100	90	75	65
1	0	2	1	1
2	0	2	2	1
3	0	1	2	1
4	None of the simulations had the given number of years in the period with a zero disbursement.	1	1	1
5	None of the simulations had the given number of years in the period with a zero disbursement.	1	2	1
6	None of the simulations had the given number of years in the period with a zero disbursement.	1	2	1
7	None of the simulations had the given number of years in the period with a zero disbursement.	1	2	1
8	None of the simulations had the given number of years in the period with a zero disbursement.	1	2	1
9	None of the simulations had the given number of years in the period with a zero disbursement.	0	2	1
10	None of the simulations had the given number of years in the period with a zero disbursement.	0	12	27
<b>Total<sup>a</sup></b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: GAO analysis of Republic of Palau compact trust fund documents. | GAO-22-104436

Note: The projections shown are based on the current rules for the compact trust fund and on the fund's unaudited balance at the end of fiscal year 2020. We assumed that the trust fund's annual net return would have a normal distribution with a mean of 6.5 percent and a standard deviation of 13 percent. We also assumed that the Palau compact trust fund would disburse \$15 million each year if funds were available. We calculated the likelihood of zero disbursement by counting the number of

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**Appendix V: Additional Details of Compact  
Trust Fund Projections**

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cases with zero disbursement across the number of years shown for each of the given periods over 10,000 simulated cases.

<sup>a</sup>The percentages shown in each column may not sum to 100 because of rounding.

## Appendix VI: Additional Information from the Federated States of Micronesia Single Audits, Fiscal Years 2015–2019

Single audits for the Federated States of Micronesia (FSM) are conducted for the FSM national government and four state governments—Chuuk, Kosrae, Pohnpei, and Yap. We reviewed the single audits for fiscal years (FY) 2015 through 2019 and summarized selected information, including auditor opinions, number of audit findings, and timeliness for each of the five entities (see tables 36 through 40). Table 36 summarizes selected single audit information for the FSM national government.

**Table 36: Selected Information from Single Audits of FSM National Government, Fiscal Years 2015–2019**

Single audit information	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Financial reporting (auditor's opinion <sup>a</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Schedule of Expenditures of Federal Awards (auditor's opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor's opinion <sup>c</sup> )	qualified opinion	unmodified opinion	unmodified opinion	qualified opinion	unmodified opinion
Audit findings (total number)	7	3	1	2	1
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	4,258	27	27	0	0
Timeliness of submitting single audit package <sup>e</sup>	yes	no	yes	yes	yes
Low-risk auditee <sup>f</sup>	no	no	no	no	no

Source: GAO analysis of Federated States of Micronesia (FSM) single audit reports for fiscal years (FY) 2015–2019. | GAO-22-104436

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatement.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports an auditee's expenditures of federal awards for the period covered by the auditee's financial statements. The schedule's reporting requirements include (1) reporting the individual federal programs by federal agency; (2) providing the total federal awards expended for each individual federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor's opinion is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatement.

<sup>c</sup>A qualified opinion is given on compliance with requirements of major federal programs when the auditor concludes the auditee's non-compliance with provisions of federal statutes and regulations or with the terms and conditions of federal awards. An unmodified opinion on compliance with

**Appendix VI: Additional Information from the  
Federated States of Micronesia Single Audits,  
Fiscal Years 2015–2019**

requirements of major federal programs is given when the auditor concludes that the auditee was in compliance with such requirements.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost was not supported by adequate documentation at the time of the audit; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the auditee's fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

Table 37 summarizes selected single audit information for Chuuk.

**Table 37: Selected Information from Single Audits of FSM State of Chuuk's Government, Fiscal Years 2015–2019**

Single audit information	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Financial reporting (auditor's opinion <sup>a</sup> )	qualified opinion	qualified opinion	qualified opinion	qualified opinion	qualified opinion
Schedule of Expenditures of Federal Awards (auditor's opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor's opinion <sup>c</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	qualified opinion
Audit findings (total number)	6	3	3	4	6
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	364	364	364	0	33
Timeliness of submitting single audit package <sup>e</sup>	yes	yes	yes	yes	yes
Low-risk auditee <sup>f</sup>	no	no	no	no	no

Source: GAO analysis of Federated States of Micronesia (FSM) single audit reports for fiscal years (FY) 2015–2019. | GAO-22-104436

<sup>a</sup>A qualified opinion on financial reporting is given when the auditor (1) obtains sufficient appropriate audit evidence and concludes that misstatements in the financial statement are material but not pervasive or (2) was unable to obtain sufficient appropriate audit evidence and concludes that the possible effects on the financial statements of any undetected misstatements could be material but not pervasive. The effect of the auditor's qualified opinion can be significant enough to reduce the usefulness and reliability of the auditee's financial statements.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal awards for the period covered by the auditee's financial statement. The schedule's reporting requirements include (1) reporting the individual federal programs, by federal agency; (2) providing the total federal awards expended for each federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor's opinion is given when the auditor is reasonably assured that the auditee's financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>An unmodified opinion on compliance with requirements of major federal programs is given when the auditor concludes that the auditee was in compliance with provisions of federal statutes and regulations and with the terms and conditions of federal awards. A qualified opinion on compliance is given when the auditor finds auditee's non-compliance with such requirements.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was or may have been violated; (2) the cost was not supported by adequate documentation at the time of the audit; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the auditee's fiscal year ends.

**Appendix VI: Additional Information from the  
Federated States of Micronesia Single Audits,  
Fiscal Years 2015–2019**

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

Table 38 summarizes selected single audit information for Kosrae.

**Table 38: Selected Information from Single Audits of FSM State of Kosrae’s Government, Fiscal Years 2015–2019**

Single audit information	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Financial reporting (auditor’s opinion <sup>a</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Schedule of Expenditures of Federal Awards (auditor’s opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor’s opinion <sup>c</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Audit findings (total number)	1	0	0	0	0
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	0	0	0	0	0
Timeliness of submitting single audit package <sup>e</sup>	yes	yes	yes	yes	yes
Low-risk auditee <sup>f</sup>	yes	yes	yes	yes	yes

Source: GAO analysis of Federated States of Micronesia (FSM) single audit reports for fiscal years (FY) 2015–2019. | GAO-22-104436

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal awards for the period covered by the award recipients’ financial statements. The schedule’s reporting requirements include (1) reporting the individual federal programs, by federal agency; (2) providing the total federal awards expended for each program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor’s opinion is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>An unmodified opinion on compliance with requirements of major federal programs is given when the auditor concludes that the auditee was in compliance with provisions of federal statutes and regulations and with the terms and conditions of major federal awards.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost was not supported by adequate documentation at the time of the audit; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the auditee’s fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

Table 39 summarizes selected single audit information for Pohnpei.

**Appendix VI: Additional Information from the  
Federated States of Micronesia Single Audits,  
Fiscal Years 2015–2019**

**Table 39: Selected Information from Single Audits of FSM State of Pohnpei’s Government, Fiscal Years 2015–2019**

Single audit information	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Financial reporting (auditor’s opinion <sup>a</sup> )	unmodified opinion	qualified opinion	qualified opinion	qualified opinion	qualified opinion
Schedule of Expenditures of Federal Awards (auditor’s opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor’s opinion <sup>c</sup> )	qualified opinion	unmodified opinion	unmodified opinion	unmodified opinion	qualified opinion
Audit findings (total number)	5	3	2	2	9
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	910	911	585	585	1,320
Timeliness of submitting single audit package <sup>e</sup>	yes	yes	yes	yes	yes
Low-risk auditee <sup>f</sup>	no	no	no	no	no

Source: GAO analysis of Federate States of Micronesia (FSM) single audit reports for fiscal years (FY) 2015–2019. | GAO-22-104436

<sup>a</sup>An unmodified opinion on financial reporting is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements. A qualified opinion on financial reporting is given when the auditor (1) obtains sufficient appropriate audit evidence and concludes that misstatements in the financial statement are material but not pervasive or (2) was unable to obtain sufficient appropriate audit evidence and concludes that the possible effects on the financial statements of any undetected misstatements could be material but not pervasive. The effect of the auditor’s qualified opinion can be significant enough to reduce the usefulness and reliability of the auditee’s financial statements.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal wards for the period covered by the award recipients’ financial statements. The schedule’s reporting requirements include (1) reporting the individual federal programs by federal agency; (2) providing the total federal awards expended for each individual federal program; and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor’s opinion is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>A qualified opinion on compliance with requirements of major federal programs is given when the auditor finds the lack of the auditee’s compliance with provisions of federal statutes and regulations or with the terms and conditions of major federal awards. An unmodified opinion on compliance is given when the auditor concludes that the auditee was in compliance with such requirements.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost was not supported by adequate documentation at the time of the audit; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the auditee’s fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.

Appendix VI: Additional Information from the  
Federated States of Micronesia Single Audits,  
Fiscal Years 2015–2019

Table 40 summarizes selected single audit information for Yap.

**Table 40: Selected Information from Single Audits of FSM State of Yap’s Government, Fiscal Years 2015–2019**

Single audit information	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Financial reporting (auditor’s opinion <sup>a</sup> )	adverse opinion	adverse opinion	adverse opinion	adverse opinion	adverse opinion
Schedule of Expenditures of Federal Awards (auditor’s opinion <sup>b</sup> )	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion	unmodified opinion
Compliance with requirements of major federal programs (auditor’s opinion <sup>c</sup> )	qualified opinion	qualified opinion	qualified opinion	qualified opinion	qualified opinion
Audit findings (total number)	4	6	3	3	3
Cumulative questioned costs <sup>d</sup> (thousands of dollars)	1,024	1,099	277	653	646
Timeliness of submitting single audit package <sup>e</sup>	yes	yes	yes	yes	no
Low-risk auditee <sup>f</sup>	no	no	no	no	no

Source: GAO analysis of Federated States of Micronesia (FSM) fiscal year (FY) 2015–2019 single audit reports. | GAO-22-104436

<sup>a</sup>An adverse opinion on financial reporting is given when the auditor concludes, after obtaining sufficient appropriate evidence, that misstatements in the auditee’s financial statement are both material and pervasive.

<sup>b</sup>The Schedule of Expenditures of Federal Awards reports the expenditures of federal wards for the period covered by the award recipients’ financial statements. The schedule’s reporting requirements include (1) reporting the individual federal programs by federal agency, (2) providing the total federal awards expended for each individual federal program, and (3) providing the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number if the CFDA number is not available. An unmodified auditor’s opinion is given when the auditor is reasonably assured that the auditee’s financial statements and Schedule of Expenditures of Federal Awards are free of material misstatements.

<sup>c</sup>A qualified opinion on compliance with requirements of major federal programs is given when the auditor concludes the auditee’s was not in compliance with provisions of federal statutes and regulations or with the terms and conditions of federal awards.

<sup>d</sup>An auditor may question an incurred cost for several reasons, including the following: (1) a provision of a law, regulation, contract, or grant was, or may have been, violated; (2) the cost was not supported by adequate documentation at the time of the audit; or (3) the cost appears unreasonable. The questioned costs shown were outstanding as of the end of the fiscal year.

<sup>e</sup>Single audit packages must be submitted to the Federal Audit Clearinghouse no later than 9 months after the auditee’s fiscal year ends.

<sup>f</sup>An auditee would be considered low risk if it submitted its single audit package within the required time frame and met several other criteria, including, but not limited to, having no material weaknesses reported for each of the two prior audit periods and receiving unmodified opinions from auditors for its financial statements.



## Appendix VII: Comments from the Department of State



United States Department of State  
Comptroller  
Washington, DC 20520  
DEC 13 2021

Thomas Melito  
Managing Director  
International Affairs and Trade  
Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548-0001

Dear Mr. Melito:

We appreciate the opportunity to review your draft report,  
“COMPACTS OF FREE ASSOCIATION: Implications of Planned Ending  
of Some U.S. Economic Assistance” GAO Job Code 104436.

The enclosed Department of State comments are provided for  
incorporation with this letter as an appendix to the final report.

Sincerely,

A handwritten signature in blue ink, reading "Jeffrey C. Mounts".

Jeffrey C. Mounts

Enclosure:  
As stated

cc: GAO – Latesha Love  
EAP – Daniel J. Kritenbrink  
OIG - Norman Brown

**Department of State Response to GAO Draft Report**

**COMPACTS OF FREE ASSOCIATION: Implications of Planned Ending of  
Some U.S. Economic Assistance**  
**(GAO-22-104436, GAO Code 104436)**

Thank you for the opportunity to comment on your draft report “*Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance*”.

**Recommendation 1:** The Secretary of State, working with the Department of the Interior, should establish timeframes with milestones to constitute the Palau Advisory Group on Economic Reform before its 2023 termination date.

**Department Response:** The Department concurs with this recommendation and will seek to establish a timeframe, in coordination with the Department of the Interior, with the Government of Palau to constitute the Palau Advisory Group on Economic Reform, consistent with the Compact Review Agreement, as amended.

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## Agency Comment Letter

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### Text of Appendix VII: Comments from the Department of State

#### Page 1

Thomas Melito  
Managing Director  
International Affairs and Trade  
Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548-0001

Dear Mr. Melito:

We appreciate the opportunity to review your draft report, "COMPACTS OF FREE ASSOCIATION: Implications of Planned Ending of Some U.S. Economic Assistance" GAO Job Code 104436.

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Sincerely,

Jeffrey C. Mounts

Enclosure:

As stated

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EAP -Daniel J. Kritenbrink OIG - Norman Brown

Page 2

**Department of State Response to GAO Draft Report**

**COMPACTS OF FREE ASSOCIATION: Implications of Planned Ending of Some  
U.S. Economic Assistance**

**(GAO-22-104436, GAO Code 104436)**

Thank you for the opportunity to comment on your draft report “*Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance*”.

**Recommendation 1:** The Secretary of State, working with the Department of the Interior, should establish timeframes with milestones to constitute the Palau Advisory Group on Economic Reform before its 2023 termination date.

**Department Response:** The Department concurs with this recommendation and will seek to establish a timeframe, in coordination with the Department of the Interior, with the Government of Palau to constitute the Palau Advisory Group on Economic Reform, consistent with the Compact Review Agreement, as amended.

## Appendix VIII: Comments from the U.S. Agency for International Development



November 24, 2021

Latesha Love  
Director, International Affairs & Trade

U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20226

Re: Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance (GAO-22-104436)

Dear Ms. Love:

I am pleased to provide the formal response of the U.S. Agency for International Development (USAID) to the draft report produced by the U.S. Government Accountability Office (GAO) titled, *Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance* (GAO-22-104436).

We thank you for the draft report highlighting the implications of the planned ending of some of the U.S. economic assistance for the Compacts of Free Association.

The draft report is relevant to USAID in that although the compact programs and services agreements with FSM, RMI, and Palau will end in 2024, current U.S. law enables U.S. agencies, including USAID, to continue providing programs and services. For example, under the prior agreements, FEMA would provide disaster relief funding which was then programmed by USAID. Once the agreements end, FEMA will no longer be able to provide funding, but USAID will be able to provide foreign disaster assistance to the FSM, RMI, and Palau under the same terms as it provides this assistance to other countries under the Foreign Assistance Act. Similarly, with the end of the agreements, FSM and RMI will remain eligible to receive disaster resilience and preparedness assistance from USAID under the same terms it provides this assistance to other countries under the Foreign Assistance Act.

I am transmitting this letter from USAID for inclusion in the GAO's final report. USAID has no formal comments on the report. Thank you for the opportunity to respond to the draft report, and for the courtesies extended by your staff while conducting this engagement. We appreciate the

opportunity to participate in the complete and thorough evaluation of the implications of the planned ending of some of the U.S. economic assistance for Compacts of Free Association.

Sincerely,

*Colleen R. Allen*

Colleen Allen  
Assistant Administrator  
Bureau for Management

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## Agency Comment Letter

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### Text of Appendix VIII: Comments from the U.S. Agency for International Development

#### Page 1

November 24, 2021

Latesha Love  
Director, International Affairs & Trade  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20226

Re: Compacts of Free Association: Implications of Planned Ending of Some U.S.  
Economic Assistance (GAO-22-104436)

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Page 2

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Sincerely,  
Colleen Allen  
Assistant Administrator Bureau for Management



## Appendix IX: Comments from the U.S. Department of Agriculture



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## Agency Comment Letter

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### Text of Appendix IX: Comments from the U.S. Department of Agriculture

#### Page 1

Ms. Latesha Love  
Director, International Affairs and Trade  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Ms. Love:

The U.S. Department of Agriculture (USDA) Natural Resources Conservation Service (NRCS) appreciates the opportunity to respond to the U.S. Government Accountability Office (GAO) draft report “Compacts of Free Association, Implications of Planned Ending of Some U.S. Economic Assistance.” The NRCS generally agrees with the report, and notes the report contained no recommendations for NRCS. As a learning organization, we are always interested in engaging with our partners, stakeholders, and the public.

The focus of this report appears to be on grants, programs, and services that Federal agencies will be able to continue to provide when the financial provisions of the Compact of Free Association Agreements (COFAs) expire in the Federated States of Micronesia (FSM) and Republic of the Marshall Islands (RMI) after 2023 and in Palau after 2024. Our interpretation is the current NRCS technical assistance service provided by Pacific Islands Area will cease unless the COFAs are renewed. NRCS has requested a USDA Office of General Counsel opinion on continuation of financial provisions of the COFAs. This report shows the shortfall for the three countries without the U.S. funding. Based on the information NRCS originally provided to GAO, this report seems factual and represents the information the agency provided.

We appreciate the GAO’s review as we constantly seek to make progress toward providing technical assistance to FSM and RMI after 2023, and in Palau after 2024. Thank you again for the opportunity to review the draft report. If you have any questions, please contact Travis Thomason, Director, Pacific Islands Area.

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Travis can be contacted at (808) 600-2969 or by e-mail at [travis.thomason@usda.gov](mailto:travis.thomason@usda.gov).

Sincerely,  
Terry J. Cosby Chief

## Appendix X: Comments from the U.S. Postal Service

ROBERT H. RAINES JR.  
MANAGING DIRECTOR, GLOBAL BUSINESS



December 1, 2021

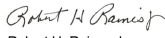
Ms. Latesha Love  
Director, International Affairs & Trade  
United States Government Accountability Office  
441 G Street, NW  
Washington, DC 20548-0001

Dear Ms. Love:

The United States Postal Service would like to express its gratitude for having the opportunity to provide background, institutional knowledge, and organizational concerns related to the Government Accountability Office's report on the Compacts of Free Association Grants & Trust Funds (GAO-22-104436). We appreciate the report's findings insofar as the provision of postal services is concerned.

We do, however, wish to point out that the Postal Service has incurred losses in excess of \$110 million since 2002 by providing service to the Freely Associated States under the current Compact Agreements. The mounting costs of providing service without sufficient compensation is unsustainable. Going forward, the Postal Service intends to ensure that it will be fully compensated for the services in any future arrangements, including full reimbursement for past expenses incurred.

Sincerely,

  
Robert H. Raines Jr.

475 L'ENFANT PLAZA SW  
WASHINGTON DC 20260-0004  
WWW.USPS.COM

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**Appendix X: Comments from the U.S. Postal  
Service**

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- 2 -

STEVE MONTEITH  
CHIEF CUSTOMER AND MARKETING OFFICER  
ROOM 4100  
[STEVE.W.MONTEITH@USPS.GOV](mailto:STEVE.W.MONTEITH@USPS.GOV)

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ROOM 6100  
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## Agency Comment Letter

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### Text of Appendix X: Comments from the U.S. Postal Service

#### Page 1

December 1, 2021

Ms. Latesha Love  
Director, International Affairs & Trade  
United States Government Accountability Office  
441 G Street, NW  
Washington, DC 20548-0001

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Sincerely,  
Robert H. Raines Jr.

Page 2

STEVE MONTEITH

CHIEF CUSTOMER AND MARKETING OFFICER ROOM 4100

[STEVE.W.MONTEITH@USPS.GOV](mailto:STEVE.W.MONTEITH@USPS.GOV)

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GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT ROOM 6100

[THOMAS.J.MARSHALL@USPS.GOV](mailto:THOMAS.J.MARSHALL@USPS.GOV)

## Appendix XI: Comments from the Government of the Federated States of Micronesia



GOVERNMENT OF THE  
FEDERATED STATES OF MICRONESIA  
Department of Finance and Administration  
P.O. Box PS 158  
Palikir, Pohnpei FM 96941  
Tel: (691) 320-2640/5852 Fax: (691) 320-7728  
E-mail: fsmsofa@mail.fm

December 15, 2021

Ms. Latesha Love  
Director, International Affairs & Trade  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Ms. Love:

On behalf of the Government of the Federated States of Micronesia (FSM), I am pleased to provide comments on the Government Accountability Office's draft report entitled "Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance," as provided to the FSM on November 11, 2021. Our government appreciates the opportunity to provide input on the GAO draft. Our comments begin with some general observations on the close relationship between the FSM and the United States and then address several issues in the draft report.

### Overview of U.S.-FSM Relationship

The United States and the FSM have a longstanding strategic partnership that reflects the common values of our two countries, including our commitment to promoting the rule of law, democracy, and regional security. In 1986, the FSM and the U.S. entered into a Compact of Free Association. The 1986 Compact was renewed and amended with the entry into force of the 2003 Amended Compact of Free Association, which remains in effect today.

These agreements have served both governments extremely well and act as the bedrock for security throughout much of the Pacific. Moreover, these agreements fulfill important strategic objectives for both countries. Since the first Compact entered into force, the FSM has continuously granted the U.S. security and defense rights in the territory of the FSM, which constitutes a large section of the Pacific Ocean of key strategic importance. This includes the right of the U.S. military to operate in the FSM and to deny foreign militaries access to or use of FSM's territory. This defense partnership is vital to securing and maintaining peace and prosperity in the Indo-Pacific region. The Federated States of Micronesia is fully committed to maintaining and building its relationship with the U.S., which contributes to the strength and prosperity of both countries.



Reflecting these close bonds, FSM citizens have proudly served in the U.S. military for decades and continue to volunteer to serve in the U.S. military at per capita rates higher than most of the United States. Some of those men and women have paid the ultimate sacrifice in Iraq and Afghanistan. Many FSM citizens who are veterans of the U.S. military live in the United States and pursue opportunities there, while many others have returned home to Micronesia to use newly acquired skills to help in the growth of our nation.

We are well aware of the U.S. Government's increased attention to the security in our region and the steps it has announced to work more closely with the Freely Associated States. We look forward to continuing to be a part of this enhanced effort to promote a free and open Indo-Pacific and to advance our defense partnership even further.

Through the 2003 Amended Compact, the U.S. committed to providing the FSM certain key financial assistance through the end of FY 2023 — a date that is rapidly approaching. This financial assistance includes sector grants supporting areas such as health, education, infrastructure, and the environment, as well as annual contributions to a Compact Trust Fund. The U.S. also supports the FSM education sector through annual Supplemental Education Grants, and many U.S. federal agencies provide key programs and services in the FSM.

As noted in the GAO draft report, a number of provisions in U.S. law relating to economic assistance to the FSM will lapse unless extended. Clearly, a cutoff of U.S. assistance at the end of FY 2023 (now less than two years away) will have devastating consequences for the prosperity and stability of our Nation.

The FSM has begun talks with the United States on the details of the next phase of our relationship and, as such, this letter will refrain from discussing our ongoing negotiations. Our comments below are therefore on broad issues that we have previously discussed with GAO staff or stated publicly and are well known to the United States.

In general, the FSM believes that the GAO draft report presents many key issues well, but there are several areas where the FSM believes additional emphasis or clarification is needed to ensure that GAO fully addresses the questions posed by the U.S. Congress.

#### **Comments on GAO Draft**

To begin, we wish to emphasize and strongly endorse two overarching and fundamental issues raised by the GAO throughout the draft report.

- The corpus of the Compact Trust Fund will not be adequate to generate sufficient income to replace sector grants and other expiring economic assistance at the end of the current Compact period in 2023. Substantial new U.S. economic assistance is needed during the next Compact period so that the FSM won't need to tap into the Compact Trust Fund prior to FY 2044 and erode the corpus, as pointed out repeatedly in the draft GAO Report.

- Continued sector grant assistance from the United States, as well as renewal of the programs and services provided to the FSM through the Amended Compact and US Public Law 108-188, is essential for our people and our government. Despite having achieved considerable economic advancement during the years of the Compact, the FSM Government cannot replace this vital assistance with its own resources or with funding from other countries or international organizations. As reflected in the GAO draft, our government relies on the United States for support in each of the categories discussed in the draft report.

In addition to these two key issues raised by the GAO, the FSM takes this opportunity to observe that without additional financial contributions to the Compact Trust Fund by the United States during the upcoming Compact period we do not believe the corpus of the Fund will be adequate to secure the FSM's long-term viability. The FSM will discuss the details with the United States in the ongoing talks, but wishes to be clear that it believes that additional U.S. contributions to the Compact Trust Fund will be key to the FSM's long term financial and budgetary self reliance and therefore would be consistent with the other crucial elements of our bilateral relationship, including our enduring security and defense alliance.

Our government's ongoing discussions with the United States provide the appropriate vehicle for the detailed discussions relating to the next Compact period, on issues including 1) the Compact Trust Fund, 2) U.S. economic support, and 3) U.S. programs and services, all of which are of crucial importance. As noted, we will not use this letter to go into those details, but we would like to highlight several issues referred to in the GAO draft as it is important that our government's views be reflected in the final version of the report.

A. Mandatory Appropriations

As reflected throughout the GAO's draft report, including on pages 8-9 and 26-30, the United States provides the FSM funding under the Amended Compact in six core sectors: education, health, infrastructure, environment, private sector development, and public sector capacity building.<sup>1</sup> The United States also makes annual contributions to the FSM Compact Trust Fund established under the Amended Compact. The baseline amounts of the U.S. sector grant and Compact Trust Fund contributions are set forth in Section 216 of Title II of the Amended Compact. These contributions are subject to an annual inflation adjustment provided in Section 217 of Title II.

The U.S. Congress funds these payments to the FSM under a *mandatory* 20-year appropriation in Section 109 of Public Law 108-188. Consistent with longstanding U.S. practice as to the FSM, Section 109 both authorized and appropriated these funds: "*There are authorized and appropriated ... out of any funds in the Treasury not otherwise appropriated, to remain available until expended, such sums as are necessary ...*"

<sup>1</sup> The draft GAO report does not mention a seventh sector on "Enhanced Reporting and Accountability" that was created by the United States and the FSM in 2011 after the Amended Compact entered into force. Additional detail on the seventh sector is discussed beginning on page 8 of this submission.

Because of this provision, U.S. economic assistance in these core areas is not subject to discretionary payments subject to annual congressional appropriations (and the accompanying uncertainty). As a result, in 2003, the FSM knew exactly what the United States grant assistance would be in all future years of the Amended Compact, subject only to the inflation adjustment in Title II of the Compact. This certainty is consistent with the unique and important relationship between the United States and the FSM and is critical to the national and four State governments.

The need for mandatory funding is reflected, for example, in Table 2 on page 27 of the draft GAO report, which explains the FSM's dependence on the steady and certain flow of U.S. assistance.<sup>2</sup> This dependence is underlined again in Table 3 on page 28 of the draft report, which shows that well over half of the budgets of the four FSM states in the health and education sectors are directly derived from sector grant support. As an example, in Chuuk, our largest State, 70% of its education sector and 86% of its health sector is funded by mandatory appropriations under Title II of the Amended Compact. The other three FSM States are similarly reliant on U.S. assistance, as reflected in Table 3 and throughout the draft GAO Report.

The U.S. Government's commitment to mandatory appropriations for the FSM has always been a fundamental part of this relationship and in our view must continue to be so. The United States has not only agreed to the negotiated amounts but also to the certainty that comes with them being *guaranteed in future annual appropriations*. Thus, U.S. Public Law 99-239, which approved the original 1986 U.S.-FSM Compact and approved the current international legal relationship between the two countries, purposely made U.S. funding to the FSM at the agreed levels mandatory and not subject to U.S. annual discretionary appropriations, as reflected in Congressional approval of the "full faith and credit" clause in Title II of the Compact in that 1986 statute. In 2003, the United States maintained this important commitment in Section 109 of Public Law 108-188 ("authorized and appropriated"), as quoted above. Any U.S. departure from this current practice and commitment would be a dramatic change that would undermine our economic and financial viability. This issue is fundamental for the FSM.

In light of this history and the essential role of U.S. assistance to the people and economies of the FSM, its four States, and its people, the FSM asks that the GAO clearly reflect in its report the importance of the U.S. Government's commitment to mandatory appropriations and include a recommendation that the status quo of mandatory appropriations be maintained into the next Compact period. Such action is appropriate and necessary in light of the U.S. Government's longstanding commitment to assist the FSM in its development and in keeping with the fundamentally important strategic relationship between the two countries.

#### B. Supplemental Education Grant Funding

The problems that result from discretionary annual appropriations for the FSM have been demonstrated by the FSM's difficult experience in connection with Supplemental Education Grants (SEGs), a form of assistance discussed extensively in the draft GAO report, including on pages 13,

<sup>2</sup> As reflected in Table 2 on page 27, over half of the annual budgets of three of the four FSM states is derived from U.S. assistance under the Compact and the Supplemental Education Grants. These Governments would be unable to function without the certainty of this assistance.



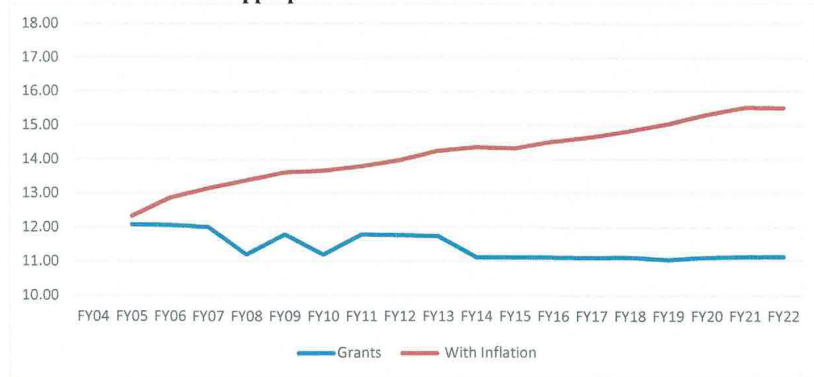
26-28, and 33. Supplemental Education Grants for the FSM were *authorized but not appropriated* in Section 105 (f)(B)(iii) of Public Law 108-188. This law eliminated longstanding FSM access to key U.S. educational programs that had been available to the FSM, such as Head Start and vocational and technical training. Congress replaced this actual eligibility by merely *authorizing* an annual block grant of \$12,230,000 with an inflation index.

U.S. funding has consistently been well below the authorization. FSM students, teachers, and the entire FSM educational system have suffered as a result. The shortfall has adversely affected the full range of programs funded by the SEGs: early childhood education; vocational education program, workforce development and skills training; assessment and evaluation; teacher training; principal training; after school programs; tutorial programs; school improvement programs; data management; procurement and development of instructional materials; and school support staffing.

For example, during the last two fiscal years (FY 2020 and FY 2021), the United States appropriated only \$11,130,547 for SEGs, far below the authorized \$12,230,000 prior to inflation adjustment (which would have resulted in an appropriation well over \$15,000,000). This shortfall has led to fewer children benefitting from early childhood care, less training for teachers, and fewer educational opportunities overall. The consequences of this shortfall have accumulated over time and continue to be felt today.

The total shortfall from the authorized amount when compared with the amount actually appropriated totals \$45.1 million. The following chart shows the disparity during the life of the Compact:

**Figure 1: Supplemental Education Grant (\$ million) - Difference Between Authorized and Appropriated Amounts**



The FSM requests that the SEGs be funded through mandatory appropriation and treated in the same manner as sector grants in the next Compact period, either by folding the SEG funding into the education sector grant or having it otherwise authorized by Congress. In either case, this

should be a mandatory and not discretionary appropriation. Correcting this problem is a priority for the FSM. In our view, the programs covered under SEGs should be folded into the education sector grants, and both categories of education assistance made the subject of mandatory appropriations.

C. Grants Management Issues

On page 9 and elsewhere in the draft report, GAO discusses the U.S.-FSM intergovernmental committee established under the Amended Compact called the Joint Economic Management Committee (JEMCO). JEMCO currently is comprised of three representatives of the United States and two representatives from the FSM. It also discusses the current role of the Interior Department managing grants to the FSM.

Under the Amended Compact the FSM has professionalized its management of U.S. assistance and sought to ensure that Compact assistance is used effectively in each sector for which it has been allocated. Throughout the Amended Compact period, the FSM has developed more sophisticated internal controls on the management of funds than existed during the first Compact period (1986-2003). The FSM's Office of Compact Management (OCM) is within the Office of the President of the FSM and provides oversight of funds received. The FSM Government and relevant officials in each state have highly trained and professional teams in place for each sector.

The FSM looks forward to discussing with the United States potential reforms in the provision and management of U.S. assistance to reflect the many positive developments that have taken place since the Amended Compact was agreed upon in 2003. The FSM would ensure that any new proposal to the United States would maintain U.S. visibility into the FSM's planned use of the funds and that the United States will continue to have audit rights as required by the Amended Compact. The current grants management scheme, with U.S. officials overseeing in detail the actions of officials of a foreign sovereign, results in a structure that does not reflect the advances in oversight and accountability that have taken place in the FSM over the last 20 years.

The GAO draft discusses audit findings relating to the FSM national government and the four FSM States on pages 43-50 and in Appendix VI. The FSM believes that the drafting is unduly negative (including the opening paragraph on page 43) and does not reflect the positive developments on audits and the major advances in the professionalism and competence of FSM authorities to manage foreign assistance funds. The following should be noted:

1. As reflected in the summaries in the GAO draft, many audits were unmodified (meaning no substantive concerns) or had only very minor questions.
2. Where concerns or questions were raised, the FSM and its States have addressed, and will continue to address, all issues as needed and expected under the current grants scheme.
3. The performance trend is overall positive with questioned costs generally reducing over time, with information flowing from the FSM to the auditors and the United

States to address issues.<sup>3</sup>

4. Overall accountability for the management of Compact funds rests with our National Government, which has an outstanding record on audits and has instituted a successful program to assist four State Governments on audits. The improvements at the State level are made clear by the charts in the report, if not the narrative.
5. Fifth, the Department of Interior staff has confirmed the improvements by informing the GAO that based on Interior's analysis "*the FSM governments continue to improve the accuracy of reporting financial data and accountability in the use of federal funds.*" (Page 47 of draft).

Thus, while there were areas identified for improvement (as there are for virtually any U.S. grant recipient), the overall results were favorable and reflected positive trends, all in the context of the complex nature of the grants management regime under which the FSM has been required to operate. We, therefore, ask that the final GAO report make clear the progress and success of our government in each of the areas discussed above and avoid an erroneous impression that review problems are widespread and chronic. Doing so would fail to adequately recognize the progress our national and state governments have made. The FSM notes that *any* recipient of U.S. grants with detailed requirements such as those imposed (and periodically amended) by the United States would periodically have questioned costs and other issues.<sup>4</sup>

Details of the future management of U.S. assistance to the FSM in the next Compact period will be discussed in direct negotiations with the United States. The FSM is grateful for the partnership of the Interior Department over the years but believes that a fresh and frank review is needed regarding the current oversight regime.

#### D. Additional Issues

The three issues above are key points for the FSM. We also ask that the final GAO report adequately emphasize the following additional points:

1. The draft GAO Report notes correctly throughout the report, including on pages 10 and 15, that the U.S. Postal Service currently provides service to the FSM and that this service will end at the end of the FY 2023 unless it is renewed.

Maintaining USPS service to and from the FSM is an urgent priority for the FSM Government. It is essential for the economic and personal wellbeing of our country and our

<sup>3</sup> In consolidating information, the GAO Report misses several positive issues. For example, on page 155, the GAO draft states that the State of Kosrae has had no material weakness in "the last two audit periods" but in fact there have been none for the last five years. Earlier on page 44, the GAO draft reflects that Yap has had an adverse opinion, but this was only for the Yap Fishing Authority, a local entity that does not receive Compact funds. All other component units of Yap State Government, including the General Fund, Foreign Grant Assistance Fund, Government and business activities, and Trust Funds, had unmodified opinions for the full 5-year period being analyzed in the Report.

<sup>4</sup> This would include U.S. states, municipalities, or other recipients of U.S. federal assistance.



citizens. Failing to extend US Postal Service in FY 2024 would be severely disruptive to the people and economy of the FSM. Our government currently lacks the capacity or resources to replace this vital service, which ties us to the world.

The FSM is geographically one of the most remote regions on earth, and the USPS provides the FSM with a vital link to the world. Many small businesses in the FSM, private citizens, and organizations rely on the USPS to access suppliers and markets in the U.S. and throughout the world. Failing to extend the existing arrangement would disrupt, and in many cases sever, these links and have a devastating effect on the private sector in this country. Postal correspondence between FSM citizens in the U.S. (including FSM citizens serving in the U.S. armed forces) and their families back home constitutes a large part of the mail that passes through FSM post offices every year. Continued USPS service is also important to U.S. businesses that rely on it for commerce with FSM persons and businesses, as well as U.S. citizens and personnel in the FSM.

The 1986 U.S.-FSM Compact of Free Association and the 2003 Amended Compact now in force include postal services as a core service to the FSM and a key component of the partnership and exchange of benefits between the two governments. The U.S. executive branch and the U.S. Congress have consistently ensured continuation of USPS services for the FSM, including through U.S. Public Laws 99-239 and 108-188, and the FSM asks that the service continue uninterrupted.

See GAO comment 1.

2. The draft GAO report reflects, on page 5 and elsewhere in the report, that the U.S. Government provides support in six sectors in Title II of the Amended Compact: education, health, infrastructure, environment, private sector development, and public sector capacity building. However, the GAO draft doesn't reflect that JEMCO agreed upon a seventh sector in 2011 entitled "Enhanced Reporting and Accountability" in Resolution JEMCO-MT-2011-3, as provided for in Article II(1)(g) of the U.S. FSM Fiscal Procedures Agreement. The FSM recommends that, for the sake of completeness, the GAO report mention the existence of this sector in a footnote or elsewhere.

In this respect, Resolution JEMCO-MT-2011-3 states that the amendment to the FPA adding a seventh sector would only become effective 90 days after it was transmitted to the U.S. Congress. This sector has been funded continuously since the JEMCO resolution, but the FSM does not know if that transmittal occurred and whether the United States has taken the necessary steps with respect to this seventh sector within the United States Government.

See GAO comment 2.

3. As noted throughout the draft GAO report, including on pages 10-14, by its own terms, the Compact Trust Fund Agreement needs to be updated before the end of FY 2023. The FSM has presented a proposal to the United States for an updated agreement.

See GAO comment 3.

4. The FSM notes that the GAO draft states in several locations, including on pages 4, 25, 26, and 31, that the Federal Programs and Services Agreement (FPSA) between the United States and the FSM is set to expire in 2024. For example, on page 31 the GAO draft states that "These services [to the FSM] include disaster services, postal service, and weather service, which will end in June 2024, and judicial training, which will end after September

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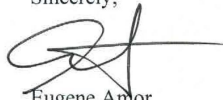
**Appendix XI: Comments from the Government of the  
Federated States of Micronesia**

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2023.” However, the U.S.-FSM exchange of diplomatic notes dated June 25, 2004, that brought the Amended Compact and its subsidiary agreements into force states: “The twenty year period for the Federal Programs and Services Agreement (Article XIV (3)) shall be deemed to end on September 30, 2023.” The FSM therefore recommends that the GAO report adjust its references to the U.S.-FSM FPSA to reflect that the parties agreed that FPSA will expire on September 30, 2023.

The Government of the FSM appreciates this opportunity to comment on the draft GAO Report. Please do not hesitate to let us know if you have any questions or if we can be of further assistance.

Sincerely,



Eugene Amor  
Secretary of Finance & Administration



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## Agency Comment Letter

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### Text of Appendix XI: Comments from the Government of the Federated States of Micronesia

#### Page 1

December 15, 2021

Ms. Latesha Love  
Director , International Affairs & Trade  
Government Accountability Office  
441 G St., NW  
Washington, DC 20548

Dear Ms. Love:

On behalf of the Government of the Federated States of Micronesia (FSM), I am pleased to provide comments on the Government Accountability Office's draft report entitled "Compacts of Free Association: Implications of Planned Ending of Some U.S. Economic Assistance," as provided to the FSM on November 11, 2021. Our government appreciates the opportunity to provide input on the GAO draft. Our comments begin with some general observations on the close relationship between the FSM and the United States and then address several issues in the draft report.

#### **Overview of U.S.-FSM Relationship**

The United States and the FSM have a longstanding strategic partnership that reflects the common values of our two countries, including our commitment to promoting the rule of law, democracy, and regional security. In 1986, the FSM and the U.S. entered into a Compact of Free Association. The 1986 Compact was renewed and amended with the entry into force of the 2003 Amended Compact of Free Association, which remains in effect today.

These agreements have served both governments extremely well and act as the bedrock for security throughout much of the Pacific. Moreover, these agreements fulfill important strategic objectives for both countries. Since the first Compact entered into force, the FSM has continuously granted the U.S. security and defense rights in the territory of the FSM, which constitutes a large section of the Pacific Ocean of key strategic importance. This includes the right of the U.S. military to operate in the FSM and to deny foreign militaries access to or use of FSM's territory.

This defense partnership is vital to securing and maintaining peace and prosperity in the Indo - Pacific region. The Federated States of Micronesia is fully committed to maintaining and building its relationship with the U.S., which contributes to the strength and prosperity of both countries.

## Page 2

Reflecting these close bonds, FSM citizens have proudly served in the U.S. military for decades and continue to volunteer to serve in the U.S. military at per capita rates higher than most of the United States. Some of those men and women have paid the ultimate sacrifice in Iraq and Afghanistan. Many FSM citizens who are veterans of the U.S. military live in the United States and pursue opportunities there, while many others have returned home to Micronesia to use newly acquired skills to help in the growth of our nation.

We are well aware of the U.S. Government's increased attention to the security in our region and the steps it has announced to work more closely with the Freely Associated States. We look forward to continuing to be a part of this enhanced effort to promote a free and open Indo- Pacific and to advance our defense partnership even further.

Through the 2003 Amended Compact, the U.S. committed to providing the FSM certain key financial assistance through the end of FY 2023 - a date that is rapidly approaching. This financial assistance includes sector grants supporting areas such as health, education, infrastructure, and the environment, as well as annual contributions to a Compact Trust Fund. The

U.S. also supports the FSM education sector through annual Supplemental Education Grants, and many U.S. federal agencies provide key programs and services in the FSM.

As noted in the GAO draft report, a number of provisions in U.S. law relating to economic assistance to the FSM will lapse unless extended. Clearly, a cutoff of U.S. assistance at the end of FY 2023 (now less than two years away) will have devastating consequences for the prosperity and stability of our Nation.

The FSM has begun talks with the United States on the details of the next phase of our relationship and, as such, this letter will refrain from discussing our ongoing negotiations. Our comments below are therefore on broad issues that we have previously discussed with GAO staff or stated publicly and are well known to the United States.

In general, the FSM believes that the GAO draft report presents many key issues well, but there are several areas where the FSM believes additional emphasis or clarification is needed to ensure that GAO fully addresses the questions posed by the U.S. Congress.

### **Comments on GAO Draft**

To begin, we wish to emphasize and strongly endorse two overarching and fundamental issues raised by the GAO throughout the draft report.

The corpus of the Compact Trust Fund will not be adequate to generate sufficient income to replace sector grants and other expiring economic assistance at the end of the current Compact period in 2023. Substantial new U.S. economic assistance is needed during the next Compact period so that the FSM won't need to tap into the Compact Trust Fund prior to FY 2044 and erode the corpus, as pointed out repeatedly in the draft GAO Report.

### **Page 3**

- Continued sector grant assistance from the United States, as well as renewal of the programs and services provided to the FSM through the Amended Compact and US Public Law 108-188, is essential for our people and our government. Despite having achieved considerable economic advancement during the years of the Compact, the FSM Government cannot replace this vital assistance with its own resources or with funding from other countries or international organizations. As reflected in the GAO draft, our government relies on the United States for support in each of the categories discussed in the draft report.

In addition to these two key issues raised by the GAO, the FSM takes this opportunity to observe that without additional financial contributions to the Compact Trust Fund by the United States during the upcoming Compact period we do not believe the corpus of the Fund will be adequate to secure the FSM 's long-term viability. The FSM will discuss the details with the United States in the ongoing talks, but wishes to be clear that it believes that additional U.S. contributions to the Compact Trust Fund will be key to the FSM's long term financial and budgetary self reliance and therefore would be consistent with the other crucial elements of our bilateral relationship , including our enduring security and defense alliance.

Our government' s ongoing discussions with the United States provide the appropriate vehicle for the detailed discussions relating to the next Compact period, on issues including 1) the Compact Trust Fund, 2) U.S. economic support, and 3) U.S. programs and services, all of which are of crucial importance. As noted, we will not use this letter to go into those details, but we would like to highlight several

issues referred to in the GAO draft as it is important that our government's views be reflected in the final version of the report.

A. Mandatory Appropriations

As reflected throughout the GAO's draft report, including on pages 8-9 and 26-30, the United States provides the FSM funding under the Amended Compact in six core sectors: education, health, infrastructure, environment, private sector development, and public sector capacity building.<sup>1</sup> The United States also makes annual contributions to the FSM Compact Trust Fund established under the Amended Compact. The baseline amounts of the U.S. sector grant and Compact Trust Fund contributions are set forth in Section 216 of Title II of the Amended Compact. These contributions are subject to an annual inflation adjustment provided in Section 217 of Title II.

The U.S. Congress funds these payments to the FSM under a mandatory 20-year appropriation in Section 109 of Public Law 108-188. Consistent with longstanding U.S. practice as to the FSM, Section 109 both authorized and appropriated these funds: "There are authorized and appropriated ... out of any funds in the Treasury not otherwise appropriated, to remain available until expended, such sums as are necessary "

<sup>1</sup> The draft GAO report does not mention a seventh sector on "Enhanced Reporting and Accountability" that was created by the United States and the FSM in 2011 after the Amended Compact entered into force. Additional detail on the seventh sector is discussed beginning on page 8 of this submission.

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Because of this provision, U.S. economic assistance in these core areas is not subject to discretionary payments subject to annual congressional appropriations (and the accompanying uncertainty). As a result, in 2003, the FSM knew exactly what the United States grant assistance would be in all future years of the Amended Compact, subject only to the inflation adjustment in Title II of the Compact. This certainty is consistent with the unique and important relationship between the United States and the FSM and is critical to the national and four State governments.

The need for mandatory funding is reflected, for example, in Table 2 on page 27 of the draft GAO report, which explains the FSM's dependence on the steady and certain flow of U.S. assistance.<sup>2</sup> This dependence is underlined again in Table 3 on page 28 of the draft report, which shows that well over half of the budgets of the four FSM states in the health and education sectors are directly derived from sector grant support. As an example, in Chuuk, our largest State, 70% of its education sector and 86% of its health sector is funded by mandatory appropriations under Title II of the Amended Compact. The other three FSM States are similarly reliant on U.S. assistance, as reflected in Table 3 and throughout the draft GAO Report.

The U.S. Government's commitment to mandatory appropriations for the FSM has always been a fundamental part of this relationship and in our view must continue to be so. The United States has not only agreed to the negotiated amounts but also to the certainty that comes with them being guaranteed in future annual appropriations. Thus, U.S. Public Law 99-239, which approved the original 1986 U.S.-FSM Compact and approved the current international legal relationship between the two countries, purposely made U.S. funding to the FSM at the agreed levels mandatory and not subject to U.S. annual discretionary appropriations, as reflected in Congressional approval of the "full faith and credit" clause in Title II of the Compact in that 1986 statute. In 2003, the United States maintained this important commitment in Section 109 of Public Law 108-188 ("authorized and appropriated"), as quoted above. Any U.S. departure from this current practice and commitment would be a dramatic change that would undermine our economic and financial viability. This issue is fundamental for the FSM.

In light of this history and the essential role of U.S. assistance to the people and economies of the FSM, its four States, and its people, the FSM asks that the GAO clearly reflect in its report the importance of the U.S. Government's commitment to mandatory appropriations and include a recommendation that the status quo of mandatory appropriations be maintained into the next Compact period. Such action is appropriate and necessary in light of the U.S. Government's longstanding commitment to assist the FSM in its development and in keeping with the fundamentally important strategic relationship between the two countries.

B. Supplemental Education Grant Funding

The problems that result from discretionary annual appropriations for the FSM have been demonstrated by the FSM's difficult experience in connection with Supplemental Education Grants (SEGs), a form of assistance discussed extensively in the draft GAO report, including on pages 13,

2 As reflected in Table 2 on page 27, over half of the annual budgets of three of the four FSM states is derived from U.S. assistance under the Compact and the Supplemental Education Grants. These Governments would be unable to function without the certainty of this assistance.

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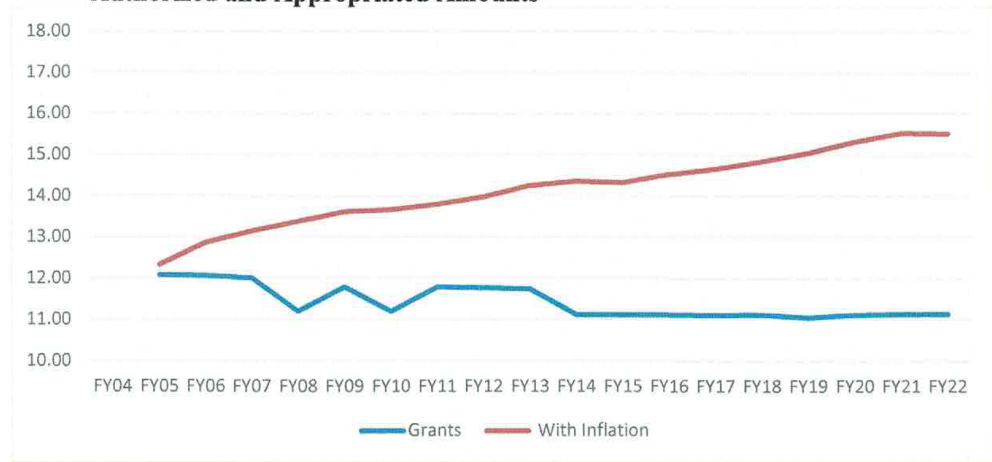
26-28, and 33. Supplemental Education Grants for the FSM were *authorized but not appropriated* in Section 105 (f)(B)(iii) of Public Law 108-188. This law eliminated longstanding FSM access to key U.S. educational programs that had been available to the FSM, such as Head Start and vocational and technical training. Congress replaced this actual eligibility by merely *authorizing* an annual block grant of \$12,230,000 with an inflation index.

U.S. funding has consistently been well below the authorization. FSM students, teachers, and the entire FSM educational system have suffered as a result. The shortfall has adversely affected the full range of programs funded by the SEGs: early childhood education; vocational education program, workforce development and skills training; assessment and evaluation; teacher training; principal training; after school programs; tutorial programs; school improvement programs; data management; procurement and development of instructional materials; and school support staffing.

For example, during the last two fiscal years (FY 2020 and FY 2021), the United States appropriated only \$11,130,547 for SEGs, far below the authorized \$12,230,000 prior to inflation adjustment (which would have resulted in an appropriation well over \$15,000,000). This shortfall has led to fewer children benefitting from early childhood care, less training for teachers, and fewer educational opportunities overall. The consequences of this shortfall have accumulated over time and continue to be felt today.

The total shortfall from the authorized amount when compared with the amount actually appropriated totals \$45.1 million. The following chart shows the disparity during the life of the Compact:

**Figure 1: Supplemental Education Grant (\$ million) - Difference Between Authorized and Appropriated Amounts**



The FSM requests that the SEGs be funded through mandatory appropriation and treated in the same manner as sector grants in the next Compact period, either by folding the SEO funding into the education sector grant or having it otherwise authorized by Congress. In either case, this

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should be a mandatory and not discretionary appropriation. Correcting this problem is a priority for the FSM. In our view, the programs covered under SEGs should be folded into the education sector grants, and both categories of education assistance made the subject of mandatory appropriations.

### C. Grants Management Issues

On page 9 and elsewhere in the draft report, GAO discusses the U.S.-FSM intergovernmental committee established under the Amended Compact called the Joint Economic Management Committee (JEMCO). JEMCO currently is comprised of three representatives of the United States and two representatives from the FSM. It also discusses the current role of the Interior Department managing grants to the FSM.

Under the Amended Compact the FSM has professionalized its management of U.S. assistance and sought to ensure that Compact assistance is used effectively in each sector for which it has been allocated. Throughout the Amended Compact period, the FSM has developed more sophisticated internal controls on the management of funds than existed during the first Compact period (1986-2003). The FSM's Office of

Compact Management (OCM) is within the Office of the President of the FSM and provides oversight of funds received. The FSM Government and relevant officials in each state have highly trained and professional teams in place for each sector.

The FSM looks forward to discussing with the United States potential reforms in the provision and management of U.S. assistance to reflect the many positive developments that have taken place since the Amended Compact was agreed upon in 2003. The FSM would ensure that any new proposal to the United States would maintain U.S. visibility into the FSM's planned use of the funds and that the United States will continue to have audit rights as required by the Amended Compact. The current grants management scheme, with U.S. officials overseeing in detail the actions of officials of a foreign sovereign, results in a structure that does not reflect the advances in oversight and accountability that have taken place in the FSM over the last 20 years.

The GAO draft discusses audit findings relating to the FSM national government and the four FSM States on pages 43-50 and in Appendix VI. The FSM believes that the drafting is unduly negative (including the opening paragraph on page 43) and does not reflect the positive developments on audits and the major advances in the professionalism and competence of FSM authorities to manage foreign assistance funds. The following should be noted:

1. As reflected in the summaries in the GAO draft, many audits were unmodified (meaning no substantive concerns) or had only very minor questions.
2. Where concerns or questions were raised, the FSM and its States have addressed, and will continue to address, all issues as needed and expected under the current grants scheme.
3. The performance trend is overall positive with questioned costs generally reducing over time, with information flowing from the FSM to the auditors and the United

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States to address issues.<sup>3</sup>

4. Overall accountability for the management of Compact funds rests with our National Government, which has an outstanding record on audits and has instituted a successful program to assist four State Governments on audits. The improvements at the State level are made clear by the charts in the report, if not the narrative.



5. Fifth, the Department of Interior staff has confirmed the improvements by informing the GAO that based on Interior's analysis "the FSM governments continue to improve the accuracy of reporting. Financial data and accountability in the use of federal funds." (Page 47 of draft).

Thus, while there were areas identified for improvement (as there are for virtually any U.S. grant recipient), the overall results were favorable and reflected positive trends, all in the context of the complex nature of the grants management regime under which the FSM has been required to operate. We, therefore, ask that the final GAO report make clear the progress and success of our government in each of the areas discussed above and avoid an erroneous impression that review problems are widespread and chronic. Doing so would fail to adequately recognize the progress our national and state governments have made. The FSM notes that any recipient of U.S. grants with detailed requirements such as those imposed (and periodically amended) by the United States would periodically have questioned costs and other issues.<sup>4</sup>

Details of the future management of U.S. assistance to the FSM in the next Compact period will be discussed in direct negotiations with the United States. The FSM is grateful for the partnership of the Interior Department over the years but believes that a fresh and frank review is needed regarding the current oversight regime.

#### D. Additional Issues

The three issues above are key points for the FSM. We also ask that the final GAO report adequately emphasize the following additional points:

1. The draft GAO Report notes correctly throughout the report, including on pages 10 and 15, that the U.S. Postal Service currently provides service to the FSM and that this service will end at the end of the FY 2023 unless it is renewed.

Maintaining USPS service to and from the FSM is an urgent priority for the FSM Government. It is essential for the economic and personal wellbeing of our country and our

3 In consolidating information, the GAO Report misses several positive issues. For example, on page 155, the GAO draft states that the State of Kosrae has had no material weakness in "the last two audit periods" but in fact there have been none for the last five years. Earlier on page 44, the GAO draft reflects that Yap has had an adverse opinion, but this was only for the Yap Fishing Authority, a local entity that does not receive Compact funds. All other component units of Yap State Government, including the General Fund, Foreign Grant Assistance Fund,

Government and business activities, and Trust Funds, had unmodified opinions for the full 5-year period being analyzed in the Report.

4 This would include U.S. states, municipalities, or other recipients of U.S. federal assistance.

citizens. Failing to extend US Postal Service in FY 2024 would be severely disruptive to the people and economy of the FSM. Our government currently lacks the capacity or resources to replace this vital service, which ties us to the world.

The FSM is geographically one of the most remote regions on earth, and the USPS provides the FSM with a vital link to the world. Many small businesses in the FSM, private citizens, and organizations rely on the USPS to access suppliers and markets in the U.S. and throughout the world. Failing to extend the existing arrangement would disrupt, and in many cases sever, these links and have a devastating effect on the private sector in this country. Postal correspondence between FSM citizens in the U.S. (including FSM citizens serving in the U.S. armed forces) and their families back home constitutes a large part of the mail that passes through FSM post offices every year. Continued USPS service is also important to U.S. businesses that rely on it for commerce with FSM persons and

businesses, as well as U.S. citizens and personnel in the FSM.

The 1986 U.S.-FSM Compact of Free Association and the 2003 Amended Compact now in force include postal services as a core service to the FSM and a key component of the partnership and exchange of benefits between the two governments. The U.S. executive branch and the U.S. Congress have consistently ensured continuation of USPS services for the FSM, including through U.S. Public Laws 99-239 and 108-188, and the FSM asks that the service continue uninterrupted.

2. The draft GAO report reflects, on page 5 and elsewhere in the report, that the U.S. Government provides support in six sectors in Title II of the Amended Compact: education, health, infrastructure, environment, private sector development, and public

sector capacity building. However, the GAO draft doesn't reflect that JEMCO agreed upon a seventh sector in 2011 entitled "Enhanced Reporting and Accountability" in Resolution JEMCO-MT-2011-3, as provided for in Article II(l)(g) of the U.S. FSM Fiscal Procedures Agreement. The FSM recommends that, for the sake of completeness, the GAO report mention the existence of this sector in a footnote or elsewhere.

In this respect, Resolution JEMCO-MT-2011-3 states that the amendment to the FPA adding a seventh sector would only become effective 90 days after it was transmitted to the

U.S. Congress. This sector has been funded continuously since the JEMCO resolution, but the FSM does not know if that transmittal occurred and whether the United States has taken the necessary steps with respect to this seventh sector within the United States Government.

3. As noted throughout the draft GAO report, including on pages 10-14, by its own terms, the Compact Trust Fund Agreement needs to be updated before the end of FY 2023. The FSM has presented a proposal to the United States for an updated agreement.

4. The FSM notes that the GAO draft states in several locations, including on pages 4, 25, 26, and 31, that the Federal Programs and Services Agreement (FPSA) between the United States and the FSM is set to expire in 2024. For example, on page 31 the GAO draft states that "These services [to the FSM] include disaster services, postal service, and weather service, which will end in June 2024, and judicial training, which will end after September

#### Page 8

2023." However, the U.S.-FSM exchange of diplomatic notes dated June 25, 2004, that brought the Amended Compact and its subsidiary agreements into force states: "The twenty year period for the Federal Programs and Services Agreement (Article XIV (3)) shall be deemed to end on September 30, 2023." The FSM therefore recommends that the GAO report adjust its references to the U.S.-FSM FPSA to reflect that the parties agreed that FPSA will expire on September 30, 2023.

The Government of the FSM appreciates this opportunity to comment on the draft GAO Report. Please do not hesitate to let us know if you have any questions or if we can be of further assistance.

Sincerely,  
Secretary of Finance & Administration

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

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## GAO Comments

1. We have added information in a footnote regarding the seventh sector.
2. In this report, we provide a description of the compact trust fund structure but do not take a position on whether the distribution policy should be changed. We have previously recommended the development of a distribution policy that takes into account potential strategies that could address compact trust fund risks (see [GAO-18-415](#)).
3. We have updated the report with new dates, based on information provided.

## Appendix XII: Comments from the Government of the Republic of the Marshall Islands



EMBASSY OF THE REPUBLIC OF THE MARSHALL ISLANDS  
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December 23, 2021

**Republic of the Marshall Islands Comments on the  
Draft Report- Compacts of Free Association Implications of Planned Ending of  
Some U.S. Economic Assistance (GAO-22-104436)**

The Government of the Republic of the Marshall Islands (RMI) welcomes the Government Accountability Office (GAO) Report entitled "Compacts of Free Association Implications of Planned Ending of Some U.S. Economic Assistance" as the RMI and U.S. Governments undertake negotiations to extend their free association.

The GAO Report provides valuable, professional, and largely objective information in its reports that will assist decision makers as the negotiation process moves forward

The following RMI comments are made with the foregoing in mind and to provide further context to several points noted in the body of the GAO Report.

**Compact Trust Fund Issues**

The RMI welcomes the reviews and analysis of the GAO, Graduate School USA, and Asian Development Bank of the Joint RMI-US "Trust Fund for the People of the Republic of the Marshall Islands" including their analysis of future distributions, trust fund modelling, and possible zero distribution years. The RMI also believes that these reviews and analyses should continue on a regular basis to fully inform the Trust Fund Committee (TFC) of the Fund's viability and status with objective and professional reporting.

RMI initiatives - Unfortunately, the U.S. Majority of the TFC has rejected further outside analyses and reviews that are not solicited and paid by the Committee, and controlled by the U.S. Majority. Instead, without the consent of the RMI members, they are relying on the Fund's Investment Advisor to perform these tasks, permitting only external reviews that are contracted by the Committee. The RMI members on the TFC proposed a resolution calling for: GAO, Graduate School USA, and the ADB to continue their reviews and analyses of the Fund; to publish links to those reviews on the Fund's website; and to provide a downloadable copy of the Compact Trust Fund Agreement in an effort for greater transparency and accountability to the

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See GAO comment 1.

people of the Marshall Islands. The U.S. Majority voted down the RMI member sponsored resolution in the Committee's meeting of September, 2021.

Similarly, the U.S. Majority voted down an RMI member sponsored resolution that would have assured that voting procedures of the Committee were done in compliance with applicable law, the Trust Fund Agreement and the corporate by-laws of the Trust Fund.

"Maximum disbursements" Although clarified at one point in the Report in a footnote, the term "maximum" to describe Trust Fund disbursements is used over 30 times in the report which could be confusing to readers. The RMI disagrees with the reference to the word "maximum" in the way that it is being used in the draft Statement of Fact regarding distributions. Maximum is not used anywhere in the Trust Fund Agreement, nor is "maximum allowed disbursement" a defined term as indicated in footnote 14 on page 6. RMI "Special Needs" may clearly be added to what GAO is referring to as maximum disbursements or distributions as provided in Article 16 of the Trust Fund Agreement. The objective and defined way (within the Agreement) to express what GAO intends is "Annual Grant Assistance in FY 2023, adjusted for inflation." We recommend this language in lieu of the misleading "maximum" characterization.

See GAO comment 2.

On the Monte Carlo modelling analysis reporting in the Statement of Facts --GAO's analysis is helpful in highlighting the problems with the Fund. However, showing only the average projected Fund balance hides the risk that the Fund may not be able to provide sustainable distributions of the Annual Grant Assistance amount. The average is vulnerable to the positive skew amongst simulations. The positive skew arises from the fact that the Fund will either grow infinitely or approach depletion, given the fixed dollar target distribution. The likelihood of maintaining the FY23 real value estimates the relative likelihood of growing vs. approaching depletion. That likelihood is therefore a much better measure of whether the Fund can fulfil its purpose.

See GAO comment 3.

Discussing distribution policy- Despite the requirements of the TFA, distribution policy cannot be discussed in the Committee on an informed basis until after the negotiations on extending free association assistance. Distribution policy is now intertwined with other bilateral issues, and needs to be addressed in government-to-government Compact negotiations, including structure and governance. Discussion in the Trust Fund Committee would, therefore, be counterproductive, at a minimum disrupting the negotiations and, at worst, dictating to those fundamental talks. Additionally, because it is controlled by U.S. representatives, the Trust Fund Committee is not the right forum to reach bilateral agreement on distributions.

Trust Fund insufficiency - GAO's analysis largely agrees with RMI's - the Trust Fund cannot guarantee sustainable, stable distributions. If poor-enough investment returns occur, the Trust Fund will be insufficient to fulfil RMI -- or U.S. -- interests. There is currently no 'failsafe,' or plan for this eventuality. The Trust Fund needs more time to grow before starting making distributions.

Attracting other Trust Fund Subsequent contributors -- After initial success with Taiwan, the Fund has struggled with attracting additional donors although the Trust Fund Agreement mandates that it does so (Article 11, Section 3). According to a senior U.S. official aware of the effort but not involved in the operation of the Trust Fund, this is related to the Fund's governance

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## Appendix XII: Comments from the Government of the Republic of the Marshall Islands

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structure, specifically U.S. majority voting rights. Trust Fund Committee reform is crucial to convince donors that they would be contributing to the RMI's real future.

The Fund is not Ready for Distributions as currently planned - The RMI does not believe that the Fund is ready to make distributions as scheduled starting in FY 2024, and doing so would be fiscally irresponsible under the current situation. The Trust Fund Agreement also must be amended before any distributions take place in order for the RMI to have confidence in its ability to provide robust and sustainable distributions in the future.

### JEMFAC Issues

The current degree of oversight should be reviewed in order to come to agreement on redesign of the process moving forward. The RMI believes it is best to focus on developing and implementing programs on the ground rather than applying significant resources to multiple layers of reporting.

The SEG and other Compact as amended agreements were designed to reduce the burden with regard to federal grant rules that do not necessarily apply to Freely Associated States. A review of 'Special Conditions' and how these are applied to Compact grants should also be conducted reviewed.

Accountability has been maintained. The RMI continues to build on improving education and health outcomes, however the process, at times, provides roadblocks and barriers that are not always prudent. RMI believes that accountability can be maintained with better results by modifying the current JEMFAC process so that the focus is on outcomes and good management, but not necessarily multiple layers of oversight.

Some JEMFAC actions which have been contrary to the plans and programs of the RMI have proven counterproductive and even harmful. In 2010, JEMFAC passed a resolution that prevented the RMI from using any Compact grant resources including SEG funds to support nutritional school lunch programs. Subsequent reports by the UNICEF and World Bank regarding malnutrition and stunted growth in Marshallese school age children demonstrate that the U.S. majority of JEMFAC was misguided and that JEMFAC actions likely hindered Marshallese education outcomes.

### Unfulfilled promises

Supplemental Education Grant - The Amended Compact implementing legislation included \$6.1m per year, adjusted for two-thirds inflation, to be provided as a Supplemental Education Grant (SEG), in lieu of discontinued education programs. However, unlike other Compact payments which are paid by mandatory appropriations, SEG uses discretionary appropriations. As a result, since 2006, the amount awarded has always been less than agreed. RMI estimates the cumulative difference between the amounts promised and amounts received to be \$34.4 million, adjusted for inflation to 30 September 2021. The SEG underscores the inadequacy of discretionary appropriations for Compact payments.

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Tax and Trade - the original Compact included a number of tax and trade incentives that were nullified in 1986 by the US, who promised \$20 million if RMI could prove actual investment losses. RMI proved the losses a decade ago but the U.S. Executive branch never asked the U.S. Congress to appropriate the \$20 million. It is only in the last couple of years, after concerted lobbying efforts, that the \$20 million is gradually being paid in annual \$5 million installments.

**RMI Auditor General Comments**

**Comments on RMI's Financial Accountability and Compliance with U.S Federal Requirements (Pages 66 – 71)**

We acknowledge the appropriateness of GAO's observation of RMI's performance on financial accountability and compliance with various federal requirements based on the five years that it reviewed (FY2015 thru FY2019). GAO highlighted that the RMI Single Audits during those years demonstrated improvement in financial accountability over use of U.S. funds but also showed a shortcoming in fully complying with the requirements of federal programs.

There has been a significant improvement in RMI's audit results since the beginning of the Amended Compact. In FYs 2003-2006, RMI's financial statements were given a "qualified" opinion, whereas all audits from 2007 onwards were "unqualified". To further illustrate, in those initial years, questioned costs (QCs) were on average \$11.0 million, compared to an average of \$2.9 million in FYs 2015-2019.

RMI's Audit Office has been strengthened to effectively carry out its audit and oversight role over all public funds. In addition to conducting performance audits of various governmental entities, programs and functions, GRMI has also invested significantly in the Audit Office's fraud investigation arm. This is to ensure the Audit Office is able to effectively carry out in-depth investigations into all known allegations of fraud, waste and abuse involving public funds, including US federal funds. To date, the Audit Office has two certified fraud investigators (CFEs) accredited by the Association of Certified Fraud Examiners or ACFE, world's largest anti-fraud organization. These kinds of investments in the Audit Office, a key accountability institution in the GRMI, are a testament to GRMI's commitment to improve accountability over use of public funds and to discourage unethical practices in government. The RMI National Strategic Plan (NSP) was approved in June 2020. The NSP is designed to enable RMI Government leaders to articulate the direction of priorities over the coming decade, and outline the chronological pathway for implementation of national priorities. As part of the Good Governance Pillar of the NSP, Goals and related Policy Objectives are defined in the areas of Public Financial Management and Public Administration. Furthermore, following its ratification of the UN Anti-Corruption Convention in 2011, the RMI endorsed with other Pacific Island Leaders the Teieniwa Vision in February 2021, a regional commitment to achieve Pacific Unity against corruption.

As a final further point of clarification, we believe that the presentation of questioned costs (QCs) in Table 8 (page 67) as cumulative is a little misleading unless one reads the footnote as it may appear to the reader that these are annual QCs given that everything else relates to annual information. We prepared the table below to separate the current year (CY) QCs from the cumulative QCs for better illustration.

See GAO comment 4.



**Appendix XII: Comments from the Government  
of the Republic of the Marshall Islands**

QCs Summary (FY2015 thru FY2019)

	2015	2016	2017	2018	2019
Cumulative beginning balance	\$2,695,612	\$3,520,208	\$2,509,983	\$2,159,993	\$2,518,629
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Cumulative ending balance	\$3,520,208	\$2,509,983	\$2,159,993	\$2,518,629	\$3,702,459

All of the other information presented in Table 8 is correct.

**Nuclear Issues**

The U.S. detonated a total of 67 thermonuclear atmospheric tests on Enewetak and Bikini Atolls in the Marshall Islands between 1946 and 1958, representing nearly 60 percent of all atmospheric tests ever conducted by the U.S. This was equivalent to the detonation of 1.7 Hiroshima bombs every day for 12 years. In terms of radioactive iodine alone, 6.3 billion curies of iodine-131 was released to the atmosphere because of the nuclear testing in the RMI—an amount 42 times greater than the 150 million curies released by the atmospheric testing in Nevada, 150 times greater than the estimated 40 million curies released as a result of the Chernobyl nuclear accident, and 8,500 times greater than the 739,000 curies released from Atomic Energy Commission operations at Hanford, Washington.

Notwithstanding the Section 177 Agreement, the nuclear testing program continues to be a major issue in the RMI's relationship of free association with the United States, and must be addressed in the current negotiations. New and unknown information at the time the Section 177 Agreement was negotiated continues to be discovered or uncovered including high cancer rates among the Marshallese people; the US dumping its nuclear waste from the Nevada tests in the Enewetak lagoon; in addition to nuclear waste, both chemical and biological waste have been dumped in Enewetak; concerning the storage facility that the U.S. built on Runit Island, the rising sea is causing radioactive waste to leak into the lagoon and the Pacific because cost cutting built the concrete dome over a bomb crater with a sand base.

The U.S. Executive has refused to even discuss these and other issues, although the Section 177 Agreement specifically provides for such consultations. The State Department makes vague references to a litigation risk even though it has been resolved in the courts that the 177 Agreement provided a “full and final settlement” of all claims that could be made judicially. If there has been a full and final settlement of claims according to the courts, how can there be a litigation risk?

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**Appendix XII: Comments from the Government  
of the Republic of the Marshall Islands**

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There are also provisions in the U.S. Compact Act which allows for continuing authorizations to address the consequences of nuclear testing which remain available, but not subject to discussion with the U.S. Executive branch. The State Department has even suggested that they cannot and will not do anything to discuss the authorization in the U.S. laws that approved the Compact and the Amended Compact for additional appropriations on *ex gratia* basis: another breach of the essence of the association between our governments.

**Conclusion-** The RMI wishes to thank the GAO for its excellent and professional report. We are always ready to work closely with the GAO in its efforts to bring timely information to topics of RMI-US concern in our relationship of free association.

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## Agency Comment Letter

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### Text of Appendix XII: Comments from the Government of the Republic of the Marshall Islands

#### Page 1

December 23, 2021

Republic of the Marshall Islands Comments on the Draft Report- Compacts of Free Association Implications of Planned Ending of Some U.S. Economic Assistance (GAO-22-104436)

The Government of the Republic of the Marshall Islands (RMI) welcomes the Government Accountability Office (GAO) Report entitled “Compacts of Free Association Implications of Planned Ending of Some U.S. Economic Assistance” as the RMI and U.S. Governments undertake negotiations to extend their free association.

The GAO Report provides valuable, professional, and largely objective information in its reports that will assist decision makers as the negotiation process moves forward

The following RMI comments are made with the foregoing in mind and to provide further context to several points noted in the body of the GAO Report.

#### Compact Trust Fund Issues

The RMI welcomes the reviews and analysis of the GAO, Graduate School USA, and Asian Development Bank of the Joint RMI-US “Trust Fund for the People of the Republic of the Marshall Islands” including their analysis of future distributions, trust fund modelling, and possible zero distribution years. The RMI also believes that these reviews and analyses should continue on a regular basis to fully inform the Trust Fund Committee (TFC) of the Fund’s viability and status with objective and professional reporting.

RMI initiatives - Unfortunately, the U.S. Majority of the TFC has rejected further outside analyses and reviews that are not solicited and paid by the Committee, and controlled by the U.S. Majority. Instead, without the consent of the RMI members, they are relying on the Fund’s Investment Advisor to perform these tasks, permitting only external reviews that are contracted by the Committee. The RMI members on the TFC proposed a resolution calling for: GAO, Graduate School USA, and the ADB

to continue their reviews and analyses of the Fund; to publish links to those reviews on the Fund's website; and to provide a downloadable copy of the Compact Trust Fund Agreement in an effort for greater transparency and accountability to the

## Page 2

people of the Marshall Islands. The U.S. Majority voted down the RMI member sponsored resolution in the Committee's meeting of September, 2021.

Similarly, the U.S. Majority voted down an RMI member sponsored resolution that would have assured that voting procedures of the Committee were done in compliance with applicable law, the Trust Fund Agreement and the corporate by-laws of the Trust Fund.

"Maximum disbursements" Although clarified at one point in the Report in a footnote, the term "maximum" to describe Trust Fund disbursements is used over 30 times in the report which could be confusing to readers. The RMI disagrees with the reference to the word "maximum" in the way that it is being used in the draft Statement of Fact regarding distributions. Maximum is not used anywhere in the Trust Fund Agreement, nor is "maximum allowed disbursement" a defined term as indicated in footnote 14 on page 6. RMI "Special Needs" may clearly be added to what GAO is referring to as maximum disbursements or distributions as provided in Article 16 of the Trust Fund Agreement. The objective and defined way (within the Agreement) to express what GAO intends is "Annual Grant Assistance in FY 2023, adjusted for inflation." We recommend this language in lieu of the misleading "maximum" characterization.

On the Monte Carlo modelling analysis reporting in the Statement of Facts --GAO's analysis is helpful in highlighting the problems with the Fund. However, showing only the average projected Fund balance hides the risk that the Fund may not be able to provide sustainable distributions of the Annual Grant Assistance amount. The average is vulnerable to the positive skew amongst simulations. The positive skew arises from the fact that the Fund will either grow infinitely or approach depletion, given the fixed dollar target distribution. The likelihood of maintaining the FY23 real value estimates the relative likelihood of growing vs. approaching depletion. That likelihood is therefore a much better measure of whether the Fund can fulfil its purpose.

Discussing distribution policy- Despite the requirements of the TFA, distribution policy cannot be discussed in the Committee on an informed basis until after the negotiations on extending free association assistance. Distribution policy is now intertwined with other bilateral issues, and needs to be addressed in government-to-government Compact negotiations, including structure and governance. Discussion

in the Trust Fund Committee would, therefore, be counterproductive, at a minimum disrupting the negotiations and, at worst, dictating to those fundamental talks. Additionally, because it is controlled by U.S. representatives, the Trust Fund Committee is not the right forum to reach bilateral agreement on distributions.

Trust Fund insufficiency - GAO's analysis largely agrees with RMI's - the Trust Fund cannot guarantee sustainable, stable distributions. If poor-enough investment returns occur, the Trust Fund will be insufficient to fulfil RMI -- or U.S. -- interests. There is currently no 'failsafe,' or plan for this eventuality. The Trust Fund needs more time to grow before starting making distributions.

Attracting other Trust Fund Subsequent contributors – After initial success with Taiwan, the Fund has struggled with attracting additional donors although the Trust Fund Agreement mandates that it does so (Article 11, Section 3). According to a senior U.S. official aware of the effort but not involved in the operation of the Trust Fund, this is related to the Fund's governance

### Page 3

structure, specifically U.S. majority voting rights. Trust Fund Committee reform is crucial to convince donors that they would be contributing to the RMI's real future.

The Fund is not Ready for Distributions as currently planned - The RMI does not believe that the Fund is ready to make distributions as scheduled starting in FY 2024, and doing so would be fiscally irresponsible under the current situation. The Trust Fund Agreement also must be amended before any distributions take place in order for the RMI to have confidence in its ability to provide robust and sustainable distributions in the future.

### JEMFAC Issues

The current degree of oversight should be reviewed in order to come to agreement on redesign of the process moving forward. The RMI believes it is best to focus on developing and implementing programs on the ground rather than applying significant resources to multiple layers of reporting.

The SEG and other Compact as amended agreements were designed to reduce the burden with regard to federal grant rules that do not necessarily apply to Freely Associated States. A review of "Special Conditions" and how these are applied to Compact grants should also be conducted reviewed.

Accountability has been maintained. The RMI continues to build on improving education and health outcomes, however the process, at times, provides roadblocks and barriers that are not always prudent. RMI believes that accountability can be maintained with better results by modifying the current JEMFAC process so that the focus is on outcomes and good management, but not necessarily multiple layers of oversight.

Some JEMFAC actions which have been contrary to the plans and programs of the RMI have proven counterproductive and even harmful. In 2010, JEMFAC passed a resolution that prevented the RMI from using any Compact grant resources including SEG funds to support nutritional school lunch programs. Subsequent reports by the UNICEF and World Bank regarding malnutrition and stunted growth in Marshallese school age children demonstrate that the U.S. majority of JEMFAC was misguided and that JEMFAC actions likely hindered Marshallese education outcomes.

#### Unfulfilled promises

Supplemental Education Grant - The Amended Compact implementing legislation included

\$6.1m per year, adjusted for two-thirds inflation, to be provided as a Supplemental Education Grant (SEG), in lieu of discontinued education programs. However, unlike other Compact payments which are paid by mandatory appropriations, SEG uses discretionary appropriations. As a result, since 2006, the amount awarded has always been less than agreed. RMI estimates the cumulative difference between the amounts promised and amounts received to be \$34.4 million, adjusted for inflation to 30 September 2021. The SEG underscores the inadequacy of discretionary appropriations for Compact payments.

#### Page 4

Tax and Trade - the original Compact included a number of tax and trade incentives that were nullified in 1986 by the US, who promised \$20 million if RMI could prove actual investment losses. RMI proved the losses a decade ago but the U.S. Executive branch never asked the

U.S. Congress to appropriate the \$20 million. It is only in the last couple of years, after concerted lobbying efforts, that the \$20 million is gradually being paid in annual \$5 million installments.

## RMI Auditor General Comments

### Comments on RMI's Financial Accountability and Compliance with U.S Federal Requirements (Pages 66 – 71)

We acknowledge the appropriateness of GAO's observation of RMI's performance on financial accountability and compliance with various federal requirements based on the five years that it reviewed (FY2015 thru FY2019). GAO highlighted that the RMI Single Audits during those years demonstrated improvement in financial accountability over use of U.S. funds but also showed a shortcoming in fully complying with the requirements of federal programs.

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**Conclusion-** The RMI wishes to thank the GAO for its excellent and professional report. We are always ready to work closely with the GAO in its efforts to bring timely information to topics of RMI-US concern in our relationship of free association.

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

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## GAO Comments

1. The Republic of the Marshall Islands (RMI) states that we should not use the term “maximum allowable disbursement” in the report because disbursements for special needs, as approved by the trust fund committees, are allowed in addition to what we consider the maximum

allowable disbursement. Our use of this terminology is consistent with our past reporting. While our projections assume that the trust fund committee will choose to disburse what we define as the maximum allowable amount each year if funds are available, we understand that the committee has the option to distribute a lower amount. We also understand that, in addition to approving the maximum allowable disbursement, the RMI compact trust fund committee may approve additional amounts for special needs, which we did not include in our projections because the amounts that may be disbursed are unknown. If disbursements for special needs occur, resulting in disbursements greater than the maximum allowable disbursement, the compact trust fund may face increased disbursement risks. We provide context throughout the report to clarify that disbursement can include additional amounts for special needs (e.g., see the discussion of disbursement as a percentage of the maximum allowable disbursement). In addition, we made several revisions to note that we defined “maximum allowable disbursement” and that the trust fund agreements do not use this specific term.

2. RMI states that our presentation of the average compact trust fund balance hides the risk that the compact trust fund may not be able to provide sustainable disbursements. Our report clearly indicates the existence of risks to the RMI compact trust fund disbursements. Specifically, we find that over time, the disbursement as a percentage of the maximum allowable disbursement is projected to decrease; the average shortfall (i.e., the maximum disbursement minus the average disbursement) is projected to increase; and the likelihood of being unable to disburse any funds in 1 or more years is projected to increase. We also note throughout the report that “the averages shown are affected by extreme values from the simulated cases” (e.g., see notes to fig. 9 and table 30). We also present the distribution of the compact trust fund balance across our simulation results (the 5th, 25th, 75th, and 95th percentiles along with the 50th percentile or median) in table 31. Presenting the average compact trust fund balance along with other measurements in the figures we include in our report captures both optimistic and pessimistic scenarios within expected return distributions. By contrast, the likelihood of the compact trust fund’s maintaining its fiscal year 2023 value may overlook optimistic cases in the simulation modeling.
3. RMI states that distribution policy cannot be discussed while compact negotiations are ongoing. However, the current trust fund agreement calls for the establishment of a distribution policy and states that the policy can be revised at any time to take into account any new circumstances, including results of current negotiations.

4. RMI notes that the presentation of questioned costs as cumulative in our report may be misleading as these may be interpreted as annual questioned costs. As RMI observes, table notes in our draft report made clear that we report questioned costs outstanding as of the end of the fiscal year represented. However, to make this point more visible in our data presentations for RMI, the Federated States of Micronesia, and the Republic of Palau, we have revised the line item description for the single audit component in the summary table to “cumulative questioned costs.”

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## Appendix XIII: GAO Contact and Staff Acknowledgments

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### GAO Contact

Latesha Love at (202) 512-4409 or [LoveL@gao.gov](mailto:LoveL@gao.gov)

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### Staff Acknowledgments

In addition to the contact named above, Joseph Carney (Assistant Director), Mark Dowling, Emil Friberg (Assistant Director), Noah Gerber, David Gootnick (Director), Jeff Isaacs, Bill Johnson, Chris Keblitis, Reid Lowe, Andrea Riba Miller (Analyst in Charge), Moon Parks, Nisha Rai, and Marc Rockmore made key contributions to this report. Ming Chen, Risto Laboski, and Terry Richardson provided technical assistance.

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