



**U.S. Department of the Interior
Office of Inspector General**

Audit Report

Compliance with the Memorandum of Understanding Between the Governor of the Virgin Islands and the Secretary of the Interior



Report No. 2003-I-0003

January 2003

EXECUTIVE SUMMARY

**Compliance with the Memorandum of Understanding Between
the Governor of the U.S. Virgin Islands
and the Secretary of the Interior
Report No. 2003-I-0003
January 2003**

BACKGROUND

In October 1999, the Governor of the U.S. Virgin Islands and the Secretary of the Interior entered into a Memorandum of Understanding (MOU) whereby the Government of the Virgin Islands agreed to carry out a financial recovery program to eliminate its long-term debt and achieve a balanced budget. The Government of the Virgin Islands also agreed to standards for financial performance and fiscal accountability as a condition for new and additional Federal financial and technical assistance. In turn, the Department of the Interior agreed to assist the Government of the Virgin Islands by considering a legislative proposal that would facilitate those efforts, including authorization of appropriations for certain capital improvement projects, and by carrying out a series of initiatives to enhance the natural resources of the Virgin Islands.

OBJECTIVE

The objective of our audit was to determine whether the Government of the Virgin Islands and the Department of the Interior were in compliance with the requirements of the MOU.

RESULTS IN BRIEF

We found that the Government of the Virgin Islands substantially achieved 5 and partially achieved 4 of the 13 financial performance and reporting standards of the MOU that related to the Government. In doing so, the Government has improved its financial condition but an assessment of the success of the Government's efforts to balance its budget for fiscal year 2003 and beyond will not be known until the audited financial statements for fiscal year 2003 are completed and published. In addition, the Department of the Interior substantially achieved 2 and partially achieved 1 of the 5 financial and environmental performance standards that related to the Department. The Department has not issued a certification that the Government has substantially complied with the MOU so that capital improvement funding could be provided to the Government.

RECOMMENDATIONS

We made six recommendations to the Governor of the Virgin Islands and five recommendations to the Department of the Interior's Office of Insular Affairs to facilitate achievement of the MOU requirements.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL EVALUATION

In response to the draft report, the Governor of the Virgin Islands provided additional information on actions taken by the Government to meet the requirements of the MOU. The Governor concluded in his response that the Government was in substantial compliance with the MOU. The Governor also stated that he believes the Department of the Interior was not in compliance with its commitment to provide funding for certain capital improvement projects. Because the Governor's response did not specifically address Recommendations 1 to 6, those recommendations are considered unresolved.

The Deputy Assistant Secretary for Insular Affairs and the Superintendent of the National Park on St. Croix both submitted responses that provided additional information on the current status of efforts to complete actions related to the performance requirements applicable to the Department of the Interior. However, the response from the Deputy Assistant Secretary did not provide a specific action plan, including target dates, for implementing Recommendations 7 to 10 and did not address Recommendation 11. Therefore, those recommendations are also considered unresolved.



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Caribbean Regional Office
Federal Building, Room 207
St. Thomas, Virgin Islands 00802

January 6, 2003

AUDIT REPORT

Honorable Charles W. Turnbull
Governor of the Virgin Islands
Government of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, VI 00802

Mr. David Cohen
Deputy Assistant Secretary
for Insular Affairs
U.S. Department of the Interior
1849 C Street, NW
Washington, DC 20240

Subject: Compliance with the Memorandum of Understanding Between the Governor of the U.S. Virgin Islands and the Secretary of the Interior (No. 2003-I-0003)

Dear Governor Turnbull and Deputy Assistant Secretary Cohen:

This report presents the results of our audit of the performance standards set forth in the October 1999 Memorandum of Understanding (MOU) between the Governor of the U.S. Virgin Islands and the Secretary of the Interior. The objective of the review was to determine whether the Government of the Virgin Islands and the Department of the Interior were in compliance with the requirements of the MOU.

BACKGROUND

In October 1999, the Governor of the U.S. Virgin Islands and the Secretary of the Interior entered into an MOU whereby the Government of the Virgin Islands agreed to carry out a financial recovery program to eliminate its long-term debt and achieve a balanced budget. The Government of the Virgin Islands also agreed to standards for financial performance and fiscal accountability as a condition for new and additional Federal financial and technical assistance. The MOU also established a process to facilitate the long-term economic recovery of the Virgin Islands through the preservation and enhancement of the natural resources of the Virgin Islands. The ultimate goal of the MOU was to keep the Government of the Virgin Islands committed to maintaining a balanced budget beyond fiscal year 2003 and reducing the deficit. In turn, the Department of the Interior agreed to assist the Government of the Virgin Islands by considering a legislative proposal that would facilitate those efforts, including authorization of appropriations for certain capital improvement projects. The MOU contained 12 performance standards, in addition to reporting requirements, by which the Department of the Interior was to measure performance on the part of the Government of the Virgin Islands and initiatives on the part of the Department of the Interior to enhance the Virgin Islands natural resources.

SCOPE OF AUDIT

The scope of the audit included a review of steps taken by the Government of the Virgin Islands in fiscal years 2000 and 2001 to achieve a balanced budget and reduce the Government's outstanding debt, which was approaching \$1 billion. The review was conducted at the Office of the Governor, the Virgin Islands Office of Management and Budget, and the Department of Finance. We also reviewed records provided by and held discussions with officials of the Department of the Interior's Office of Insular Affairs.

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. The "Standards" require that we obtain sufficient, competent, and relevant evidence to afford a reasonable basis for our findings and conclusions.

Our audit included a review of steps taken to achieve each performance standard. The status of actions to achieve each performance standard are discussed in the Results of Audit section.

RESULTS OF AUDIT

We found that the Government of the Virgin Islands substantially achieved 5 and partially achieved 4 of the 13 financial performance and reporting standards of the MOU that related to the Government. Among the items not substantially achieved, (1) the 50-50 sharing of costs related to the retirement and health insurance benefits of Government employees was not approved by the Legislature; (2) specific initiatives had not been pursued to improve the collective bargaining process; (3) comprehensive annual financial reports had not been produced within 120 days of the end of each fiscal year; and (4) at least 10 required progress reports were not submitted to the Department of the Interior.

Table 1. Government of the Virgin Islands Performance Requirements

Performance Requirement	Substantially Achieved	Partially Achieved	Not Achieved	Pending
Financial 1. Prepare a 5-year financial recovery plan.	√			
Financial 2. Reduce overtime by 50%, reduce payroll costs by 5%, and impose a hiring freeze.	√			
Financial 3. Reduce overall expenditures by 10%, implement 50-50 cost sharing of health insurance premiums and retirement contributions, eliminate 5 paid holidays.		√		
Financial 4. Limit FY-2000 budget to \$432.1 million and balance revenues and expenditures.	√			
Financial 5. Achieve a balanced budget by FY-2003 through cost reductions and revenue enhancements.		√		

Performance Requirement	Substantially Achieved	Partially Achieved	Not Achieved	Pending
Financial 6. Commit to maintaining balanced budgets after FY-2003, with any surpluses applied to liquidating outstanding debt.				√
Financial 7. Pursue collective bargaining reforms to assist the fiscal solvency of the Government.			√	
Financial 8. Contract for and complete a single audit for FY-1998.	√			
Financial 9. Produce comprehensive annual financial reports within 120 days of the end of each fiscal year.			√	
Financial 10. Complete future single audits within 9 months of the end of each fiscal year.				√
Financial 11. Implement a financial management training plan.	√			
Financial 12. Exert all efforts to reduce outstanding debt.		√		
Monitoring. Submit monthly (later changed to quarterly) progress reports.		√		

In addition, we found that although the Government achieved reductions in General Fund total expenditures and payroll costs from fiscal year 1999 to fiscal year 2000, expenditures began to increase in fiscal year 2001, as compared with the same period of fiscal year 2000, and were budgeted to increase even more in fiscal year 2002.

We also found that the Department of the Interior substantially achieved 2 and partially achieved 1 of the 5 financial and environmental performance standards that related to the Department. Most importantly, (1) the Secretary of the Interior had not issued a certification that the Government of the Virgin Islands had "substantially complied" with the MOU requirements so that capital improvement funding could be provided to the Virgin Islands and (2) the Department had not obtained funding for the V.I. Conservation Fund.

Table 2. Department of the Interior Performance Requirements

Performance Requirement	Substantially Achieved	Partially Achieved	Not Achieved	Pending
Financial Assistance. Upon certification that the Government achieved "substantial compliance," provide funds for capital improvements, technical assistance, and other assistance.				√
Environmental 1. Work to obtain funding for the V.I. Conservation Fund.			√	

Performance Requirement	Substantially Achieved	Partially Achieved	Not Achieved	Pending
Environmental 2. Work with the V.I. to draft an MOU to implement joint planning and management of the Salt River Marine and Ecological Preserve.		√		
Environmental 3. Work with the V.I. to create a consortium to promote understanding of the marine environment.	√			
Environmental 4. Work with the V.I. to provide learning opportunities through a Park Mentorship Program.	√			

Government of the Virgin Islands Compliance

Performance Standard 1: "The GVI [Government of the Virgin Islands] is preparing a five-year financial recovery plan, a copy of which will be provided to the Department within 90 days of this agreement."

Status - Substantially Achieved: The U.S.V.I. Economic Recovery Task Force prepared a Five Year Operating and Strategic Financial Plan that was submitted to the Department of the Interior on April 29, 2000, which was 3 months late.

Observation of Subsequent Events: Although the Government substantially achieved the standard by preparing a financial recovery plan, many of the plan's approximately 200 recommendations had not been implemented or specifically addressed. In particular, initiatives geared toward improving Government productivity and achieving a cooperative public-private partnership to expand the Virgin Islands economy had not been achieved. The Government's emphasis has been on paying past-due operating expenditures (primarily amounts owed to vendors and tax refunds owed to taxpayers) and reducing the level of Government employment in order to reduce payroll costs and total General Fund expenditures.

Performance Standard 2: "As part of this plan, the GVI develops a fiscal year 2000 budget that mandates substantial reductions in departmental budgets and overall General Fund expenditures, including a 50 percent reduction in overtime expenditures from fiscal year 1999 levels; a hiring freeze with limited and highly scrutinized exceptions; and a 5 percent reduction in payroll costs from fiscal year 1999 baseline costs."

Status - Substantially Achieved: On June 15, 1999 the Governor issued Memorandum No. 021-99 to all department and agency heads directing a 50 percent reduction in baseline overtime costs as of May 6, 1999. We found that overtime expenditures decreased for fiscal years 1999, 2000, and 2001 (through July 31, 2001). The memorandum also ordered the implementation of a strict hiring freeze. Further, an October 1999 memorandum from the Virgin Islands Office of Management and Budget suspended a review of funding for all Notices of Personnel Action. Act No. 6289 established an attrition program with selective refilling of vacant positions in the Executive Branch for the period of August 1999 to October 2002.

The June 1999 memorandum also stipulated a 5 percent reduction in baseline payroll costs for fiscal year 2000. Payroll costs were \$309.3 million for fiscal year 2000, as compared to \$343.2 million for fiscal year 1999, representing a reduction of \$33.9 million (9.88 percent). However, we found that although total General Fund appropriations decreased by \$12.7 million (3.11 percent) from fiscal year 1999 to fiscal year 2000, appropriations for miscellaneous expenses increased by \$3.7 million (0.92 percent).

Observation of Subsequent Events: Although the MOU did not specifically address the level of payroll costs beyond fiscal year 2000, we found that payroll costs were \$168.5 million for fiscal year 2001 (through April 30, 2001), as compared to \$151.8 million for the same period of fiscal year 2000, representing an increase of \$16.7 million (11.03 percent). The fiscal year 2001 payroll cost increase resulted primarily from increases in teachers' salaries and additional payroll expenses for firefighters and policemen. Additionally, although the MOU did not specifically address the level of General Fund appropriations beyond fiscal year 2000, we found that total General Fund appropriations increased by \$9.5 million (2.41 percent) from fiscal year 2000 to fiscal year 2001, and appropriations for miscellaneous expenses increased by \$29.7 million (7.5 percent).

On September 25, 2001, the Legislature of the Virgin Islands passed fiscal year 2002 General Fund appropriation acts totaling \$551 million, or an increase of about \$134 million (32.24 percent) over fiscal year 2001 appropriations. The increase was to be funded primarily from an approximately \$100 million revenue windfall that the Government enjoyed in late fiscal year 2001. The Virgin Islands Director of Management and Budget told us that the revenue windfall resulted primarily from one-time income tax payments made by principals of new businesses participating in the Government's Industrial Development Program.

Performance Standard 3: "In addition, the fiscal year 2000 budget mandates an additional 10 percent reduction in departments and agencies' overall expenditures, 50-50 cost sharing of retirement and health insurance premiums, and elimination of 5 paid holidays."

Status - Partially Achieved: General Fund expenditures decreased by \$55 million (11.42 percent), from \$483 million in fiscal year 1999 to \$428 million in fiscal year 2000. However, the 50-50 cost sharing of retirement contributions and health insurance premiums was not incorporated in the fiscal year 2000 budget because the proposed legislation was rejected by the Legislature. Further, although the Governor proposed the elimination of five holidays, the Legislature enacted legislation (Act No. 6333) to eliminate only three holidays, rather than the five stipulated in the performance standard. The three holidays that were eliminated are Organic Act Day, Hurricane Supplication Day, and Local Thanksgiving Day.

Observation of Subsequent Events: Although the MOU did not specifically address the level of overall General Fund expenditures beyond fiscal year 2000, we found that General Fund expenditures for fiscal year 2001 (through April 30, 2001) totaled \$252 million, as compared with total expenditures of \$159.2 million for the same period of fiscal year 2000, representing an increase of \$92.8 million (58.29 percent).

Performance Standard 4: "The GVI's FY 2000 budget mandates that current year expenditures be limited to no more than \$432.1 million and that current year revenues, including one-time revenues, match expenditures."

Status - Substantially Achieved: General Fund expenditures for fiscal year 2000 totaled \$428 million, excluding prior year's obligations funded by bond proceeds, and revenues totaled \$474 million.

Observation of Subsequent Events: General Fund expenditures for fiscal year 2001 (through April 30, 2001) totaled \$252 million and revenues totaled \$299.4 million. Revenues increased in fiscal year 2001 primarily as a result of a one-time increase in income tax collections.

Performance Standard 5: "The Governor of the Virgin Islands is committed to achieving structural balance in the General Fund budget, on a current year basis, by FY 2003 through additional cost reduction and revenue enhancement measures."

Status - Partially Achieved: The proposed expenditure reduction measures included (1) reducing payroll and fringe benefits costs, (2) implementing a 50-50 cost sharing of retirement contributions and health insurance premiums, (3) implementing a voluntary separation incentive proposal, and (4) reducing additional Executive department costs. The 50-50 cost sharing proposal was not approved by the Legislature.

The proposed revenue enhancement measures included (1) increasing the gross receipts tax rate by 1 percent, (2) increasing the collection of delinquent real property taxes, (3) increasing the Bureau of Internal Revenue's collection of other delinquent taxes, (4) establishing penalties and fees for Industrial Development Program beneficiaries, (5) establishing a Solid Waste Fund for tipping fees, (6) eliminating exemptions from the existing highway user (road) tax, and (7) implementing an annual highway user fee. Most of the measures related to the imposition of increased taxes or fees were not approved by the Legislature.

Performance Standard 6: "The Governor of the Virgin Islands is committed, absent extraordinary circumstances, to maintain balanced budgets after FY 2003, with generated surpluses being applied to the reduction of accumulated deficits and unfunded obligations."

Status - Pending: Government officials told us that the Government is working towards maintaining structural balance after fiscal year 2003 and that, if revenue surpluses are realized, they will be applied toward reducing the accumulated deficit.

Performance Standard 7: "Recurring General Fund deficits and unfunded current liabilities in recent years have, to a significant extent, been aggravated by collective bargaining agreements, whereby GVI employees enjoy greater bargaining rights than those enjoyed by Federal employees. In order to ensure fiscal solvency, the GVI will submit legislation to the Legislature of the Virgin Islands by June 30, 2000 that will conform Virgin Islands public labor relations law, including Act No. 4440, with Federal public labor relations law."

Status - Not Achieved: Because of opposition from Government employee unions, in October 1999, the Department of the Interior amended the MOU to revise this performance standard as follows:

Recognizing that salaries and benefits are a portion of overall local government expenditures, the Governor and union representatives are encouraged to pursue, through collective bargaining, reform initiatives to assist in the fiscal solvency of the Government of the Virgin Islands.

We are not aware of any affirmative actions having been taken, as of September 25, 2001, to accomplish the revised performance standard of achieving reforms to the collective bargaining structure for Government employees.

Performance Standard 8: "The Governor of the Virgin Islands will execute a contract by October 1, 1999 with an independent auditor to conduct a complete single audit for FY 1998. The FY 1998 single audit shall be completed and the report published by March 31, 2000."

Status - Substantially Achieved: In September 1999, the Department of the Interior provided the Government with a grant of \$400,000 for completion of the fiscal year 1998 single audit. The Secretary of the Interior subsequently approved a request by the Governor to extend the due date for publishing the single audit report to July 31, 2000. The single audit was conducted by a national accounting firm, and the audit report was submitted to the Governor on July 7, 2000 and to the Single Audit Clearinghouse by the July 31, 2000 revised due date.

Performance Standard 9: "The Governor of the Virgin Islands will produce comprehensive annual financial reports within 120 days after the end of each fiscal year, beginning with the report for FY 1999, as required by the Insular Areas Act of 1982."

Status - Not Achieved: Officials of the Government's public accounting firm informed the Governor that the existing Financial Management System did not generate information in sufficient detail to enable the preparation of comprehensive annual financial reports. However, general purpose financial statements were being produced in accordance with generally accepted accounting principles. The Office of Insular Affairs granted the Government an extension to December 31, 2000 for the fiscal year 1999 financial statements, which were completed by the accounting firm on May 31, 2001, or 5 months after the extended due date. The fiscal year 2000 financial statements were not completed until January 2002.

Performance Standard 10: "The Governor of the Virgin Islands will require independent auditors to perform a complete single audit and publish the report within nine months after the end of each fiscal year, beginning with the single audit report for fiscal year 1999, as required by the Single Audit Act of 1984, as amended."

Status - Pending: Upon request of the Governor, in May 2001, the Federal grantor agencies jointly agreed to extend the deadlines for publication of the Government's single audits, as follows:

<u>Fiscal Year</u>	<u>Original Due Date</u>	<u>Revised Due Date</u>
1999	June 30, 2000	June 30, 2001
2000	June 30, 2001	January 31, 2002
2001	June 30, 2002	August 31, 2002

For fiscal years after 2001, the single audit reports would be due within 9 months of the end of the fiscal year.

The Government's single audit report for fiscal year 1999 was completed by a national accounting firm and submitted to the Governor on May 31, 2001. It was submitted to the cognizant Federal audit agency on June 29, 2001, thus meeting the revised due date. The single audit report for fiscal year 2000 was submitted to the cognizant Federal audit agency on February 25, 2002. The single audit report for fiscal year 2001 is pending.

Observation of Subsequent Events: In January 1999, the Governor had requested the Office of Inspector General to grant permission to skip the single audits for fiscal years 1996 and 1997 and begin work on the fiscal year 1998 single audit. This request was approved with the understanding that the 1996 and 1997 single audits would eventually have to be performed. Based on a subsequent request from the Governor, in May 2001, the Federal grantor agencies agreed to allow the Government to perform "agreed-upon procedures" reviews, in lieu of full-scope single audits, for fiscal years 1996 and 1997. On May 7, 2002, the Governor's legal representatives submitted documentation from the Virgin Islands Commissioner of Finance indicating that a national accounting firm had been engaged to perform the "agreed-upon procedures" reviews, with target completion dates of September 30, 2002. However, the Commissioner of Finance indicated that the Government anticipated receiving Federal funding to pay the \$590,000 cost of the "agreed-upon procedures" reviews. As of May 15, 2002, this funding issue had not been resolved.

Performance Standard 11: "The Governor of the Virgin Islands, in cooperation with the Department [of the Interior], shall develop and implement a training plan to ensure that all key managers in all GVI departments receive training in the administration of Federal grants, including cost principles and documentation requirements."

Status - Substantially Achieved: During April 18 to 20, 2001, training on Federal grant management topics was provided to Government financial managers. The training also covered hiring, purchasing, financial reconciliation, drawdowns, and postings to the Financial Management System. Additional training was being planned.

Performance Standard 12: "The Governor of the Virgin Islands will exert all efforts to enact resources that will reduce the outstanding debt of the GVI."

Status - Partially Achieved: A major privatization effort -- a public/private partnership for ownership of the Virgin Islands Water and Power Authority -- was initiated, but later terminated after much public debate that resulted in disapproval by the Legislature. The Government has used

some of the fiscal year 2001 revenue windfall to bring Government employees to the salary levels called for by collective bargaining agreements. However, lump sum amounts are still due to Government employees for prior salary increases that were not paid. Government officials told us that other efforts by the Governor have included attempts to restore the tourism market, implementation of capital improvement projects, and initiatives to improve public safety. Most of these efforts, however, have yet to produce measurable results.

Performance Standards Monitoring and Financial Assistance: "The Governor of the Virgin Islands agrees to provide the Department [of the Interior] with a monthly progress report on the budget and cash flow impacts of performance standards 2 through 4 above, as well as any other actions taken by the GVI pursuant to government reorganization and the Five Year Fiscal Recovery Plan referenced in performance standard 1 above."

Status - Partially Achieved: The MOU became effective in October 1999. In September 2000, the Government requested a change in the reporting requirement from monthly to quarterly progress reports. The request was approved by the Director, Office of Insular Affairs, on November 7, 2000, with the first quarterly report being due on December 30, 2000. According to Office of Insular Affairs officials, monthly progress reports were received for April, August, and October 2000 and quarterly reports were received for the quarters ending December 2000 and March 2001. Therefore, as of September 2001, progress reports had not been submitted to the Office of Insular Affairs for a total of 9 months (November 1999 to March 2000, May to July 2000, September 2000) and for the quarter ended June 30, 2001.

Department of the Interior Compliance

Performance Standards Monitoring and Financial Assistance: "[U]pon certification by the Secretary of the Interior that the GVI has achieved substantial compliance with the targeted reductions in the recurring, or structural, General Fund deficit in FY 2000 and has substantially complied with all other performance standards contained herein, the Department [of the Interior] shall make available any funds to the GVI for capital improvements, other assistance, and mutually agreed technical assistance that may be provided by the fiscal year 2001 and future appropriations acts for the Department of the Interior and Related Agencies or by other legislation."

Status - Pending: As of October 2001, the Secretary of the Interior had not issued a certification that the Government of the Virgin Islands had "substantially complied" with the performance standards contained in the MOU. Although the fiscal year 2001 budget proposal for the Office of Insular Affairs sought \$10 million as new capital improvement funds for the Virgin Islands, the Congress did not approve such funding. The fiscal year 2002 budget proposal for the Office of Insular Affairs did not include any capital improvement or other additional funding for the Virgin Islands. In response to the draft of this report, the Deputy Assistant Secretary for Insular Affairs stated that since signing the MOU, the Department of the Interior has provided financial assistance to the Government of the Virgin Islands totaling almost \$25 million (see Appendix 2, page 2 of 4). However, based on our review of the funding provided by the Department of the Interior, we concluded that, except \$650,000 provided to help the Virgin Islands achieve compliance with the Single Audit Act, the funding either was initiated before execution of the MOU or was not for purposes contemplated by the MOU.

Enhancement of Natural Resources Standard 1: The Secretary of the Interior will "work on obtaining funding and assets for the Virgin Islands Conservation Trust."

Status - Not Achieved: An official of the Office of Insular Affairs told us that the Department of the Interior was attempting to convince the Governor to set aside "twenty-five cents on the dollar" from the rebated rum excise taxes (the Internal Revenue Matching Fund) to finance the startup of the proposed Virgin Islands Conservation Trust Fund. However, this had not been accomplished as of September 2001. In November 2001, Office of Insular Affairs officials stated that they were also working with the Fish and Wildlife Service to develop a plan to accomplish this performance standard. In response to the draft report, the Deputy Assistant Secretary stated that the Governor did not agree to the suggestion by the former Secretary of the Interior to set aside "twenty-five cents on the dollar" from the rum excise taxes because the Governor could not commit the funds.

Enhancement of Natural Resources Standard 2: The Secretary of the Interior will "work with the GVI to draft a memorandum of understanding that would implement joint planning and management of the Salt River Marine and Ecological Park."

Status - Partially Achieved: In August 2001, the National Park Service drafted two versions of a cooperative agreement with the Government of the Virgin Islands for management of the Salt River National Historic Park and Ecological Preserve. According to Office of Insular Affairs officials, the cooperative agreement has since been executed, but funding has not yet been made available to implement the agreement. In response to the draft report, the National Park Superintendent stated that the Governor had not responded to repeated requests to meet and sign the cooperative agreement for management of the Salt River National Historical Park and Ecological Preserve.

Enhancement of Natural Resources Standard 3: The Secretary of the Interior will "work with the GVI and the University of the Virgin Islands (UVI) to create a consortium to promote the understanding of the marine environment, including coral reef ecosystems, and to promote marine education and public awareness within the Caribbean region."

Status - Substantially Achieved: According to an official of the Office of Insular Affairs, an initial meeting was held on St. Croix approximately "2 1/2 years ago" (around the Spring of 1999), at which the Secretary of the Interior, other Interior officials, and Government and University of the Virgin Islands officials were present. In November 2001, Office of Insular Affairs officials provided us with a copy of the memorandum of understanding that was executed to establish the proposed environmental consortium. Participants in the consortium include the Department of the Interior, the National Oceanic and Atmospheric Administration, the University of the Virgin Islands, and three universities from the United States." In response to the draft report, the National Park Superintendent stated that the consortium was unable to secure a lease for the old West Indies Lab site on St. Croix and was working with the National Park on the possibility of establishing a marine base on Park-owned property at the Salt River site.

Enhancement of Natural Resources Standard 4: The Secretary of the Interior will "work with the GVI and the UVI to provide opportunities for UVI students to learn about the stewardship of resources by working with National Park Service experts at the Virgin Islands National Park through a Park Mentorship Program funded at an amount up to \$50,000 per year for fiscal years 2000, 2001, and 2002, subject to the availability of funds."

Status - Substantially Achieved: In May 2000, the Office of Insular Affairs and the National Park Service entered into a reimbursable support agreement whereby the Office of Insular Affairs would provide \$150,000 over 3 years for the National Park Service to establish an internship program for University of the Virgin Islands students.

Conclusion

In our opinion, the Governor of the Virgin Islands has acted in good faith to achieve the performance and reporting standards contained in the MOU. However, certain initiatives to cut costs and enhance revenues were not approved by the Legislature, and the Government continued to experience pressure to increase expenditures, particularly as related to payroll costs. Therefore, we believe that the Governor needs to take additional steps to control expenditures and increase revenues in order to achieve the long-term balanced budget goals of the MOU. We also believe that the Office of Insular Affairs should take a stronger role in monitoring the Government's compliance with the MOU and coordinating with other Department of the Interior agencies to accomplish the natural resources enhancement goals that have not yet been achieved.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Take affirmative action to consider and implement the recommendations contained in the Five Year Operating and Strategic Financial Plan, including those related to public-private partnerships to enhance the economy of the Virgin Islands.
2. Require department and agency heads to monitor and control payroll costs and overall expenditures in order to maintain a balanced budget for fiscal year 2002 and beyond.
3. Develop a plan of action to ensure that any General Fund surpluses generated in future years are earmarked to reducing the Government's accumulated debt.
4. Establish an ongoing dialogue with Government employee unions to develop a plan of action to improve the collective bargaining process in such a way as to assist in the fiscal solvency of the Government.
5. Take action to ensure that (at a minimum) general purpose financial statements are prepared within 120 days of the end of each fiscal year. Actions should also be taken to upgrade the Government's financial management system so that it can produce timely comprehensive annual

financial reports, as required by the Memorandum of Understanding and by the generally accepted accounting principles promulgated by the Government Accounting Standard Board.

6. Establish a process to ensure that quarterly progress reports regarding compliance with the Memorandum of Understanding are submitted to the Office of Insular Affairs on a timely basis.

We also recommend that the Office of Insular Affairs, U.S. Department of the Interior:

7. Closely monitor and report to the Secretary of the Interior on the progress of the Government of the Virgin Islands in achieving the performance and reporting standards contained in the Memorandum of Understanding, so that the Secretary can make an informed decision as to whether or not a certification is warranted that the Government has achieved "substantial compliance" with the Memorandum of Understanding.

8. Confer with Government of the Virgin Islands officials to update the Government's capital improvement plan and, upon certification of "substantial compliance" by the Secretary of the Interior, request funding in future budget proposals for high priority projects identified in the capital improvement plan.

9. Confer with Government of the Virgin Islands officials to develop and implement a plan of action to upgrade the Government's financial management system so that it will meet the long-term needs of the Government and provide the capability to produce comprehensive annual financial reports within 120 days of the end of each fiscal year.

10. Take a lead role in coordinating with other Department of the Interior agencies to accomplish the action items related to the enhancement of the natural resources of the Virgin Islands.

11. Confer with Government of the Virgin Islands officials to determine whether the Memorandum of Understanding should be modified based on the status of actions taken to date to comply with the existing Memorandum of Understanding, the current and projected future financial status of the Government, and the current priorities of the Governor of the Virgin Islands and the Secretary of the Interior.

Governor of the Virgin Islands Response and Office of Inspector General Reply

In his March 25, 2002 response (Appendix 1) to the draft report, the Governor of the Virgin Islands provided additional information on actions taken by the Government to meet the requirements of the MOU. However, the response did not specifically address the six recommendations made to the Governor. Therefore, Recommendations 1 to 6 are considered unresolved (see Appendix 4).

General Comments. Although the Governor's response generally did not take exception to the financial data presented in the report, it disagreed with our interpretation of the data. The response concluded that the Government was in substantial compliance with the MOU and that the Department of the Interior was not in compliance with its commitment to provide funding for certain capital improvement projects. While we do not completely agree with the Governor's assessment,

we do acknowledge that significant positive action has been taken by the Government, since execution of the MOU, to improve the Government's overall financial condition. Because the primary goal of the MOU is for the Government to achieve balanced budgets for fiscal year 2003 and beyond, this report was intended to be an interim progress report on the status of compliance by both the Government and the Department of the Interior. Whether or not the Government ultimately achieves the MOU's primary goal will not be definitively known until its audited financial statements for fiscal year 2003 are completed and published.

Our comments on specific statements made in the Governor's response are presented in the following paragraphs.

Governor of the Virgin Islands Response. The response (page 1 of 10) stated, "In consideration for the Government's commitment to undertake certain fiscal reforms and to meet certain financial performance standards, the Department [of the Interior] committed, inter alia, to provide significant new federal assistance to the Government to address its long-term debt and unfunded obligations, including \$10 million a year over 10 years for federally mandated infrastructure improvements."

Office of Inspector General Reply. This statement is not entirely accurate. The MOU does not contain a specific commitment of funds (such as "\$10 million a year over 10 years"). Instead, the MOU states that upon certification by the Secretary of the Interior that the Government is in "substantial compliance" with the performance standards contained in the MOU, "the Department shall make available any funds to the GVI for capital improvements, other assistance, and mutually agreed technical assistance that may be provided by the FY 2001 and future appropriations acts for the Department of the Interior and Related Agencies or by other legislation."

Governor of the Virgin Islands Response. The response (page 4 of 10) stated, "The precise means, or benchmarks, to structural balance [of the Government's budget] is less important than the achievement of the actual objective of structural balance. That is, the subsequent adoption of different cost reduction or revenue enhancement measures is less important than the actual cost reduction or revenue enhancement achieved by such measures."

Office of Inspector General Reply. In general, we agree with this statement because the achievement of balanced budgets for fiscal year 2003 and beyond is the ultimate measure of success. However, in the interim, there is no other reasonable and objective method for measuring compliance with the MOU than an item-by-item appraisal of the level to which the performance goals in the MOU have been achieved. That is the methodology we used in our review.

Governor of the Virgin Islands Response. The response (page 5 of 10) stated that while the draft report acknowledged that the Government "essentially" met the standard related to development of a financial recovery plan, "the draft report also gratuitously and erroneously notes that 'most' of the plan's 200 recommendations have not been implemented or specifically addressed. The Government submits that such criticism is not only wide of the mark, it is outside the scope of the audit." The response further stated, "The plan and the specific recommendations it incorporates is merely that – a plan that invites executive and legislative review and that makes specific recommendations which, after, consideration, invites further review, adoption, modification, or even

rejection. . . . A rigid scorecard of recommendations accepted or rejected thus is not only simplistic, it is dubious as an indicator of compliance, and it undermines the flexibility that should be inherent in any plan."

Office of Inspector General Reply. We do not agree with the Governor's assertion that our criticism of the level of implementation of the financial recovery plan is "wide of the mark" and "outside the scope of the audit." Because preparation of a five-year financial recovery plan was one of the MOU's primary performance standards (Performance Standard No. 1), our review of the plan and its implementation was clearly within the scope of this audit. Additionally, we believe that we were fair in our evaluation of the extent to which the Government achieved the performance standard. Specifically, we concluded that Performance Standard No. 1 had been substantially achieved because the financial recovery plan was completed and submitted to the Secretary of the Interior, as required by the performance standard. However, we also believe that it is unreasonable to expect that the mere preparation of a financial recovery plan will bring about meaningful changes in the long-term financial condition of the Government. The plan contained a wealth of detailed information about the economy of the Virgin Islands, the operations of most Government agencies, the status of the Virgin Islands private sector, and about 200 recommendations (called "initiatives" in the plan) for improvements in the areas of revenue enhancement, expenditure control, personnel management, overall government productivity, detailed agency operations, Federal grant management, capital improvement, and private sector enhancement. Although we acknowledge that some of the initiatives related to revenue enhancement, expenditure control, and government reorganization have been carried out and that the plan should be flexible and allow for some level of discretion on the part of Government officials during the implementation phase, we continue to assert that the majority of the recommendations contained in the financial recovery plan have not been given the consideration that they deserve and have not been implemented.

Governor of the Virgin Islands Response. The response (page 7 of 10) stated that Performance Standards Nos. 8 through 10 "were superceded by letter agreement dated May 31, 2001, which incorporates the Government's plan to achieve full compliance with the Single Audit Act and other relevant federal law."

Office of Inspector General Reply. This statement is not entirely correct. The May 31, 2001 letter agreement referred to in the response applied only to the due dates for single audit reports, while Performance Standard No. 9 is not related to the requirements of the Single Audit Act. Performance Standard No. 9 relates to a separate financial reporting requirement contained in the Insular Areas Act of 1982 (codified in Section 11 of the Revised Organic Act of the Virgin Islands). This requirement is that:

The Governor shall prepare, publish, and submit to the Congress and the Secretary of the Interior a comprehensive annual financial report in conformance with the standards of the National Council on Governmental Accounting within one hundred and twenty days after the close of the fiscal year. The comprehensive annual financial report shall include statistical data as set forth in the standards of the National Council on Governmental Accounting relating to the physical, economic, social, and political characteristics of the government, and any other information required by the Congress.

The National Council on Governmental Accounting cited in the Insular Areas Act has since been replaced by the Government Accounting Standards Board (GASB), which sets accounting and financial reporting standards and requirements for state and local government entities in the United States, including the U.S. Virgin Islands. The GASB requirements define two separate levels of financial reporting: (1) "general purpose financial statements," which include the customary complement of statements (balance sheet, revenue and expenditure statement, cash flow statement, and notes to the financial statements), and (2) a "comprehensive annual financial report," which includes the general purpose financial statements plus detailed fund-by-fund statements, summaries of historical financial data, statistical data, and a comprehensive narrative report on the government's finances for the year. Single audit reports issued in compliance with the Single Audit Act include the audited general purpose financial statements and other information related specifically to the Federal grants received by the government entity. Single audit reports serve a different purpose than comprehensive annual financial reports, and the two types of reports are not interchangeable. With regard to the Government of the Virgin Islands, although the Government is on the road to compliance with the requirements of the Single Audit Act, it is still far from being in compliance with the financial reporting requirements of the Insular Areas Act of 1982 and, by reference, the standards issued by the Government Accounting Standards Board.

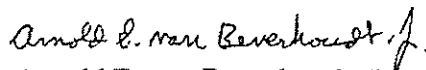
Office of Insular Affairs Response and Office of Inspector General Reply

The August 16, 2002 response (Appendix 2) from the Deputy Assistant Secretary of the Interior and the August 14, 2002 response (Appendix 3) from the Superintendent of the National Park on St. Croix both provided additional information on the current status of efforts to complete actions related to the performance requirements applicable to the Department of the Interior. That information has been incorporated into the body of the report. However, the response from the Deputy Assistant Secretary did not provide a specific action plan, including target dates, for implementing Recommendations 7 to 10 and did not address Recommendation 11. Therefore, those recommendations are considered unresolved (see Appendix 4).

Section 5(a) of the Inspector General Act (5 U.S.C. app. 3) requires the Office of Inspector General to list this report in its semiannual report to the U.S. Congress. In addition, the Office of Inspector General provides audit reports to the Congress.

Please provide a response to this report by February 8, 2003. The response should provide the information requested in Appendix 2 and should be addressed to our Caribbean Regional Office, Federal Building - Room 207, Charlotte Amalie, Virgin Islands 00802.

Sincerely,


Arnold E. van Beverhoudt, Jr.
Regional Audit Manager

GOVERNOR OF THE VIRGIN ISLANDS RESPONSE



THE UNITED STATES VIRGIN ISLANDS

OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE

Charlotte Amalie, V.I. 00802
340-774-0001

March 25, 2002

Mr. Arnold E. van Beverhoudt
Audit Manager for Insular Areas
U.S. Department of the Interior
Federal Building, Room 207
Charlotte Amalie, St. Thomas
U.S. Virgin Islands 00802

Dear Mr. van Beverhoudt:

Thank you for the opportunity to comment on the draft compliance audit performed by your office with respect to the Memorandum of Understanding between the Governor of the U.S. Virgin Islands ("Governor") and the Secretary of the Interior ("Secretary"), executed on October 7, 1999 and amended on October 27, 1999 (the "MOU"), and the draft findings related thereto. As you know, the MOU established a partnership between my office and the office of the Secretary to facilitate the fiscal and economic recovery of the Virgin Islands from the serious financial conditions that existed as of the date my Administration assumed office in January 1999.

Executive Summary

The partnership incorporated in the MOU was based on mutual covenants between the Department of the Interior ("Department") and the Government of the Virgin Islands ("Government" or "GVI"). In consideration for the Government's commitment to undertake certain fiscal reforms and to meet certain financial performance standards, the Department committed, inter alia, to provide significant new federal assistance to the Government to address its long-term debt and unfunded obligations, including \$10 million a year over 10 years for federally mandated infrastructure improvements.

It is the Government's position that it has substantially complied, as demonstrated by the Government's audited general purpose financial statements for Fiscal Years 1999 and 2000, with the individual performance standards set forth in the MOU. More importantly, it is well on its way to compliance with the ultimate objective set forth in the MOU, i.e., a structurally balanced General Fund budget for Fiscal Year 2003. In addition, the Government has substantially complied with the financial reporting and accountability standards set forth in the MOU by substantially meeting the target dates, set forth in the superseding May 31, 2001 letter agreement

with the Department's Office of Inspector General ("OIG"), for producing single audits as required by the Single Audit Act of 1984, as amended. Indeed, upon release of the Fiscal Year 2001 single audit by the end of August 2002, the Government is committed to produce such audits for Fiscal Year 2002 and thereafter within the nine months permitted by law after the close of the relevant fiscal year.

At the same time, it is also the Government's position that the Department has not fully complied with its commitments under the MOU, particularly its commitment to provide \$10 million per year to assist the Government in bringing its environmental infrastructure, including its aged and deteriorating wastewater treatment facilities, into compliance with federal environmental standards. It is the position of the Government that the Department's commitment subsumes not only support for directed appropriations in the President's budget for the next 10 years, but also includes the possibility and/or alternative of allocating discretionary funds, where available, and reprogramming unexpended Departmental funds, where appropriate.

Background

While it was painfully clear in January 1999 that the Government was in financial extremis, it was also clear that, in the then absence of current audited financial statements, a concise picture of our true financial condition was difficult to establish or articulate with precision. The problem caused by the lack of audited financial statements was further exacerbated by questionable practices utilized by the previous administration, and documented in previous audits by the U.S. Interior Office of Inspector General ("OIG"), to mask the full extent of the Government's financial exposure.

Nevertheless, by the beginning of June, 1999, the Government's financial team had determined that the Government was technically insolvent, burdened by a structural, or recurring, deficit approaching \$100 million, an accumulated deficit estimated to exceed \$250 million, and total debt and unfunded liabilities in excess of \$1 billion. These imbalances caused a serious cash flow problem which forced the Government to (1) delay a scheduled payday in April, 1999, (2) negotiate suspension of debt service payments on its FEMA loan obligations, and (3) initiate by executive memorandum, dated June 15, 1999, a series of cost-containment measures including a strict hiring freeze, with limited exceptions, substantial reductions in baseline overtime costs, and related spending restraints. I also instructed the Director of the Office of Management and Budget ("OMB") to prepare a revised budget for Fiscal Year 2000 with at least a 10 percent reduction in the \$486 million budget which had already been pared from the previous fiscal year.

It was also clear at the time that fiscal recovery was not possible without significant additional federal assistance. While self-help initiatives could, over time, substantially reduce the imbalance between current revenues and expenditures in a static environment, it was also clear that the Government had no control over certain extraordinary expenditures and thus required external assistance in order to succeed. In particular, debt service payments on the Government's Hurricane Hugo FEMA loan obligations totaled approximately \$10 million a year and interest on the Government's Hurricane Marilyn FEMA loan obligations was accruing at a rate of approximately \$22,000 per day. In the absence of debt forgiveness or loan cancellation,

the Government projected that its total FEMA debt service payments could balloon to as much as \$30 million a year beginning as early as June 2001. As a result of the Government's inability to pay previously negotiated or arbitrated salary increases for Government employees dating back in some cases to 1994, the Government's accrued liability for retroactive labor claims continued to increase by millions of dollars each year. And, not least, the Government was subject to federal court orders and agency consent decrees that mandated substantial Government outlays, totaling additional millions of dollars, to construct major improvements to its environmental, public health and safety infrastructure, thus requiring further diversion of Government resources and imposing additional obstacles to achieving fiscal balance on a current basis and eliminating accumulated debt.

Because of the scope and complexity of the fiscal problems confronting the Government and the need to provide coherence and structure to the multiplicity of actions required for success, I directed my financial team in August of 1999 to develop a five-year fiscal and economic recovery plan to guide the Government's efforts. To address immediate cash flow requirements and to pay the Government's current obligations, my financial team advised that it would be necessary for the Government to finance its accumulated deficit and generate sufficient working capital to ensure the continuation of essential services as the other elements of the Government's fiscal recovery program began to take effect and produce results. While such financing was critical to our plan, it also became clear that the Government's main borrowing authority for such financings -- hybrid revenue bonds secured by federal rum taxes pursuant to 48 U.S.C. § 1574a -- was not available due to capacity constraints caused by the previous administration's 1998 refinancing and issuance of consolidated debt. At the same time, the Government's general obligation authority under 48 U.S.C. § 1574 was not available due to artificial and antiquated limits imposed by Congress on such authority dating back to 1954. After consultation with our financial advisors, my administration determined that the required financing could only be secured by modernizing the Government's borrowing authority through amendment to the Revised Organic Act, which process required the consultation and approval by the federal government, including the U.S. Office of Management and Budget. As a condition for its approval of new borrowing authority, the U.S. Office of Management and Budget required that the Secretary of the Interior enter into an agreement with the Government of the Virgin Islands to develop a fiscal recovery plan with financial performance standards. Ensuing discussions between the Office of Insular Affairs and my financial team resulted in the execution of the MOU which is the subject of the present compliance audit.

The Memorandum of Understanding

The Memorandum of Understanding executed by the Secretary and the Governor establishes a partnership between the Government and the Department to facilitate fiscal and economic recovery and to address the Government's long-term indebtedness and unfunded obligations. In addition to setting certain performance standards based on my administration's revised FY 2000 budget (submitted to the Legislature prior to the execution of the MOU), the Government committed to making continued progress to achieve a structurally balanced General Fund budget by Fiscal Year 2003 and, absent extraordinary circumstances, to maintain structurally balanced budgets thereafter. The Government also committed to produce comprehensive financial reports and single audits of the operations of the Government nine

months after the end of each fiscal year, as required by the Insular Areas Act of 1982 and the Single Audit of 1984, as amended.

In consideration for these commitments by the Government, the Secretary committed that the Department would support legislation and appropriations to increase federal funding and support for the Government's fiscal recovery efforts, including new funding for federally mandated improvements to the Government's environmental, public health and safety infrastructure such as wastewater treatment facilities. The MOU also established a process, based on consultation and respect for the rights of each jurisdiction, to facilitate the long-term economic recovery of the Virgin Islands through the preservation and enhancement of the natural resources of the Virgin Islands.

A. The Government Has Substantially Complied with its Commitments under the MOU

In analyzing the Government's compliance with the specific accountability and financial performance standards set forth in the MOU, it is important to recognize that Performance Standard Nos. 1-4 provide specific benchmarks, or means, by which to achieve the ultimate objective set forth in Performance Standard No. 5, i.e., the achievement of a structurally balanced General Fund budget by Fiscal Year 2003.

The precise means, or benchmarks, to structural balance is less important than the achievement of the actual objective of structural balance. That is, the subsequent adoption of different cost reduction or revenue enhancement measures is less important than the actual cost reduction or revenue enhancement achieved by such measures. While it is the Government's position, as discussed below, that it has substantially complied with Performance Standard Nos. 1-4, the best indicator of the Government's progress toward a structurally balanced General Fund budget required by Performance Standard No. 5 is found in the Government's audited financial statements, published by the Government's outside auditors, KPMG, LLP, for Fiscal Years 1999 and 2000. As a result of the self-help measures and spending controls initiated by the Government in my administration's first year in office, including the cost reductions required by my June 15, 1999 executive memorandum, the Government reversed course and finished Fiscal Year 1999 with a current year deficit of approximately \$50 million, nearly half of the projected amount at the time the Government took its decisive action. See Attachment A. Further substantial progress toward structural balance is also demonstrated by the single audit and audited financial statements for Fiscal Year 2000, which show a structural deficit of just \$8 million, setting the stage for the Government's achievement of its ultimate goal in advance of the Fiscal Year 2003 target set forth in Performance Standard No. 5. See Attachment B. It is expected that the single audit for Fiscal Year 2001, now due by the end of August 2002, will demonstrate further progress toward this important goal.

While the single audits provide the best evidence of the Government's compliance with the goal of achieving structural balance in the General Fund Budget by Fiscal Year 2003, it is also the Government's position that it has achieved substantial compliance with the specific benchmarks, or "means" standards, set forth in Performance Standard Nos. 1-4. Performance Standard No. 1, for example, committed the Government to complete its Five-Year Financial Recovery Plan within 90 days of the execution of the MOU. In point of fact, while the

Government did not release its plan until some three months after the target date, the task force charged with developing the plan required additional time to consult with members of the Legislature, unions, local businesses, citizens and other stakeholders in the process. It is the Government's position that the additional time allowed for a better and more comprehensive plan with greater stakeholder involvement and support.

While the draft findings contained in the draft audit report acknowledge that the Government "essentially" met the standard by preparing the financial recovery plan, the draft report also gratuitously and erroneously notes that "most" of the plan's 200 recommendations have not been implemented or specifically addressed. The Government submits that such criticism is not only wide of the mark, it is outside of the scope of the audit. The draft finding ignores the substantial number of recommendations that to date have been adopted or accepted. More important, however, it ignores the purpose of the plan and its various recommendations. The Government did not abrogate its constitutional responsibilities when I established the task force and directed the preparation of a plan. The plan and the specific recommendations it incorporates is merely that -- a plan that invites executive and legislative review and that makes specific recommendations which, after, consideration, invites further review, adoption, modification, or even rejection. The plan does not displace the executive and legislative functions; it is a stimulus to further action or to further alternatives to the recommended action. A rigid scorecard of recommendations accepted or rejected thus is not only simplistic, it is dubious as an indicator of compliance, and it undermines the flexibility that should be inherent in any plan.¹

Performance Standard No. 2 committed the Government to develop a Fiscal Year 2000 budget that "mandates substantial reductions in departmental budget and overall General Fund expenditures, including a 50 percent reduction in overtime expenditures from FY 1999 levels; a hiring freeze with limited and highly scrutinized exceptions; and a 5 percent reduction in payroll costs from Fiscal Year 1999 baseline costs." In addition, Performance Standard No. 3 committed the Government to "an additional 10 percent reduction in departments and agencies' overall expenditures; 50-50 cost-sharing of retirement and health insurance premiums; and elimination of 5 paid holidays." Finally, Performance Standard No. 4 committed the Government to limit total Fiscal Year 2000 expenditures to \$432.1 million and to match FY 2000 expenditures with current year revenues, including where appropriate non-recurring revenues.

Performance Standard Nos. 2-4 incorporate the expenditure limitations and controls I imposed in my June 15, 1999 executive memorandum and parallel the spending levels included in the revised Fiscal Year 2000 budget I had earlier submitted to the Legislature. The original FY 2000 budget totaled \$486 million. The revised FY 2000 budget I submitted in September, 1999 cut proposed spending by \$54 million, or a reduction of more than 11 percent.

¹ In point of fact, the Government undertook a number of significant cost-cutting and revenue enhancement measures in 1999-2000 not specifically referenced in the MOU, including the implementation of a governmental reorganization plan, the consolidation and renegotiation of government leases, the enactment of an early retirement program to complement the hiring freeze imposed by executive authority, and the enhancement of revenue collection capabilities through increased automation and selective staff increases.

Recognizing the division of fiscal authority provided by the Revised Organic Act, the budget ultimately approved by the Legislature for the fiscal year in question totaled approximately \$450 million. Through the allotment process, however, my administration held spending in that fiscal year to a total of \$442 million, or approximately 9 percent less than originally proposed.

With respect to the specific benchmarks, or means, of compliance, the Government was equally successful. As acknowledged in the draft findings, overtime expenditures decreased dramatically from baseline costs as of the date of the June 15, 1999 executive memorandum in the balance of Fiscal Year 1999, and continued to decline significantly in Fiscal Years 2000 and 2001. As also acknowledged in the draft findings, baseline payroll costs declined as a result of the hiring freeze and related attraction program by \$33.9 million in Fiscal Year 2000 over FY 1999 baseline costs, a nearly 10 percent reduction or twice the target commitment. While the draft audit found that payroll costs increased during the first seven months of Fiscal Year 2001, the draft report correctly notes that this increase was primarily a result of negotiated teacher salary increases to bring critical employees up to step and to settle a crippling teacher strike that imperiled the welfare of our young people.

While Performance Standard No. 2 committed the Government to a five percent reduction in baseline payroll costs only in Fiscal Year 2000, which standard was exceeded as noted above, it is more important to note that the measured reduction in the size of government work force through the attrition and retirement incentive program -- a more appropriate benchmark -- has continued to date. As I have previously reported, total executive branch employment had escalated to nearly 12,000 workers when I first assumed office in January 1999. By the end of 2000, executive branch employment had declined to 10,240 employees, a 10 percent reduction from the previous year; by the end of 2001, executive branch employment had declined an additional 10 percent to 9,275 workers, producing the smallest government work force in a quarter of a century. These reductions are an important first step to eliminate bureaucratic overstaffing and to build an efficient and productive work force through reorganization and restructuring. Cost-savings from this restructuring, together with increased revenues generated by our tax administration and economic development policies, have also enabled the Government to pay previously negotiated or arbitrated step increases and properly incentivize our government work force. It is the Government's position that reference to baseline payroll costs alone could be misleading because frozen pay levels below negotiated or arbitrated levels, while perhaps necessary in previous years for cash flow reasons, do not eliminate the liability for the unfunded difference. In point of fact, the Government has been carrying these unfunded totals for retroactive claims as an unfunded obligation on its books of account. Thus, the Government's decision last year to put government workers on step once available resources permitted, while increasing baseline payroll costs over 1999 levels, simultaneously eliminated corresponding growth in the Government's unfunded obligations for retroactive pay.

The draft findings make reference to the reductions to General Fund "appropriations" from Fiscal Year 1999 to Fiscal Year 2000, but also note that General Fund "expenditures" increased from Fiscal Year 2000 to Fiscal Year 2001. Beyond lacking technical precision and exceeding the scope of the audit, the draft findings also question, without factual or revenue analysis, the basis for the increase in Fiscal Year 2002 appropriations. In point of fact, tax collections increased across the board from all sources, with a single exception, last year.

Moreover, the Bureau of Internal Revenue projects an additional increase in collections in the current fiscal year. In any event, the most accurate assessment of my administration's tax collection efforts and economic development policies may be discerned by reference to the audited financial statements incorporated in the single audits for these years.

While Performance Standard No. 7 originally committed the Government to conform its public labor relations law to federal public labor relations standards, the Secretary subsequently sought to amend the standard. Amended Performance Standard No. 7 now is precatory in nature, merely "encouraging" the Government and its unions "to pursue, through collective bargaining, reform initiatives to assist in the fiscal solvency of the Government." My administration is, and always has been, committed to pursuing such initiatives to assist in our fiscal recovery efforts and has actively engaged in consultation, as well as collective bargaining, with certified unions. Accordingly, it is the Government's position that this standard, vague and precatory though it may be, has been satisfied.

Performance Standard Nos. 8 through 10 address requirements of federal law that the Government produce comprehensive financial reports within 120 days after the end of each fiscal year, and that the Government perform and publish a complete single audit report within nine months of the end of each fiscal year. These performance standards, however, were superseded by letter agreement dated May 31, 2001, which incorporates the Government's plan to achieve full compliance with the Single Audit Act and other relevant federal law. That agreement, a copy of which is appended as Attachment C, establishes a process which has been approved by the Department of the Interior and accepted by the principal federal grantor agencies.

As you know, the one and only single audit to be issued prior to my administration covered Fiscal Year 1994. While the outside auditors had been at work on the Fiscal Year 1995 single audit for nearly three years, it was not yet complete in January 1999 when my administration assumed office. Moreover, at that time, that GAAP conversion for Fiscal Years 1996, 1997 and 1998 had not yet been initiated. In response to this situation, I instructed my Commissioner of Finance and Director of the Office of Management and Budget to commence work immediately to come into compliance with the Single Audit Act at the earliest practicable time. The single audit for Fiscal Year 1995 was released in September 1999, and work was begun on the single audit for Fiscal Year 1998, on the understanding that more current years were priorities for audit completion. The single audit for Fiscal Year 1998 was completed in July 2000 and released in October, 2000, while the audit for Fiscal Year 1999 was begun in August 2000.

The Office of Inspector General, Department of the Interior, subsequently concluded that a comprehensive compliance plan, one that would be accepted by all grantor agencies, should be developed. The plan, in addition to meeting the requirements of federal law, had to be realistic in its demand on the Government with its limited resources. On May 10, 2001, I met with the OIG of the Department of the Interior and representatives of the OIGs of the majority of the other federal grantor agencies. As cognizant agency under the terms of the Single Audit Act, the Department took the initiative to resolve all outstanding compliance issues. Under the terms of the May 31, 2001 agreement, agreed-upon procedures are being established in lieu of a complete

audit for Fiscal Year 1996 and 1997. The single audit for Fiscal Year 1999 meanwhile was released in June 2001, and the single audit for Fiscal Year 2000 was released in early February 2002. The single audit for Fiscal Year 2001 is due to be released in August 2002. Thereafter, the single audits for each fiscal year will be released by the July 1st due date (nine months following the end of the fiscal year).

Performance Standard No. 11 commits the Government, in cooperation with the Department, to develop and implement a training program for key government managers with respect to administration of federal grants, including cost principles and documentation requirements. I am pleased to note, as is acknowledged in the draft and its findings, that this training program has been developed and implemented and is in compliance with this performance standard.

Performance Standard No. 12 commits the Government to "enact resources that will reduce the outstanding debt of the GVI." Since 1999, the Government (1) has been successful in eliminating its \$46 million Hurricane Hugo FEMA debt through remedies available under the Federal Credit Reform Act, (2) has petitioned FEMA to forgive its estimated \$160 million outstanding Hurricane Marilyn debt under the provisions of the Robert T. Stafford Act, (3) has negotiated an agreement with the Federal Bureau of Prisons ("BOP") to address the Government's \$10 million obligation to the BOP which dates back more than 10 years, and (4) has refinanced, through the November 1999 bond issue, a significant portion of its accumulated debt arising from its obligations to pay vendors for past services and to pay long delinquent tax refunds. While it is our position that these actions comply with the vague standard to "reduce the outstanding debt" of the Government, the Government still has substantial liability for such debt, including, inter alia, the total of \$170 million in federal debt noted above, claims in excess of \$250 million for retroactive payments arising from previously negotiated or arbitrated union contracts, and hundreds of millions of dollars in compliance costs associated with costly federal environmental standards and other infrastructure requirements for which no discernable source of funding is immediately available and which must therefore be included in any computation of the Government's total outstanding debt. It is, in fact, this portion of the Government's outstanding debt which was the subject of the Department's commitment in the MOU and which requires equally close scrutiny by the Office of Inspector General, as discussed below.

In sum, it is my administration's position that the Government has fully or substantially complied with all of performance standards to which it has committed in the MOU.

B. The Department of the Interior Has Failed to Fully
 Comply with Its Commitments Under the MOU

In consideration for the Government's commitments set forth in the MOU, the Secretary committed the Department to be a "partner" with the Government and to support efforts directed at "eliminating the Government's long term debts and liabilities." In particular, the MOU stated that the Department was considering legislation to assist the Government in its fiscal and economic recovery, "including authorization of appropriations for certain capital improvement projects." In discussions with Departmental officials, my administration was advised that the Department would seek to include annual funding of \$10 million for such capital improvement

projects over 10 years as part of the Department's baseline budget. This funding would be available to assist the Government in constructing major improvements to its environmental and public health infrastructure, particularly in the area of wastewater treatment facilities, which have been mandated by federal court order or federal agency consent decree.

As the draft findings in the draft audit report make clear, "the Department of the Interior did not meet the most important element on its side of the MOU because Congress did not approve funding for a \$10 million capital improvement grant to the Virgin Islands that was included in the Office of Insular Affairs' Fiscal Year 2001 budget proposal." In point of fact, the President's budget for Fiscal Year 2001 proposed \$10 million for Virgin Islands capital improvements as an "advance appropriation" in Fiscal Year 2002 -- a budget practice that is disfavored and rarely used by Congress -- and contained no proposed authorization referenced in the MOU. While neither the Government's commitment to achieve fiscal recovery in compliance with the performance standards set forth in the MOU, nor its demonstrated need to address and reduce its outstanding unfunded obligations including the court-ordered capital improvements referenced above (See Attachment D), has abated as a result of this failure, it is unclear whether and to what extent the Department's commitments to assist the Government still prevail.

Notwithstanding the Department's failure, as referenced in the draft findings, to secure the promised appropriation in Fiscal Year 2001, the MOU commits the Department to make available to the Government any funds under its control that are not specifically directed or "earmarked" by Congress, i.e., those funds which are within the discretion of the Secretary or which may be reprogrammed by administrative action. In particular, the MOU provides that, upon certification that the Government has achieved "substantial compliance" with "the targeted reductions in the recurring, or structural, General Fund deficit in Fiscal Year 2000 and has substantially complied with all other performance standards" contained in the MOU, the Department "shall make available any funds to the GVI for capital improvements, other assistance, and mutually agreed technical assistance" that may be provided by future appropriations acts for the Department or by other legislation.

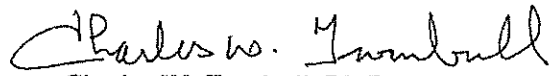
It is the Government's position that, in the absence of directed, or "earmarked," appropriations by the Congress, the Department must review its unobligated and/or unexpended funds and to identify those funds which may be reprogrammed or redirected to the Government by administrative or other action in order to achieve compliance with its obligations under the MOU, including the \$10 million per year for federally mandated environmental infrastructure improvements. It is the Government's further position that the OIG compliance audit should focus no less equally on these commitments to assist the Government and, indeed, the Government welcomes any recommendations from the Office of Inspector General on ways in which the Department may fulfill or otherwise realize its commitments.

CONCLUSION

The Government has made substantial progress in its efforts to restore fiscal integrity, accountability and balance to its general operations, as well as to reduce its overall debt. Further progress in addressing its long term unfunded obligations, including compliance with federal environmental mandates, however, will require significant additional external assistance. Future

compliance by the Department with its commitments set forth in the MOU will provide material assistance to the Government in achieving these vital objectives.

Respectfully submitted,

A handwritten signature in black ink, reading "Charles W. Turnbull". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Charles W. Turnbull, Ph.D.
Governor

Attachments as stated

cc: The Honorable Gale A. Norton
Mr. Nik Pula
Mr. Roy C. Kime

OFFICE OF INSULAR AFFAIRS RESPONSE



United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, D.C. 20240

August 16, 2002

Mr. Arnold F. van Beverhoudt Jr.
Regional Audit Manager
Caribbean Regional Office
Federal Building, Room 207
Charlotte Amalie, U.S. Virgin Islands 00802

Dear Mr. van Beverhoudt:

This is in response to draft audit no. V-IN-VIS-0045-2001, entitled *Compliance with the Memorandum of Understanding Between the Governor of the U.S. Virgin Islands and the Secretary of the Interior*. The draft audit listed five performance requirements, as Department of the Interior (DOI) responsibilities relative to the memorandum of understanding (MOU). However, the *Results in Brief* section stated that "3 of the 5 financial and performance standards that related to the DOI had not been substantially achieved." This statement is somewhat misleading because DOI has addressed all five areas.

Of the five DOI performance requirements, the first and fifth fall under the Office of Insular Affairs (OIA), while the second, third and fourth are under the National Park Service (NPS), within the Office of the Assistant Secretary for Fish, Wildlife and Parks.

- (1) **Financial Assistance.** Upon certification that the Government achieved "substantial compliance," provide funds for capital improvements, technical assistance, and other assistance.

OIA Comments: Governor Charles Turnbull agreed in the MOU to provide DOI with monthly progress reports on the budget and cash flow impacts of three performance standards. The Government of the Virgin Islands (GVI) subsequently requested that the reporting requirements be amended from a monthly to a quarterly basis. The request was approved; however, quarterly reports have been sporadic at best. OIA has respectively requested timely progress reports with the Governor's office. The MOU calls for an independent entity to certify the progress reports. DOI agreed to allow GVI's financial advisors to serve as the independent entity to review the quarterly progress reports' authenticity. The financial advisors were with First Union; however, that entity discontinued providing financial services to municipalities in February, and subsequently the principals transferred to Banc of America Securities. OIA received a quarterly report this week from GVI's financial advisors. DOI has provided substantial financial support to GVI since the MOU was signed including:

- \$5,420,000 in the fiscal year 2000 budget for capital improvements in solid waste and wastewater
- \$500,000 to develop a long-range economic recovery plan
- \$16,000,000 for Y2K re-mediation efforts
- \$300,000 in technical assistance funds towards the payment of interest on the Hurricane Hugo community disaster loan (CDL)
- \$75,000 in technical assistance funds to complete a technical re-estimate of the net present value of the Hurricane Hugo CDL.
- \$2,000,000 in the fiscal year 2001 budget to permit cancellation of the Hurricane Hugo CDL.
- \$400,000 towards the completion of the fiscal year 1998 single audit.
- \$250,000 towards the completion of the fiscal years 1996 and 1997 agreed-upon procedures in lieu of full-blown single audits

- (2) **Environmental 1.** Work to obtain funding for the Virgin Islands (VI) Conservation Trust.

OIA Comments: Former Secretary Babbitt approached Governor Turnbull about "setting aside twenty-five cents on the dollar" from the rum excise taxes to generate seed money. However, Governor Turnbull felt that he could not commit the funds.

- (3) **Environmental 2.** Work with the VI to draft an MOU to implement joint planning and management of the Salt River Marine and Ecological Preserve.

OIA Comments: NPS will provide comments on this performance requirement in a separate letter to the Office of Inspector General.

- (4) **Environmental 3.** Work with the VI to create a consortium to promote understanding of the marine environment.

OIA Comments: NPS will provide comments on this performance requirement in a separate letter to the Office of Inspector General.

- (5) **Environmental 4.** Work with the VI to provide learning opportunities through a Park Mentorship Program.

OIA Comments: OIA and NPS entered into a reimbursable support agreement in May 2000, in which we agreed to provide \$150,000 over three years, for the development of a park mentorship program between NPS and the University of the Virgin Islands

(UVI). The main purpose was to expose students majoring in natural sciences to future job opportunities within the Department. UVI students would work with various park professionals during the academic year. Two students would be hired from the UVI campus on Saint Thomas to work on Saint John and one student would be hired from the UVI campus on Saint Croix to work on Saint Croix.

The following comments are directed at the draft audit's recommendations to OIA beginning on page 13.

- (7) Closely monitor and report to the Secretary of the Interior on GVI's progress in achieving the performance and reporting standards contained in the MOU.

OIA Comments: While GVI has made substantial progress in implementing its performance standards under the MOU, the lack of consistent quarterly progress reports has made it difficult for OIA to monitor GVI's progress. With the continuance of quarterly progress reports, OIA will be in a better position to monitor GVI's achievements.

- (8) Confer with GVI to update GVI's capital improvement plan, and consider requesting, as warranted by the extent to which GVI achieves "substantial compliance" with the performance and reporting standards, funding in future budget proposals to the Congress for high-priority projects.

OIA Comments: In fiscal year 2001 DOI budgeted \$10 million for GVI, but it was not approved by the Congress. As mentioned earlier, OIA worked closely with GVI in addressing GVI's numerous capital improvement requests.

- (9) Confer with GVI officials to develop a plan of action to upgrade GVI's financial management system.

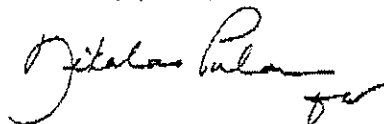
OIA Comments: The current financial management system that OIA provided is near the end of its useful life. GVI has expressed a desire to replace the existing system. OIA would be willing to assist GVI in upgrading GVI's financial management capability; however, OIA is concerned about unnecessary modification to a new system which would shorten the life expectancy of a new comprehensive system.

- (10) Take a lead role in coordinating with other DOI agencies to complete actions needed to accomplish the pending action items related to enhancement of the VI's natural resources.

OIA Comments: The only pending action item related to natural resource enhancement of which OIA is aware is the joint planning and management of the Salt River Marine and Ecological Preserve. OIA understands that actions pending are those to be taken by GVI. Moreover, other DOI agencies play their respective roles according to the MOU.

I hope these comments will adequately address the Office of Inspector General's concerns.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "David B. Cohen", with a stylized flourish at the end.

David B. Cohen
Deputy Assistant Secretary
for Insular Affairs

NATIONAL PARK SERVICE RESPONSE

REPLY REFER TO:

United States Department of the Interior

NATIONAL PARK SERVICE
Christiansted National Historic Site
Buck Island Reef National Monument
Salt River Bay National Historic Park & Ecological Preserve
2100 Church Street #100
St. Croix, US Virgin Islands 00820

August 14, 2002

Mr. Arnold F. van Beverhoudt, Jr.
Regional Audit Manager
U.S. Department of the Interior
Office of Inspector General
Caribbean Regional Office
Federal Building, Room 267
St. Thomas, Virgin Islands 00802

Dear Sir:

After reviewing the draft audit report dated January 18, 2002, on the MOU between the Governor of the U.S. Virgin Islands and the Secretary of the Interior (No. V-DN-VIS-0045-2001), please allow me to submit the following information for correction or clarification to the report.

Enhancement of Natural Resources Standard 2: page 12.

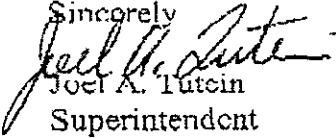
Status- Partially Achieved: Recommended statement should be: In August of 2001, the National Park Service drafted two version of a cooperative agreement with the Government of the Virgin Islands for management of the Salt River National Historic Park & Ecological Preserve. According to the National Park Service, the Governor has not responded to repeated request to meet and sign the agreement.

Enhancement of Natural Resources Standard 3: page 12.

Status-Substantially Achieved: Please in-cooperate the Following information if necessary: The consortium was unable to secure a lease for the old West Indies Lab site on St. Croix and that made it impossible for them establish the marine operation base. In 2001, the National Park Service purchased 74 acres of Land at Salt River Bay National Historic Park & Ecological Preserve. The consortium has shown great interest in establishing the marine base on this property and has written several letters to the National Park Service requesting a meeting to discuss the possibilities of establishing a Marine Lab at that site.

Thank you for giving me this opportunity to comment of this draft audit report. If you have any questions, please call me at (340) 773-1460 ext.22.1

Sincerely



Joel A. Tutein
Superintendent
CHRI/BUIS/SARI

STATUS OF AUDIT REPORT RECOMMENDATIONS

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
1 to 6	Unresolved.	Consider the recommendations and submit a response that states concurrence or nonconcurrence with each recommendation. If nonconcurrence is indicated, provide the reasons for nonconcurrence. If concurrence is indicated, provide a plan of action that includes a target date and the title of the official responsible for implementing each recommendation.
7 to 10	Unresolved.	Provide a plan of action that includes a target date and the title of the official responsible for implementing each recommendation.
11	Unresolved.	Consider the recommendation and submit a response that states concurrence or nonconcurrence. If nonconcurrence is indicated, provide the reasons for nonconcurrence. If concurrence is indicated, provide a plan of action that includes a target date and the title of the official responsible for implementing the recommendation.

How to Report Fraud, Waste, Abuse and Mismanagement

Fraud, waste, and abuse in Government are the concern of everyone. Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or insular area programs and operations. You can report allegations to us by:

Mail: U.S. Department of the Interior
Office of Inspector General
Mail Stop 5341-MIB
1849 C Street, NW
Washington, DC 20240

Phone: 24-Hour Toll Free 800-424-5081
Washington Metro Area 202-208-5300
Hearing Impaired (TTY) 202-208-2420
Fax 202-208-6081
Caribbean Region 340-774-8300
Northern Pacific Region 671-647-6051

Internet: www.oig.doi.gov/hotline_form.html



U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW
Washington, DC 20240

www.doi.gov
www.oig.doi.gov