

COMPACT OF FREE ASSOCIATION

Fiscal Procedures

**Agreement between
the UNITED STATES OF AMERICA
and MICRONESIA**

Signed at Palikir May 14, 2003

with

Annex



NOTE BY THE DEPARTMENT OF STATE

Pursuant to Public Law 89—497, approved July 8, 1966
(80 Stat. 271; 1 U.S.C. 113)—

“ . . .the Treaties and Other International Acts Series issued under the authority of the Secretary of State shall be competent evidence . . . of the treaties, international agreements other than treaties, and proclamations by the President of such treaties and international agreements other than treaties, as the case may be, therein contained, in all the courts of law and equity and of maritime jurisdiction, and in all the tribunals and public offices of the United States, and of the several States, without any further proof or authentication thereof.”

MICRONESIA

Compact of Free Association: Fiscal Procedures

*Agreement signed at Palikir May 14, 2003;
Entered into force June 25, 2004.
With annex.*

**Agreement Concerning Procedures for the Implementation of United States
Economic Assistance Provided in the Compact of Free Association, as amended,
Between the Government of the United States of America and
the Government of the Federated States of Micronesia**

This Agreement is entered into by the Government of the United States and the Government of the Federated States of Micronesia in recognition of their mutual desire to fulfill their obligations and responsibilities in the implementation of United States Economic Assistance, Programs, and Services as Set Forth in Title Two of the Compact, as amended. The purpose of this Agreement is to record the procedures that are most efficient, economical, and beneficial to the discharge of the obligations and responsibilities of each government and which each party agrees to implement and abide by. This Agreement shall be construed and implemented in a manner consistent with the Compact, as amended.

**Article I
Definition of Terms**

For purposes of this Agreement, the following terms shall have the following meanings when capitalized:

“Agreement” means this Agreement Concerning Procedures for the Implementation of United States Economic Assistance Provided in the Compact, as amended, of Free Association Between the Government of the United States of America and the Government of the Federated States of Micronesia.

“Accrued Expenditures” means the charges incurred by the Government of the Federated States of Micronesia during a given period requiring the provision of funds for: (1) goods and other tangible property received; (2) services performed by employees, contractors, Sub-Grantees, subcontractors, and other third party non-contractors; and (3) other amounts becoming owed under programs for which no current services or performance is required, such as annuities, insurance claims, and other benefit payments.

“Allowable Costs” mean those necessary and reasonable costs allocable to a Grant that comply with the limitations of any agreement relating to such Grant as well as to applicable laws and regulations, are allocated to the Grant on a basis consistent with policies that apply to all activities of the Grant, are accounted for consistently and in accordance with generally accepted accounting principles, are adequately documented, and are net of all applicable credits.

“Annual Report” has the meaning assigned to such term in Article V, section 1(d).

“Appeal” means the right of a Grantee to request a hearing from the director of the United States Department of the Interior’s Office of Hearings and Appeals regarding an adverse agency decision (43 C.F.R. Part 4). An ad hoc appeals board of two or more administrative law judges may be appointed by the director to hear the dispute at the Grantee’s written request. Decisions will be in writing and signed by a majority of board members. Grantees (and their representatives) who appear before the board are governed by specific rules of practice (43 C.F.R. Part 1).

“Audits” mean financial, program and management audits, including the determination as to whether the Government of the Federated States of Micronesia has met the requirements set forth in the Compact, as amended, or its related agreements regarding the purposes for which Grants or other assistance are to be used; determinations as to the propriety of the financial transactions of the Government of the Federated States of Micronesia with respect to such Grants or assistance; and the substantiation of appropriate follow-up actions by the Government of the United States and the Government of the Federated States of Micronesia.

“Committee” has the meaning assigned to such term in Article III.

“HAFSM” has the meaning assigned to such term in Article II, section 2.

“Closeout” means the normal process by which the awarding agency determines that all applicable administrative actions and all required work on the annual Grant have been completed.

“Compact” means the Compact of Free Association Between the United States and the Federated States of Micronesia and the Marshall Islands, that was approved by the United States Congress in section 201 of Public Law 99-239 (Jan. 14, 1986) and went into effect with respect to the Federated States of Micronesia on November 3, 1986.

“Compact, as amended” means the Compact of Free Association Between the United States and the Federated States of Micronesia, as amended. The effective date of the Compact, as amended, shall be on a date to be determined by the President of the United States, and agreed to by the Government of the Federated States of Micronesia, following formal approval of the Compact, as amended, in accordance with section 411 of this Compact, as amended.

“Contract” means a procurement Contract under a Grant or Sub-Grant. It also means a procurement sub-contract under a contract.

“Core Labor Standards” mean those fundamental rights that are guaranteed to all workers in the Federated States of Micronesia, including but not limited to freedom of association, non-discrimination in employment, the prohibition of forced labor, and the prohibition of exploitive child labor.

“Cost Accounting” means the method by which incurred costs are allocated to sector Grants by classification or type of expenditure linked to performance goals or, in lieu of performance budgeting, as line items of a traditional budget. Regardless of format, Cost Accounting structures for performance budgets should be capable of reporting on the cost of operations at three levels: (1) on an entity-wide (or agency basis); (2) by responsibility segment, defined as a component of the reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services; and (3) by segment outputs, that is, the cost centers associated with the separate types of outputs produced within each responsibility segment.

“Development Plan” has the meaning assigned to such term in Article V, section 1.

“Economic Assistance, Programs, and Services as Set Forth in Title Two” means the annual assistance provided to the Government of the Federated States of Micronesia by the Government of the United States under the Compact, as amended.

“Equipment” means tangible, non-expendable, personal property having a useful life of more than one year and an acquisition cost of \$5,000 or more per unit. The Government of the Federated States of Micronesia may use its own definition of Equipment provided it at least includes all Equipment defined above.

“Expenditure Report” means: (1) for non-construction Grants, the financial status or other equivalent report, and (2) for construction Grants, the outlay report and request for reimbursement or other equivalent report.

“Fiscal Year” means each one year period beginning October 1 and ending on the next following September 30. Each Fiscal Year shall be designated by the number of the calendar year in which such Fiscal Year ends. For example, “Fiscal Year 2022” means the Fiscal Year ending in calendar year 2022.

“Government of the United States” means the federal government of the United States of America.

“Government of the Federated States of Micronesia” means the Government established and organized by the Constitution of the Federated States of Micronesia including all the political subdivisions and entities comprising that Government.

“Grant” means an award of sector-based financial assistance, including cooperative agreements, in the form of money, or property in lieu of money, by the Government of the United States to the Government of the Federated States of Micronesia in accordance with section 211 of Title Two of the Compact, as amended. The term does not include technical assistance instead of money, or other assistance in the form of revenue sharing, loans, loan guarantees, interest subsidies, insurance, or direct appropriations. Acceptance of a Grant from the Government of the United States creates a legal duty on the part of the Government of the Federated States of Micronesia to use funds in accordance with the terms and conditions of the Grant.

“Grantee” means the recipient of a Grant under the Compact, as amended, or hereunder.

“Grants Administration” means those matters common to Grants in general, such as financial management, kinds and frequency of reports and records retention. These are distinguished from “programmatic” requirements, which concern matters that can be treated only on a program-by-program or Grant-by-Grant basis, such as activities supported by Grants.

“Gross Domestic Product Implicit Price Deflator” means the “Gross Domestic Product Implicit Price Deflator” as published from time to time in the *Survey of Current Business* by the Bureau of Economic Analysis of the United States Department of Commerce, or any successor thereto. It is a weighted average of the detailed price indices

used in the deflation of the United States Gross Domestic Product. In each period, it uses as weights the composition of constant dollar output in that period. Changes in the implicit price deflator reflect both changes in prices and changes in the composition of output.

“IDP” has the meaning assigned to such term in Article V, section 1(e).

“IMF” has the meaning assigned to such term in Article VII, section 7.

“Implementing Agency” means the United States Federal agency that is authorized by the United States Congress to receive, disburse, and monitor financial assistance pursuant to Title Two of the Compact, as amended.

“Indirect Costs” mean costs incurred for common institution-wide or joint objectives that cannot be identified readily and specifically with a particular program or activity, such as general administration not associated with a sector Grant or project funded under the Compact, as amended.

“Matching” means the value of the in-kind contributions or the portion of the costs of a project or program of the Government of the United States that is required to be borne by the Government of the Federated States of Micronesia.

“Obligations” means the amounts of orders placed, Contracts and subcontracts awarded, goods and services received and similar transactions during a given period that will require payment by the Government of the Federated States of Micronesia during the same or future period.

“Operational Costs” means the customary and usual direct costs associated with the operations of a sector Grant program that continue from a given period to a subsequent period.

“Operational Grants” means the grants associated with a sector Grant program that continue from a given period to a subsequent period.

“Operational Reserve Account” has the meaning assigned to such term in Article IV, section 5(b)(2).

“Original Compact” means the Compact of Free Association Between the United States and the Federated States of Micronesia and the Marshall Islands, that was approved by the United States Congress in section 201 of Public Law 99-239 (Jan. 14, 1986) and went into effect with respect to the Federated States of Micronesia on November 3, 1986.

“Payment Bond” has the meaning assigned to such term in Article VI, section 1(j)(13)(iii).

“Performance Bond” has the meaning assigned to such term in Article VI, section 1(j)(13)(ii).

“Prior Approval” means documentation evidencing consent of the awarding agency of the Government of the United States prior to incurring specific cost.

“Program Income” has the meaning assigned to such term in Article VI, section 1(i).

“Real Property” means land, including land improvements, structures and appurtenances thereto, excluding movable machinery and Equipment.

“Standard Form SF-269” has the meaning assigned to such term in Article VI, section 1(b)(1)(iii).

“Standard Form SF-272” has the meaning assigned to such term in Article VI, section 1(b)(1)(iii).

“Sub-Grant” means an award of financial assistance in the form of money, or property in lieu of money, made by the Government of the Federated States of Micronesia to an eligible Grantee, including but not limited to local governments. The Government of the Federated States of Micronesia, as the legal entity to which United States financial assistance is awarded, is accountable for the use of all such funds by its Sub-Grantees.

“Sub-Grantee” means the recipient of a Sub-Grant under the Compact, as amended, or hereunder.

“Supplies” mean all tangible personal property other than “Equipment” as defined in this Article.

“Suspension” means, depending on the context, either (1) temporary withdrawal of the authority to obligate Grant funds pending corrective action by the Government of the Federated States of Micronesia or its Sub-Grantee; (2) a decision to terminate the Grant; or (3) an action taken to immediately exclude a person from participating in Grant transactions for a period, pending completion of an investigation and such legal or debarment proceedings as may ensue.

“Termination” means permanent withdrawal of the authority to obligate previously awarded Grant funds before that authority would otherwise expire. It also means the voluntary relinquishment of that authority by the Government of the Federated States of Micronesia or its Sub-Grantee. It does not include: (1) withdrawal of funds awarded on the basis of an underestimation of the unobligated balance in a prior period; (2) withdrawal of the unobligated balance as of the expiration of a Grant; (3) refusal to extend a Grant or award additional funds; or (4) voiding of a Grant upon determination that the award was obtained fraudulently, or was otherwise illegal or invalid from inception.

“United States” means the United States of America.

“Withholding” means the retention of payments including reimbursements, by the Government of the United States, with respect to any Grant if the Government of the Federated States of Micronesia is in breach of the terms and conditions of Title Two of the Compact, as amended, or this Agreement with respect to such Grant, fails to comply with any award condition with respect to such Grant, or is indebted to the Government of the United States. Further description of Withholding is in Article IV, section 5(c)(1).

Article II

Economic Assistance Implementation

1. Subject to the terms and conditions of this Agreement, the Government of the United States shall provide financial assistance on an annual sector Grant basis for a period of 20 years in the amounts set forth in section 217 of Title Two of the Compact, as amended. Such Grants shall be used for assistance in education, health care, public infrastructure, the environment, public sector capacity building and private sector development, or for other areas as mutually agreed, with priorities in the education and health care sectors.

(a) The education sector Grant shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education, respectively, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. Emphasis should be on advancing a quality basic education system according to performance standards appropriate for the Federated States of Micronesia, providing secondary education or vocational training to qualified students, improving management and accountability within the educational system, raising the level of staff quality, including teacher training, and improving the relevance of education to the needs of the economy.

(b) The health sector Grant shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. Priority should be given to establishing sustainable funding mechanisms for operating a community-based system with emphasis on prevention, primary care, mental health, substance abuse prevention, and the operation of hospitals to provide secondary care at appropriate levels and reduce reliance on medical referrals abroad.

(c) The sector Grant for private sector development shall support the efforts of the Government of the Federated States of Micronesia to attract new foreign investment and increase indigenous business activity by vitalizing the commercial environment, ensuring fair and equitable application of the law, promoting adherence to Core Labor Standards, maintaining progress toward the privatization of state-owned and partially state-owned enterprises, and engaging in other reforms. Priorities should be given to advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, regulations and policies to foster private sector development, to facilitate investment by potential private investors, and to develop business and entrepreneurial skills.

(d) The sector Grant for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable, and transparent national and local government and other public sector institutions and systems. Priority should be given to improving economic planning, financial management, auditing, law enforcement, immigration controls, the judiciary, and the

compilation and analysis of appropriate statistical indicators with the goal of ensuring that essential functions can be carried out and that essential positions are filled with qualified personnel.

(e) The environment sector grant shall support the efforts of the Government of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources. These efforts include the ongoing development, adoption and enforcement of policies, laws and regulation in pursuit of the above stated goals; the reduction and prevention of environmental degradation and all forms of environmental pollution; adaptation to climate change; the protection of biological diversity, including the assurance of adequate legal and international treaty safeguards relating to the protection of botanical and other agro-ecological property belonging to the Federated States of Micronesia; the establishment and management of conservation (sustainable use) areas; environmental infrastructure planning, design construction, and operation; interaction and cooperation with non-governmental organizations; the promotion of increased environmental awareness in governmental and private sectors; and the promotion of increased involvement of citizens and traditional leaders of the Federated States of Micronesia in the process of conserving their country's natural resources.

(f) In accordance with section 211(a) of the Compact, as amended, unless otherwise agreed, annual Grant assistance shall be made available to assist the Government of the Federated States of Micronesia in its efforts to provide adequate public infrastructure assistance. With respect to the public infrastructure sector Grant, the highest priority shall be given to primary and secondary education capital projects and projects that directly affect health and safety, including water and wastewater projects, solid waste disposal projects, and health care facilities. Second priority shall be given to economic development-related projects, including airport and seaport improvements, roads, sea walls, and energy development including renewable energy that cannot be funded through the rate structure.

2. In recognition of the special development needs of the Federated States of Micronesia, the Government of the United States shall make available a Humanitarian Assistance – Federated States of Micronesia Program (“HAFSM”) upon request. Emphasis shall be on health, education, and infrastructure projects, including transportation, and such other projects as mutually agreed. The specific terms and conditions for requesting HAFSM assistance and for deducting costs from a sector Grant(s) awarded to the Government of the Federated States of Micronesia, are set forth in a separate agreement which shall come into effect simultaneously with the Compact, as amended.

3. The Government of the United States shall make annual contributions on or about the beginning of the Fiscal Year, into a trust fund established in accordance with sections 215 and 216 of Title Two of the Compact, as amended. Specific terms regarding fund investment, management, and use of proceeds are set forth in a separate agreement which shall come into effect simultaneously with the Compact, as amended.

4. The Government of the United States shall make an annual contribution of two hundred thousand dollars (\$200,000) on or about the beginning of the Fiscal Year, into a Disaster Assistance Emergency Fund established by the Government of the Federated States of Micronesia in accordance with section 211(d) of Title Two of the Compact, as amended. The Government of the Federated States of Micronesia shall annually deposit an equal amount to the fund. The terms and conditions for use are set forth in Annex A to this agreement.

5. Except as otherwise provided in the Compact, as amended, economic assistance under Title Two of the Compact, as amended, shall be adjusted for each Fiscal Year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit Price Deflator, or five percent, whichever is less in the applicable Fiscal Year, using the beginning of Fiscal Year 2004 as a base. This adjustment shall be done prior to depositing the amounts set forth in section 217 of Title Two of the Compact, as amended, into the trust fund. After year one, the annual change will use an additive percentage change formula. The percent change shall be calculated to two decimal points (xx.xx%) by subtracting the previous calendar year third quarter GDP index from the GDP index of the current calendar year's third quarter, dividing the result by the base year's index (normalized base year equals 100). Funds arising from such adjustments shall be available for allocation to the sector Grants.

6. Funds provided under section 211(a) of the Compact, as amended, shall be considered to be local revenues of the Government of the Federated States of Micronesia when used as the local share required to obtain federal programs and services that enhance its ability to meet stated performance goals.

7. The Government of the Federated States of Micronesia shall not issue negotiable or transferable obligations evidencing indebtedness or encumbrance of funds received under Section 211 of Title Two. On a case-by-case basis, as part of the grant formulation process, the Committee may consider requests by the Federated States of Micronesia for commitment of Section 211 funds beyond the current Fiscal Year.

Article III

Joint Economic Management

1. A Joint Economic Management Committee (the "Committee") shall be established to strengthen management and accountability with regard to assistance provided under the Compact, as amended, and to promote the effective use of funding provided thereunder.

2. The Committee shall be composed of five members, three of which shall be from the Government of the United States and two from the Government of the Federated States of Micronesia.

3. The chairperson of the Committee shall be from the Government of the United States. The Government of the United States shall consult with the Government of the Federated States of Micronesia when making the appointment, and the Government of the Federated States of Micronesia shall have an opportunity to present its views which shall be considered.

4. Appointments by the Government of the United States and the Government of the Federated States of Micronesia shall be made not later than 90 days after the effective date of this Agreement. The chairperson and members of the Committee shall serve a term of two years and may be reappointed.

5. The duties of the Committee shall be to:

(a) Review the Development Plan and other planning and budget documents of the Government of the Federated States of Micronesia, and monitor the progress made by the Government of the Federated States of Micronesia toward sustainable economic development and budgetary self-reliance in relation to its written goals and performance measures;

(b) Consult with providers of United States Federal Grant programs and services and other bilateral and multilateral partners to monitor the use of development assistance from all sources-as it relates to the allocation of financial assistance under the Compact, as amended;

(c) Review Audits called for in the Compact, as amended, or this Agreement and actions taken or being taken to reconcile problems and qualified findings;

(d) Review performance outcomes and other reported data in relation to the previous year's Grant funding levels, terms, and conditions;

(e) Review and approve Grant allocations and performance objectives for the upcoming year;

(f) Review and approve any change proposed by the Government of the Federated States of Micronesia to the sectors to receive economic assistance set forth in Title Two of the Compact, as amended;

(g) Evaluate progress, management problems and any shifts in priorities in each sector, and identify ways to increase the effectiveness of United States assistance;

(h) Review quarterly trust fund investment reports;

(i) Comment on the comprehensive report prepared by the Government of the Federated States of Micronesia as required by section 214 of Title Two of the Compact, as amended, before it is submitted to the President of the United States; and

(j) Stipulate special conditions to attach to any or all annual Grant awards to improve program performance and fiscal accountability, and ensure progress toward macroeconomic goals.

6. The Committee shall meet at least once annually but no later than 30 days before the beginning of each Fiscal Year.

7. Sector Grant allocation decisions of the Committee shall be binding. In the event that the Government of the Federated States of Micronesia overrides all or part of these

decisions, the Government of the United States may withhold Grant payments until the issues in dispute are resolved.

8. Each government shall provide the necessary staff support to its representatives on the Committee, to enable the parties to monitor closely the use of assistance under the Compact, as amended. No United States funding shall be used to support the travel or honoraria of Committee members from the Government of the Federated States of Micronesia, or any special salaries paid for serving as members of the Committee.

Article IV Grants Administration

1. Grant funds may not be used for any purpose other than that for which they are awarded. Unobligated funds shall carry over to the following Fiscal Year for reallocation to the applicable sector Grant, unless otherwise provided in this Agreement or the Compact, as amended.

2. All terms and conditions imposed on the Government of the Federated States of Micronesia shall apply to Sub-Grantees.

3. The President of the Federated States of Micronesia, acting on behalf of the national, state and local governments of the Federated States of Micronesia, shall be responsible for all certifications to the Government of the United States pursuant to this Agreement.

4. Grant Conditions:

(a) General terms and conditions of the sector Grants shall include conformance to the plans, strategies, budgets, project specifications, architectural and engineering specifications, performance standards, and other criteria developed by the Government of the Federated States of Micronesia and concurred with by the Committee.

(b) After consultation with the Government of the Federated States of Micronesia, the Government of the United States may recommend that the Committee attach certain terms and conditions to an annual allocation to assist the Government of the Federated States of Micronesia to achieve the goals of the sector Grant.

(c) Other special conditions or restrictions may be required by the Government of the United States during the course of the Grant year if it determines that the Government of the Federated States of Micronesia or a Sub-Grantee has a history of unsatisfactory performance, is not financially stable, has not conformed to terms and conditions of previous awards, or is otherwise not responsible. Special conditions or restrictions may include:

(1) Payment on a reimbursement basis;

- (2) Withholding authority to proceed to the next phase of the Grant until receipt of evidence of acceptable performance within a given period;
- (3) Requiring additional, more frequent and/or detailed financial reports;
- (4) Providing for additional project monitoring;
- (5) Requiring the acquisition of technical or management assistance; and
- (6) Requiring additional Prior Approvals.

(d) If the Government of the United States imposes such conditions as stated above in clause (c), it shall immediately notify the Government of the Federated States of Micronesia in writing of its intent. This notification shall include a description of the:

- (1) Nature of the special conditions or restrictions;
- (2) Reasons for imposing them;
- (3) Corrective actions which must be taken before they will be removed and the time allowed for completing the corrective actions; and,
- (4) Method of requesting reconsideration of the conditions and restrictions imposed.

(e) If the explanation from the Government of the United States or any subsequent discussion between the Government of the United States and the Government of the Federated States of Micronesia is disputed, the Government of the Federated States of Micronesia may submit an Appeal in writing to the Implementing Agency of the Government of the United States. This Appeal must be initiated within 30 days of the receipt of a sector Grant award or a notification of intent to impose special conditions. In such case, the Appeal for reconsideration will be handled in accordance with established administrative procedures of the Implementing Agency.

5. Payment Procedures:

- (a) Establishment of Account. The Government of the Federated States of Micronesia shall establish an account with a bank or commercial financial institution organized in accordance with the laws of the United States or a State of the United States; or, subject to the approval of the Government of the United States, a bank or commercial financial institution in accordance with the laws of the Federated States of Micronesia, in either case for the purpose of receiving payments of Grant funds pursuant to the Compact, as amended, and this Agreement. The Government of the Federated

States of Micronesia shall provide the Government of the United States with wiring instructions with respect to such account.

(b) Advance Payment. In general, payments for Operational Grants under the Compact, as amended, shall be made monthly, as set forth below, in advance. The amounts of the payments will match the percentage of the Fiscal Year to be completed during the advance period, or may be based on an outlay analysis performed by the Government of the Federated States of Micronesia and concurred with by the Government of the United States.

- (1) Periodic Payments. The first payment of each Fiscal Year for Operational Grants will be sufficient to fund financial requirements for the first two months of each Fiscal Year. All other payments will be made on or about the first Business Day of each month (except that no payment shall be made on the second month of each Fiscal Year) to fund financial requirements of that month.
- (2) Operational Reserve Account. The Government of the Federated States of Micronesia shall establish an interest-bearing account that complies with the terms and conditions of this clause (2) (the "Operational Reserve Account"). The Operational Reserve Account shall be established at a financial institution that complies with the requirements of Article IV, section 5(a). On or about the date on which the first payment in respect of Operational Grants is made during each Fiscal Year, the Government of the United States shall deposit into the Operational Reserve Account an amount equal to one-fifty-second (1/52) of the aggregate amount of funds in respect of Operational Grants that will be payable to the Government of the Federated States of Micronesia during such Fiscal Year. The amount deposited into the Operational Reserve Account during any Fiscal Year shall be credited toward the final payment in respect of Operational Grants during such Fiscal Year. Provided that all conditions to the obligation of the Government of the United States to make payments in respect of Grants have been satisfied and the Government of the United States is not entitled to effect a Withholding or Suspension, the principal balance of the Operational Reserve Account (which, for the avoidance of doubt, shall not include any interest or other earnings paid or accrued with respect to the Operational Reserve Account) as of the date of the final payment in respect of Operational Grants during any Fiscal Year shall be released to the Government of the Federated States of Micronesia as part of such final payment. Interest, and other earnings on the Operational Reserve Account shall be paid to the Government of the United States promptly from time to time when earned. Except as set forth above, funds on deposit from time to time in the Operational Reserve Account shall be used solely to cover unanticipated delays of payments from the Government of the United States of funds in respect of Grants, provided that the

Government of the United States shall approve any such use of funds in the Operational Reserve Account (which approval shall not be unreasonably withheld). In the event that any amount of funds from the Operational Reserve Account is used in accordance with the immediately preceding sentence, then such amount shall be deducted from the next payment from the Government of the United States of funds in respect of Grants and the amount so deducted shall be deposited into the Operational Reserve Account. Notwithstanding any other provision of this Agreement, the Government of the United States shall be entitled to withdraw all amounts on deposit in the Operational Reserve Account at any time that the Government of the United States is entitled to effect a Withholding or Suspension. The Government of the Federated States of Micronesia and the Government of the United States shall review the continued need for the Operational Reserve Account from time to time, and may discontinue its use upon mutual consent.

- (3) Advances for Accrued Expenditures. All infrastructure projects and projects that are not funded by Operational Grants will be paid on the basis of Accrued Expenditures, provided the Government of the Federated States of Micronesia maintains procedures to minimize the time elapsing between transfer of funds and their disbursement.

(c) Breach of Terms and Conditions:

- (1) Withholding of Payments. The Government of the United States may withhold payments, including reimbursement payments, with respect to any Grant if the Government of the Federated States of Micronesia is in breach of any of the terms and conditions of Title Two of the Compact, as amended, or this Agreement with respect to such Grant, fails to comply with any award condition with respect to such Grant, or is indebted to the Government of the United States with respect to such Grant. The amount of the withholding shall be proportional to the breach of the term or condition. If the Government of the Federated States of Micronesia disputes the withholding of payments with respect to a Grant, it may submit an Appeal in writing to the Implementing Agency of the Government of the United States. That Appeal must be initiated within 30 days of the receipt of notice of withholding of payment. In such case, the Appeal for reconsideration must be handled in accordance with established administrative procedures of the Implementing Agency. Cash withheld for failure to comply with Grant terms shall be released upon subsequent compliance, provided that such Grant has not been revoked pursuant to any applicable Appeal or dispute resolution proceeding.

- (2) Suspension. Notwithstanding any other provision of this Agreement, the Government of the United States may suspend payment with respect to any or all sectors in the event that the Government of the United States reasonably determines that the Government of the Federated States of Micronesia has engaged in a pattern of gross negligence, willful misconduct or material breach of terms and conditions with respect to the use of financial assistance provided under the Compact, as amended, provided that such determination is made on a sector by sector basis. If the Government of the Federated States of Micronesia disputes the Suspension of Grant assistance under this sub-paragraph, it may seek to resolve the matter through the conference and dispute resolution procedures set forth in Article II of Title Four of the Compact, as amended. The Suspension of payment shall stand unless otherwise determined through the conference and dispute resolution process described in Article II of Title Four of the Compact, as amended.

Article V

Pre-Award Requirements

1. Planning As a Requirement of Economic Assistance:

(a) No later than 90 days after the effective date of Title Two of the Compact, as amended, and thereafter at appropriate intervals, the Government of the Federated States of Micronesia shall prepare and submit to the Government of the United States a “Multi-Year Rolling Development Plan” pursuant to section 211(f) of Title Two of the Compact, as amended (the “Development Plan”). The Development Plan shall be strategic in nature and continuously reviewed and updated through the annual budget process. It shall identify the goals and broad strategies of the Government of the Federated States of Micronesia to promote economic advancement, budgetary self-reliance, and economic self-reliance, and contain specific multi-year objectives for the sectors described in section 211(a) of the Compact, as amended. Each of the sectors so named, or other sectors as agreed to by the Committee, shall be accorded specific treatment in the Development Plan. Those portions of the Development Plan that contemplate use of United States Grant funds require the concurrence of the Committee.

(b) United States sector Grant assistance shall be made available in accordance with annual implementation plans developed by the Government of the Federated States of Micronesia in conjunction with its budget process. The Government of the Federated States of Micronesia shall submit the plan for the division of annual economic assistance among the sectors described in Article II of this Agreement and, for each sector, the proposed expenditures and related performance goals and measures for the next Fiscal Year to the Government of the United States for review no later than 90 days prior to the beginning of the Fiscal Year. Annual Grant budgets by sector should provide:

- (1) Actual expenditures in the most recently completed Fiscal Year;
- (2) Appropriated Grant amounts and estimated expenditures in the current Fiscal Year;
- (3) Estimated Grant requirements for the upcoming Fiscal Year, including a detailed breakdown of personnel expenditures and compensable staff years, travel and other objects;
- (4) Specific performance indicators for each sector;
- (5) Funds provided to each sector in the current and upcoming Fiscal Years by United States Federal programs, international donors and local, state or national governments; and
- (6) Any available planning estimates for ensuing Fiscal Years.

(c) Changes to sector Grant priorities or performance goals of the Government of the Federated States of Micronesia during the course of the Grant year shall have the concurrence of the Government of the United States.

(d) In accordance with section 214 of Title Two of the Compact, as amended, the Government of the Federated States of Micronesia shall prepare and submit an Annual Report in February of each year to the President of the United States on the use of Grant assistance and other assistance provided by the Government of the United States during the previous Fiscal Year, and on the progress of the Federated States of Micronesia in meeting mutually agreed program and economic goals.

(e) The Government of the Federated States of Micronesia shall develop and submit a nationwide infrastructure development plan ("IDP") to the Government of the United States for review. Projects may be phased over two or more years. The annual implementation plan for the infrastructure sector referred to in (b) above, shall include a list of integrated state and national priorities for new and reconstructed capital infrastructure to be financed by Compact funds, cost requirements, and implementation schedule. This project list and any revision thereto shall be submitted to the Government of the United States. Insofar as Grant funds are involved, the IDP shall be subject to the concurrence of the Committee.

2. Annual Budget Consultation:

(a) The Government of the United States shall evaluate the proposed sector Grant budgets of the Government of the Federated States of Micronesia to ascertain consistency with the funding requirements of the Compact, as amended, and its related agreements, the appropriateness of performance objectives and indicators, and the adequacy of expenditures in achieving stated purposes. Upon the completion of the review, the Government of the United States and the Government of the Federated States of Micronesia shall confer to discuss any need for special terms or conditions and to make adjustments to the annual sector

Grant budgets or implementation plans as may be appropriate prior to the awarding of Grants. This consultation shall occur before the meeting of the Committee but not later than 30 days after the receipt of the implementation plans and proposed budgets by the Government of the United States.

(b) The Committee shall receive and review the progress reports and annual proposed budgets and implementation plans of the Government of the Federated States of Micronesia, and approve sector Grant allocations no later than 30 days before the beginning of the Fiscal Year. Consistent with the provisions set forth in Article III of this Agreement, the Committee may establish alternative funding levels, special Grant terms and conditions or other actions it deems appropriate to help the Government of the Federated States of Micronesia meet the stated goals and objectives of the Compact, as amended.

3. Notification of Grant Acceptance:

(a) The Government of the United States shall forward official Grant award notices to the Government of the Federated States of Micronesia no later than October 1 of each year.

(b) Return of signed Grant awards by the President of the Federated States of Micronesia shall signify acceptance of the funding amounts and any Grant terms and conditions that may be attached to the sector Grants.

Article VI
Post-Award Requirements

1. Financial Administration:

(a) Standards for Financial Management Systems:

(1) The Government of the Federated States of Micronesia shall expend and account for funds provided pursuant to the Compact, as amended, in accordance with its laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the Government of the Federated States of Micronesia, as well as its Sub-Grantees and cost-type contractors, shall be sufficient to:

(i) Permit preparation of reports required by this Agreement and the Compact, as amended; and,

(ii) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have been used in compliance with the provisions of the Compact, as amended, and applicable agreements.

(2) The financial management systems used by the Government of the Federated States of Micronesia shall meet the following standards:

- (i) Financial Reporting. Accurate, current, and complete disclosure of the financial results of United States funded activities shall be in accordance with the reporting requirements of the sector Grant or Sub-Grant.
- (ii) Accounting Records. Accounting records shall adequately identify the source and application of funds provided for all sector Grant activities. These records must contain information pertaining to awards and authorizations, Obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
- (iii) Internal Control. The system shall maintain effective controls and accountability for all Grant and Sub-Grant cash, Real Property and personal property, and other assets to safeguard and ensure uses are solely for authorized purposes.
- (iv) Budget Control. Actual expenditures or outlays must be compared with budgeted amounts for each Grant or Sub-Grant. Financial information must be related to performance or productivity data, including the development of unit cost information whenever appropriate or specifically required in the Grant terms and conditions. If unit cost data are required, estimates based on available documentation will be accepted whenever possible.
- (v) Allowable Cost. Applicable cost principles and Grant terms shall be followed in determining the reasonableness and allowability of costs. An Indirect Cost rate may not be charged against funds provided pursuant to the Compact, as amended.
- (vi) Source Documentation. Accounting records shall be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, Contract and Sub-Grant award documents, and other financial data.
- (vii) Cash Management. Compact payments shall be made in accordance with Article IV of this Agreement. To the extent that the Government of the Federated States of Micronesia awards Sub-Grants to states, local governments or other entities, it shall establish reasonable procedures to ensure the timely receipt of reports on cash balances and cash disbursements to enable the preparation of complete and accurate cash transactions reports.

(viii) The Government of the United States may review the adequacy of the financial management system of any recipient of financial assistance provided pursuant to the Compact, as amended, at any time.

(b) Financial Reports:

- (1) Quarterly Financial Reports. The Government of the Federated States of Micronesia shall provide the following financial reports each fiscal quarter to the Government of the United States. These reports will be used to monitor the general budget and fiscal performance of the Government of Federated States of Micronesia and to monitor disbursement or outlay information for each sector Grant.
 - (i) The Government of the Federated States of Micronesia shall submit the following reports 30 days after the end of each fiscal quarter: (1) a statement of revenues and expenditures for governmental fund types, and (2) a comparison of budget and actual expenditures by function for governmental fund types.
 - (ii) The quarterly report for all Operational Grants shall contain a budget execution report for each function and include major offices, cost centers and budget activities.
 - (iii) For all Grants provided pursuant to the Compact, as amended, the Government of the Federated States of Micronesia shall submit a quarterly financial status report on form SF-269 or any successor thereto, as issued by the Government of the United States from time to time (“Standard Form SF-269”) and a quarterly federal cash transactions report on form SF-272 or any successor thereto, as issued by the Government of the United States from time to time (“Standard Form SF-272”). The Government of the Federated States of Micronesia may use the Federal forms available for this purpose or, as mutually agreed, provide the information in an alternative format.
- (2) Annual Financial Report(s). The Government of the Federated States of Micronesia shall submit a final cash transactions report for each sector Grant 90 days after the end of the funding period. For Operational Grants, the purpose of this report is to establish the amount of unobligated Grant funding that will carry over to subsequent Fiscal Years.
- (3) The Government of the United States may extend the due date of any financial report upon receiving a justified request from the Government of the Federated States of Micronesia.

(4) Accounting Basis. The Government of the Federated States of Micronesia shall report on a cash or accrual basis consistent with its own policies. Provided the information is not changed in substance, the format of the report may be adapted when reporting is accomplished with the aid of automated data processing Equipment.

(c) Period of Availability of Grant Funds:

- (1) Funding for each Grant, other than Grants for infrastructure and other Grants that are not Operational Grants, shall generally be available for one year. Funding for infrastructure and projects that are not funded by Operational Grants shall be available for obligation for the time period described in the terms and conditions of the sector Grants.
- (2) The Government of the Federated States of Micronesia shall liquidate all Obligations incurred under a Grant not later than 90 days after the end of the funding period or as otherwise mutually agreed, to coincide with the submission of the final annual cash transactions report.

(d) Changes, Property, and Sub-Awards:

- (1) Budget Changes. Re-allocation of funds from one sector to another sector shall not be permitted during the course of the Grant year. Except as set forth below, the Government of the Federated States of Micronesia may reprogram up to 15 percent of the total budget or \$1,000,000, whichever is less, within an approved sector Grant to meet unanticipated requirements and make limited program changes to approved projects. However, unless waived by the Government of the United States, the following changes in budgets and projects during the course of the Grant year shall require prior written approval of the United States:
 - (i) Budget Changes in Non-Construction Projects. Except as stated in the Grant document, the Government of the Federated States of Micronesia shall obtain Prior Approval whenever any of the following changes is anticipated:
 - (1) any revision that would result in the need for additional funding over and above the original award, and
 - (2) cumulative transfers among direct cost categories, or, if applicable, among separately budgeted programs, projects, functions, or activities that exceed or are expected to exceed the threshold described above in sub-clause (1) of clause (d).
 - (ii) Construction Projects. The Government of Federated States of Micronesia shall obtain prior written approval for any

budget revision that would result in the need for additional funds.

- (2) Programmatic Changes. The Government of the Federated States of Micronesia shall obtain Prior Approval whenever any of the following actions is anticipated:
- (i) Any revision of the scope or performance objectives of the sector Grant or infrastructure project;
 - (ii) The need to extend the period of funding availability;
 - (iii) Changes in key persons specifically named in a Grant award; and,
 - (iv) The contracting out or otherwise obtaining the services of a third party to perform non-construction related activities that are central to the purposes of the Grant. This approval is in addition to the requirements described below in clause (j) but does not apply to the procurement of Equipment, Supplies, and general support services.

(e) Real Property:

- (1) Title. Subject to the Obligations and conditions set forth in this section, title to Real Property acquired with funds provided pursuant to the Compact, as amended, shall vest upon acquisition in the Government of the Federated States of Micronesia.
- (2) Use. Except as mutually agreed by the Government of the Federated States of Micronesia and the Government of the United States, Real Property acquired with funds provided pursuant to the Compact, as amended, shall be used as long as needed for the purposes originally authorized, and the Government of the Federated States of Micronesia shall not dispose of or encumber Real Property titles or other interests.
- (3) Disposition. When Real Property is no longer needed for the originally authorized purpose, the Government of the Federated States of Micronesia and the Government of the United States shall consult on the choice of one of the following disposition alternatives:
 - (i) Retention of Title. If the Real Property will continue to be used for a public purpose, the Government of the Federated States of Micronesia shall retain title.
 - (ii) Sale of Property. The Government of the Federated States of Micronesia may sell the property and reimburse the Compact accounts held by the Government of the United

States. The amount due shall be calculated by applying the percentage of the original price paid by United States funding to the proceeds of the sale after deducting any actual and reasonable expenses. Any funds reimbursed shall be considered unobligated funding under the Compact, as amended, to be reallocated to sector Grants.

(iii) Transfer of Title. The Government of the Federated States of Micronesia may transfer title to a third party approved by the Government of the United States.

(f) Equipment:

(1) Title. Subject to the Obligations and conditions set forth in this section, title to Equipment acquired with funds provided pursuant to the Compact, as amended, will vest upon acquisition in the Government of the Federated States of Micronesia.

(2) Consistent with paragraphs (3) through (5) of this clause (f), the Government of the Federated States of Micronesia shall use, manage and dispose of Equipment acquired with funds provided pursuant to the Compact, as amended, in accordance with its laws and procedures.

(3) Use:

(i) Equipment shall be used in the program or project for which it was acquired as long as needed. When no longer needed for the original purpose, the Equipment may be used in other activities currently or previously supported by an agency of the Government of the United States.

(ii) Equipment acquired with Grant funds provided pursuant to the Compact, as amended, may be used by other projects or programs currently or previously supported by the Government of the United States, provided such use does not interfere with the work on activities funded pursuant to the Compact, as amended, for which such Equipment was originally acquired.

(iii) Unless specifically permitted by Grant terms and conditions, Equipment acquired with funds provided pursuant to the Compact, as amended, to provide services for a fee may not be used to compete unfairly with private companies that provide equivalent services.

(4) Management Requirements. Procedures for managing Equipment, whether acquired in whole or in part with funds provided pursuant to the Compact, as amended, shall meet the following minimum requirements:

- (i) Property records shall be maintained which include: (1) a description of the property, (2) a serial number or other identification number, (3) the source of property, (4) who holds title, (5) the acquisition date and cost of the property, (6) the percentage of United States funding used in the purchase, (7) the location, use and condition of the property, and (8) any ultimate disposition data including the date of disposal and sale price.
- (ii) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.
- (iii) A control system shall be developed to ensure adequate safeguards against property loss, damage or theft. Any loss, damage, or theft shall be investigated.
- (iv) Adequate maintenance procedures shall be developed to keep the property in good condition.
- (v) If the property is sold, proper sales procedures shall be established to ensure the highest possible return.

(5) Disposition. When Equipment acquired with funds provided pursuant to the Compact, as amended, is no longer needed for the original project or program, or for other activities supported by other agencies of the Government of the United States, it shall be disposed as follows:

- (i) Items of Equipment with a current per-unit fair market value of less than \$5,000 may be retained, sold or otherwise disposed of with no further obligation to the Government of the United States.
- (ii) Items of Equipment with a current per unit fair market value in excess of \$5,000 may be retained or sold. The Government of the Federated States of Micronesia may sell the property at fair market value and reimburse the Compact accounts-held by the Government of the United States. Any such funds shall be considered unobligated funding for reallocation to sector Grants.

(g) Supplies. Title to Supplies acquired with funds provided pursuant to the Compact, as amended, will vest, upon acquisition, in the Government of the Federated States of Micronesia.

(h) Sub-Awards to Debarred and Suspended Parties. The Government of the Federated States of Micronesia shall not award funds received pursuant to the Compact, as amended, to any party which is debarred, suspended or otherwise excluded from and ineligible for participation in United States assistance

programs under Executive Order 12549, "Debarment and Suspension." issued by the President of the United States on February 18, 1986.

(i) Program Income. For the purposes of this Agreement, "Program Income" shall include: (1) earnings from the use or rental of Real Property or personal property acquired with funds provided pursuant to the Compact, as amended; (2) the sale of commodities or items fabricated under a sector Grant; and (3) fees assessed in the areas of public utilities, health services and any other activities provided by government or government-owned enterprises that are supported by sector Grants.

(1) The Government of the Federated States of Micronesia shall seek opportunities to earn Program Income to defray government program costs and shall establish fees for services in the areas of public utilities, health services, and any other government-owned or operated enterprises to comply with the terms and conditions of certain sector Grants.

(2) Unless otherwise authorized by the Grant, Program Income shall remain with the programs in which they are earned, to offset Operational Costs and capital costs not covered by funds provided pursuant to the Compact, as amended.

(j) Procurement:

(1) The Government of the Federated States of Micronesia may use its own procedures for procurement, whether done by government or its Sub-Grantees, provided that they meet the standards identified in this section.

(2) The Government of the Federated States of Micronesia shall maintain a Contract administration system that ensures that contractors perform in accordance with the terms, conditions, and specifications of their Contracts or purchase orders.

(3) A written code of conduct shall be maintained by the Government of the Federated States of Micronesia to govern the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent of the Government of the Federated States of Micronesia shall participate in the selection, award, or administration of a Contract supported by funds provided pursuant to the Compact, as amended, if a conflict of interest, real or apparent, is involved.

(i) Officers, employees or agents shall neither solicit nor accept gratuities, favors, or anything of monetary value from contractors, potential contractors, or parties to sub-agreements.

- (ii) The Government of the Federated States of Micronesia may set minimum rules where the financial interest is not substantial or the gift is unsolicited and of nominal intrinsic value.
 - (iii) To the extent permitted by law or regulations of the Government of the Federated States of Micronesia, the standards of conduct shall provide for penalties, sanctions, or other disciplinary actions for violations.
- (4) Awards shall be made only to contractors who possess the ability to perform responsibly and successfully under the terms and conditions of a proposed procurement. Selection must consider contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.
- (5) Records shall be maintained with sufficient detail to document the history of a procurement, including but not limited to the rationale for and method of procurement, the selection of Contract type, contractor selection or rejection, and the basis for the Contract price.
- (6) The Government of the Federated States of Micronesia shall use time and material type Contracts only after determining that no other Contract is suitable and if the Contract includes a ceiling price that the contractor exceeds at its own risk.
- (7) The Government of the Federated States of Micronesia shall be solely responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurement. These issues include but are not limited to source evaluation, protests, disputes, and claims.
- (8) The Government of the Federated States of Micronesia shall have protest procedures to handle and resolve procurement disputes.
- (9) Competition:
 - (i) All procurement transactions shall be conducted in a manner providing full and open competition. Some of the situations considered to be restrictive of competition include but are not limited to: (1) placing unreasonable requirements on firms in order for them to qualify to do business; (2) requiring unnecessary experience and excessive bonding; (3) noncompetitive pricing practices between firms or between affiliated companies; (4) making noncompetitive awards to consultants on retainer; (5) organizational conflicts of interest; (6) specifying a “brand

name" instead of allowing "an equal" product to be offered and describing the performance of other relevant requirements of the procurement; and (7) any arbitrary action in the procurement process.

- (ii) Geographic preferences shall be allowed only if its application leaves an appropriate number of qualified firms to compete in the contract, and if there is no discrimination against race, religion or national origin.
- (iii) Written selection procedures shall govern procurement. These procedures shall ensure that all solicitations incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured. Such description shall not, in competitive procurement, contain features that unduly restrict competition.
- (iv) The Government of the Federated States of Micronesia shall ensure that all pre-qualified lists of persons, firms, or products used in acquiring goods and services are current and include enough qualified sources to ensure maximum open and free competition. Potential bidders shall not be precluded from qualifying during the solicitation period.

(10) Methods of Procurement:

- (i) Procurement By Small Purchase Procedures. Small purchase procedures are those relatively simple and informal methods for securing services, Supplies, or other property that do not cost more than \$100,000. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (ii) Procurement By Sealed Bids. Sealed bids are those bids that are publicly solicited for which a firm-fixed-price Contract is awarded to the lowest bidder who meets all the terms and conditions of the invitation. The sealed bid method is the preferred method for procuring construction, if the conditions of sub-clause (10)(iii) apply.
- (iii) The following conditions shall apply to sealed bidding: (1) a complete, adequate, and realistic specification or purchase description must be available; (2) two or more responsible bidders must be willing and able to compete effectively and for the business; (3) the procurement must lend itself to a firm fixed price contract; and (4) the selection of the successful bidder can be made principally on the basis of price.

- (iv) The following requirements shall apply if sealed bids are used: (1) the invitation for bids shall be publicly advertised, solicited from an adequate number of known suppliers, and provide bidders with sufficient time to respond; (2) the invitation shall include any specifications and pertinent attachments, and define the items or services to allow the bidder to properly respond; (3) all bids shall be publicly opened at the time and place prescribed in the invitation for bids; and (4) a firm fixed-price Contract award shall be made in writing to the lowest responsive and responsible bidder. Any or all bids may be rejected if there is a sound documented reason.
- (v) Procurement By Competitive Proposals. Competitive proposals are normally conducted when more than one source submits an offer for either a fixed-price or cost-reimbursement type contract, and when conditions are not appropriate for the use of sealed bids. If this method is used, the following requirements shall apply: (1) requests for proposals shall be publicized and identify all evaluation factors and their relative importance; (2) proposals shall be solicited from an adequate number of qualified sources; (3) the Government of the Federated States of Micronesia shall have a method for conducting technical evaluations of the proposals and for selecting awardees; and (4) awards shall be made to the firm whose proposal is most advantageous to the program. Competitive proposals may also be used when price is not a factor but only to procure architectural and engineering services. It cannot be used to purchase other types of services provided by architectural and engineering firms that are a potential source to perform the proposed effort.
- (vi) Procurement By Noncompetitive Proposals. Noncompetitive proposals are procurement through the solicitation of only one source or when competition is determined inadequate after soliciting a number of sources. This method shall be used only when the award of a Contract is infeasible under either procedures for small purchase, sealed bids or competitive proposals, and when one of the following circumstances applies: (1) the item is available only from a single source; (2) public exigency or emergency will not permit a delay resulting from competitive solicitation; or (3) competition is determined to be inadequate after the solicitation of a number of sources. Cost analysis shall be required to verify the proposed cost

data, the projections of the data, and the evaluation of the specific elements of costs and profits.

(11) The cost plus a percentage of cost and percentage of construction cost methods of contracting shall not be used.

(12) United States Review:

(i) The Government of Federated States of Micronesia shall make available, upon request of the Government of the United States, technical specifications on proposed procurements.

(ii) The Government of Federated States of Micronesia shall make available, upon request of the Government of the United States, pre-award procurement documents, including but not limited to requests for proposals or invitations for bids and independent cost estimates, when: (1) procurement procedures fail to comply with the standards set forth in this section; (2) the procurement is expected to exceed \$100,000 and is to be awarded without competition or only one bid or offer is received in response to a solicitation; (3) the proposed award is more than \$100,000 and is to be awarded to other than the apparent low bidder under a sealed bid procurement; or (4) a proposed Contract modification changes the scope of a Contract or increases the Contract amount by more than \$100,000.

(13) Bonding Requirements. For construction or facility improvement Contracts or sub-Contracts exceeding \$100,000, the Government of the United States may accept the bonding policy and requirements of the Grantee or Sub-Grantee provided the United States determines that its interests are adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

(i) Bid Guarantee. Each bidder shall guarantee an equivalent of five percent of the bid price pursuant to a bid guarantee that complies with the requirements of this clause (i). The bid guarantee shall consist of a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying the bid as assurance that the bidder will, upon acceptance of his bid, execute such contractual documents as may be required within the time specified.

(ii) Performance Bond. The contractor shall execute a Performance Bond for one hundred percent of the Contract price. A Performance Bond is one executed in connection

with a Contract to secure fulfillment of all the contractor's obligations under such contract.

- (iii) Payment Bond. The contractor shall execute a Payment Bond for one hundred percent of the Contract price. A Payment Bond is one executed in connection with a Contract to assure the lawful payment of all persons supplying labor and material in the execution of the contract.

- (14) Contract Provisions. All Contracts paid with funds provided pursuant to the Compact, as amended, shall contain the following provisions:

- (i) For Contracts in excess of \$100,000: administrative, contractual, or legal remedies in instances where contractors violate or breach Contract terms, and the provision of such sanctions and penalties as appropriate;

- (ii) For Contracts in excess of \$100,000: Termination for cause and for convenience by the Grantee or Sub-Grantee including the manner by which it will be effected and the basis for settlement;

- (iii) Compliance with the local statutes regarding kickbacks and corrupt practices;

- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to that specific Contract for the purpose of making audit, examination, excerpts, and transcriptions;

- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and

- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

(k) Sub-Grants:

- (1) The Government of the Federated States of Micronesia will follow its laws and procedures when awarding and administering Sub-Grants. The Governments shall ensure that:

- (i) Every Sub-Grant includes any clauses required by the Compact, as amended, the sector Grant awards and this Agreement;

- (ii) Sub-Grantees are aware of requirements imposed upon them by the Compact, as amended, the sector Grant awards and this Agreement; and
- (iii) The Sub-Grantee can meet the financial management standards of this Agreement.

2. Program Monitoring, Performance Reports and Records Retention:

(a) Monitoring and reporting sector Grant program performance by the Government of the Federated States of Micronesia:

- (1) The Government of the Federated States of Micronesia shall be responsible for the management and monitoring of the day-to-day operations of all sector Grants and their activities, to assure compliance with all applicable Grant terms and conditions. Monitoring shall cover each program, function, or activity to ensure the achievement of performance goals.
- (2) The Government of the Federated States of Micronesia shall submit quarterly performance reports on each sector Grant. The reports shall be due 30 days after the reporting period.
- (3) The Government of the Federated States of Micronesia and the Government of the United States shall agree on a uniform format for performance reports. Performance reports for each Grant shall contain a summary of the following:
 - (i) A comparison of actual accomplishments to the objectives and indicators established for the period;
 - (ii) Any positive events that accelerate performance outcomes;
 - (iii) Any problems or issues encountered, reasons, and impact on Grant activities and performance measures;
 - (iv) Additional pertinent information including, when appropriate, an analysis and explanation of cost overruns.
- (4) The Government of the Federated States of Micronesia shall require performance reports from its Sub-Grantees.

(b) Construction Performance Reports. Unless otherwise agreed, the Government of the Federated States of Micronesia shall submit quarterly performance reports on each project funded pursuant to the Compact, as amended, to the Government of the United States.

(c) Significant Developments. Events may occur between the scheduled performance reporting dates that have significant impact upon a sector Grant supported activity. In such cases, the Government of the Federated States of

Micronesia shall immediately inform the Government of the United States when the following conditions arise:

- (1) Problems, delays, or adverse conditions that will materially impair the ability of the Government of the Federated States of Micronesia to meet the terms and conditions of the sector Grant. This disclosure must include a statement of the action taken or contemplated, and any assistance needed to resolve the situation.
 - (2) Favorable developments that enable the meeting of time schedules and objectives sooner or at less cost than anticipated, or that produce more beneficial results than anticipated.
- (d) The Government of the United States may make site visits as warranted by program needs.
- (e) Waivers and Extensions:
- (1) The Government of the United States may waive any required performance report.
 - (2) The Government of the Federated States of Micronesia may extend the due date for any performance report from a Sub-Grantee provided its reporting obligations to the Government of the United States are met.
- (f) Frequency:
- (1) The Government of the United States may prescribe an alternative reporting frequency for a project or program. If no frequency is specified, the report shall be submitted annually.
 - (2) A final report shall be required upon the completion or termination of each infrastructure or capacity building sector project.
- (g) Due Date:
- (1) When reports are required on a quarterly or semiannual basis, they shall be due 30 days after the reporting period. When required on an annual basis, they shall be due 90 days after the end of the Grant year.
 - (2) Final reports shall be due 90 days after the completion or termination of each infrastructure or capacity building Grant project.
- (h) Retention and Access Requirements for Records:
- (1) Applicability. This clause (h) applies to all financial and programmatic records, supporting documents, statistical records, and other records of the Government of the Federated States of

Micronesia or its Sub-Grantees which are required to be maintained by this Agreement, program regulations or the Grant agreement, or are otherwise considered as pertinent to program regulations or the Grant agreement. Records of contractors or subcontractors are exempt from the requirements of this clause (h).

- (2) Length of Retention. Except as otherwise provided, records must be retained for three years from the date the Government of the Federated States of Micronesia submits the final project report to the Government of the United States.
- (3) If any litigation, claim, negotiation, audit, or other action involving the records has been started before the expiration of the three-year period, the records shall be retained until completion of the action and resolution of all issues which arise from it, or until the end of the regular three-year period, whichever is later.
- (4) Access to Records of the Government of the Federated States of Micronesia and Its Sub-Grantees. The Government of the United States shall have the right of access to any pertinent books, documents, papers, or other records of the Government of the Federated States of Micronesia and its Sub-Grantees which are pertinent to the Grant, in order to make Audits, examinations, excerpts, and transcripts.

3. Enforcement:

(a) Remedies for Noncompliance. If the Government of the Federated States of Micronesia or its Sub-Grantee materially fails to comply with any term or condition relating to records retention or to the reporting on and monitoring of a sector Grant during the course of the Grant year, the United States may take one or more of the following actions:

- (1) Temporarily withhold cash payments pending correction of the deficiency by the Government of the Federated States of Micronesia.
- (2) Disallow the use of funds provided pursuant to the Compact, as amended, and Matching credit for all or part of the activity or action not in compliance.
- (3) Wholly or partly suspend or terminate the current award.
- (4) Take other remedies that may be legally available.

(b) Hearings and Appeals. In taking an enforcement action, the Government of the United States will provide the Government of the Federated States of Micronesia an opportunity to a hearing, Appeal, or other administrative proceeding to which it is entitled under this Agreement.

(c) Effects of Suspension and Termination. The Government of the Federated States of Micronesia shall not obligate funds during a Suspension or after Termination of an award unless expressly authorized by the Government of the United States. Costs which are necessary and reasonably unavoidable are allowable if:

- (1) The costs result from Obligations that were properly incurred before the effective date of Suspension or Termination, are not in anticipation of it, and, in the case of a Termination, are non-cancelable.
- (2) The costs otherwise would be allowed if the award were not suspended or expired normally at the end of the funding period in which the Termination takes effect.

Article VII

Terms and Conditions of Infrastructure Assistance

1. Infrastructure Grants shall be subject to all laws and regulations governing the use of Grant funds provided by the Government of the United States to the extent these apply to this Agreement. Grant funds may not be used for any purpose other than for which they are offered.

2. Draw downs for reimbursement of actual or Accrued Expenditures shall be accomplished using a format provided by the Government of the United States or as mutually agreed.

3. Prior to the draw down of funds, the Government of the Federated States of Micronesia shall provide the following documentation to the Government of the United States:

(a) Evidence of title, leasehold agreement, or other legal authority for use of the land upon which the capital improvement project(s) is to be constructed.

(b) A detailed project budget for each capital development project. The budget shall include a breakdown of costs (in-house and contracts) for planning, engineering and design, real estate costs, supervision and administration, construction, and construction management and inspection. The Government of the Federated States of Micronesia and the Government of the United States shall mutually agree to the format of this submission.

(c) A scope of work that describes the work to be performed and the schedule from planning through completion of construction. A certified professional engineer or architect shall sign both the scope of work and budget for each construction project.

4. Prior to the draw down of funds for actual project construction, the Government of the United States may request to review the set of construction plans and specifications, a revised detailed cost estimate, and a detailed construction schedule.

5. All Grant monies shall remain available until expended, unless otherwise provided in this Agreement.

6. Failure to comply with program objectives, terms and conditions, or reporting requirements may result in the Suspension of Grant payments until the deficiency is corrected.

7. Infrastructure Maintenance Fund. Five percent of the annual public infrastructure Grant shall be set aside, with an equal contribution from the Government of the Federated States of Micronesia, as a contribution to an infrastructure maintenance fund to be established, maintained and utilized pursuant to the terms and conditions of this section 7 (the "IMF"). The Government of the Federated States of Micronesia may also allocate additional amounts from the health and education sector Grants to fund the maintenance requirements of those sectors.

(a) The funds shall be deposited in an operations and maintenance assistance account established by the Government of the Federated States of Micronesia, as matching contributions are received from the National Government and its Sub-Grantees. The Government of the Federated States of Micronesia may choose to advance matching contributions in advance of any specific contributions by individual Sub-Grantees.

(b) The Government of the United States shall deposit its contribution upon: certification by the Government of the Federated States of Micronesia that local Matching funds have been deposited or upon receipt of a deposit schedule and, beginning in Fiscal Year 2005, an annual financial report from the previous year showing the deposits of both the Government of the United States and the Government of the Federated States of Micronesia, the amount of income generated during the Fiscal Year, and the fund balance.

(c) The IMF shall be available for use following the annual transmittal of an infrastructure maintenance plan by the Government of the Federated States of Micronesia for concurrence in writing by the Government of the United States.

8. Reporting Requirements:

(a) A Standard Form SF 269 or a reasonable facsimile thereof approved by the Government of the United States, shall be prepared quarterly and submitted within 30 days after the end of the quarter to which it applies. The report shall include accounting information and a status of progress for each project funded by the Grant.

(b) A Federal Cash Transactions Report, or Standard Form SF 272 of the Government of the United States or a reasonable facsimile thereof approved by the Government of the United States, shall be submitted quarterly within 30 days of the end of the quarter to which it applies. Actual dates, project identification, and amounts of draw downs for the quarter should be supplied in the "Remarks" section of the form.

Article VIII

Audit

1. Standards and Scope of Audit Authority of the Government of the United States:

Audit officials or agents of the Government of the United States, acting pursuant to and in accordance with section 232 of the Compact, as amended, may perform Audits on the use of all funding provided pursuant to the Compact, as amended, including Grants, programs and services, and other assistance provided to the Government of the Federated States of Micronesia. The Government of the United States is responsible for all costs attendant to the discharge of this authority.

2. Audit Responsibility of the Government of the Federated States of Micronesia:

(a) A financial and compliance audit, within the meaning of the Single Audit Act, as amended (31 U.S.C. 7501 et seq.), of the uses of the funding provided pursuant to the Compact, as amended, by the Government of the Federated States of Micronesia, shall be performed for each Fiscal Year during which Title Two of the Compact, as amended, is in effect. The results of these Audits shall be available not later than the beginning of the third fiscal quarter following the end of the Fiscal Year under review.

(b) For purposes of these Audits, the laws and regulations of the United States shall apply which are relevant to the Original Compact and Compact, as amended, related agreements, and such other instruments as may be made expressly applicable pursuant to mutual agreement by the Government of the United States and the Government of the Federated States of Micronesia. In general, the applicable laws and regulations are those promulgated under the authority, and at the discretion, of the Government of the Federated States of Micronesia and which relate in a material, substantial or direct way to that Government's financial statements and operations.

(c) The authority of the Government of the United States set forth in section 232 of the Compact, as amended, and this Article shall continue for at least three years after the last Grant or element of assistance by the Government of the United States has been provided and expended.

3. Audit Officials:

(a) Audit officials from the Government of the United States are the officials and employees of the Government of the United States who are responsible for the discharge of its audit responsibilities, including those of the Comptroller General of the United States and any Inspector General of an agency of the Government of the United States with programs operating in or otherwise serving the Federated States of Micronesia. While present in the Federated States of Micronesia for the purposes of this Agreement, audit officials from the Government of the United States shall be immune from civil and criminal process relating to words spoken or written and all acts performed by them in their official capacity and falling within their functions, except insofar as such immunity may

be expressly waived by the Government of the United States. The Comptroller General and his duly authorized representatives shall not be liable to arrest or detention pending trial, except in the case of a grave crime and pursuant to a decision by a competent judicial authority, and such persons shall enjoy immunity from seizure of personal property, immigration restrictions, and laws relating to alien registration, fingerprinting, and the registration of foreign agents. Such persons shall enjoy the same taxation exemptions as are set forth in Article 34 of the Vienna Convention on Diplomatic Relations. The privileges, exemptions and immunities accorded under this paragraph are not for the personal benefit of the individuals concerned but are to safeguard the independent exercise of their official functions. Without prejudice to those privileges, exemptions and immunities, it is the duty of all such persons to respect the laws and regulations of the Government of the Federated States of Micronesia.

(b) Audit officials from the Government of the United States shall provide the Government of the Federated States of Micronesia with advance notice of the specific dates and nature of their visits prior to entering the Federated States of Micronesia and shall show verifiable identification to officials of the Government of the Federated States of Micronesia when seeking access to records. In the performance of their responsibilities under this Agreement, audit officials from the Government of the United States shall have due regard for the laws of the Federated States of Micronesia and the duties and responsibilities of the officials of the Government of the Federated States of Micronesia. Officials of the Government of the Federated States of Micronesia shall cooperate fully to the extent practicable with the United States audit officials to enable the full discharge of their responsibilities. Questions with respect to the identity or authorization of United States audit officials shall be referred for resolution to the United States Representative referred to in Article V of Title One of the Compact, as amended.

(c) The Comptroller General of the United States, and officials of the United States General Accounting Office acting on his or her behalf, shall have coextensive authority with the executive branch of the Government of the United States as provided in this Article of this Agreement and section 232 of the Compact, as amended. The audit officials from the executive branch of the Government of the United States shall avoid duplication between their audit programs and those of the United States General Accounting Office. The Government of the Federated States of Micronesia shall cooperate fully to the extent practicable with the Comptroller General of the United States in the conduct of such Audits as the Comptroller General of the United States determines necessary in accordance with this Article to enable the full discharge of his responsibilities.

4. Access to Records:

(a) The Government of the Federated States of Micronesia shall provide audit officials from the Government of the United States with access, without cost and during normal working hours, to all records, documents, working papers,

automated data, and files which are relevant to the uses of funding received pursuant to the Compact, as amended, by the Government of the Federated States of Micronesia. To the extent that such information is contained in confidential official documents, the Government of the Federated States of Micronesia shall undertake to extract information that is not of a confidential nature and make it available to the audit officials from the Government of the United States in the same manner as other relevant information or to provide such information from other sources.

(b) In order to reduce the level of interference in the daily operation of the activities of the Government of the Federated States of Micronesia, audit officials from the Government of the United States shall, to the extent practicable, inform the Government of the Federated States of Micronesia of their need for information, including the type of information and its relation to their annual audit schedule. To the extent practicable, the Government of the Federated States of Micronesia shall make available the information requested by audit officials from the Government of the United States relevant to Audits and available in a manner consistent with generally accepted accounting procedures that allows for the distinction of the Grants, assistance, and payments provided by the Government of the United States from any other funds of the Government of the Federated States of Micronesia. Such information shall be used and returned as quickly as accurate audit testing and surveying allow.

(c) The Government of the Federated States of Micronesia shall maintain records, documents, working papers, automated data, files, and other information regarding each such Grant or other assistance for at least three years after such Grant or assistance was provided.

5. Review of Audits:

Audit organizations and officials from the Government of the United States, including the Comptroller General of the United States and his duly authorized representatives, shall provide the Government of the Federated States of Micronesia with at least 45 days to review and comment on draft audit reports prior to the release of the reports. The comments of the Government of the Federated States of Micronesia shall be included, in full, in the final audit reports. Should a draft audit report be revised based on the comments of the Government of the Federated States of Micronesia, the Government of the Federated States of Micronesia shall have an additional period to review and comment on the report prior to its release.

Article IX

Annual Reconciliation and End-of-Grant Requirements

1. The Government of the United States shall reconcile Operational Grants at least annually, and evaluate program performance and financial reports to determine work progress, outcomes, and compliance with Grant terms and conditions.

2. The Government of the United States shall close out each award at the end of each annual Grant year once it determines that all applicable administrative actions and

required work has been completed or if all Grant monies for that year have been expended.

(a) Within 90 days of the expiration of the Grant year, the Government of the Federated States of Micronesia must submit all final financial, performance, and other reports required as a condition of the Grant. The Government of the United States may Grant an extension of the due date upon the request of the Government of the Federated States of Micronesia.

(b) Within 90 days after receipt of reports in paragraph (2) of this section, the Government of the United States shall make upward or downward adjustments to the allowable reimbursable costs.

(c) The Government of the Federated States of Micronesia shall immediately refund any balance of cash not authorized to be retained. The refunded balance shall be available for use to supplement subsequent Grants.

3. The Government of the United States shall retain the right to disallow costs and recover funds on the basis of a later audit or other review. The Closeout of a Grant does not affect the obligation of the Government of the Federated States of Micronesia to return any funds paid in excess of the amount to which it is finally determined to be entitled under the terms of the award. Such an amount shall be deemed to constitute a debt to the Government of the United States. If the amount owed is not repaid within a reasonable period, the Government of the United States may reduce the debt by:

- (a) Making an administrative offset against other requests for reimbursement;
- (b) Withholding advance payments otherwise due to the Government of the Federated States of Micronesia; or
- (c) Taking other action described in this Agreement or as otherwise permitted by law.

Article X Effective Date, Amendment, and Duration

1. This Agreement shall take effect on the effective date of the Compact, as amended.

2. This Agreement may be amended at any time in writing by mutual consent of the Government of the United States and the Government of the Federated States of Micronesia.

3. Disputes:

(a) Disputes involving sections 4, and 5(c)(1) of Article IV, and Articles III, V, VII and VIII shall be resolved in accordance with the Appeal process defined in Article I of this Agreement.

(b) All other disputes may be resolved in accordance with the Appeal process defined in Article I of this Agreement or through the conference and dispute resolution process set forth in Article II of Title Four of the Compact, as amended. Withholdings or Suspensions of payment shall stand unless otherwise determined through the conference and dispute resolution process of Article II of Title Four of the Compact, as amended.

4. This Agreement shall remain in full force and effect until terminated by mutual consent, or until the expiration or Termination of the Grants provided under section 211 and Grants administered under section 221 of the Compact, as amended, whichever occurs first. The Government of the United States shall provide any unobligated Grant balances from the last Fiscal Year of the effectiveness of section 211(a) as amended, to the Government of the Federated States of Micronesia in accordance with the procedures set forth in this Agreement and without regard to whether the Compact, as amended, its related agreements, or this Agreement are still in effect. In this case, the funds shall be budgeted and expended pursuant to the purposes set forth in Article II of this Agreement.

5. This Agreement may be accepted, by signature or otherwise, by the Government of the United States and the Government of the Federated States of Micronesia. Each Government shall possess an original English language version.

6. Interpretation. In this Agreement, all references herein to Articles, paragraphs, sub-paragraphs, clauses, and sections shall be deemed references to this Agreement unless the context shall otherwise require. References to statutes or regulations are to be construed as including all statutory or regulatory provisions, as applicable, consolidating, amending or replacing the statute or regulation referred to. All references to agreements and other documents shall be to such documents as amended, modified, supplemented or restated from time to time in a manner consistent with the terms and conditions of this Agreement. Except as otherwise expressly provided herein, all terms of an accounting or financial nature shall be construed in accordance with Generally Accepted Accounting Principles, as in effect from time to time in the United States of America.

DONE at Palikir, in duplicate, this 14th day of May, 2003, each text being equally authentic.

FOR THE GOVERNMENT OF THE
UNITED STATES OF AMERICA:

Handwritten signature of Larry M. Dwyer in black ink.

FOR THE GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA:

Handwritten signature of Joseph A. Boreham in black ink.

Annex A

Agreement on the Establishment and Use Of the Disaster Assistance Emergency Fund

1. For twenty years beginning in FY'04, and subject to the requirements of paragraph 2, on or about the beginning of each fiscal year, the Government of the Federated States of Micronesia and the Government of the United States shall each deposit \$200,000 in a Disaster Assistance Emergency Fund (DAEF) account established by the Government of the Federated States of Micronesia in accordance with section 211(d) of Title Two of the Compact, as amended. The account shall be with a bank or commercial financial institution organized in accordance with the laws of the United States or a State of the United States; or, subject to the approval of the Government of the United States, a bank or commercial financial institution organized in accordance with the laws of the Government of the Federated States of Micronesia.
2. The Government of the United States shall deposit its contribution upon: certification by the Government of the Federated States of Micronesia that local matching funds have been deposited; and beginning in Fiscal Year 2005, receipt by the Government of the United States of an annual financial report from the previous year showing deposits of both the Government of the United States and the Government of the Federated States of Micronesia, the amount of interest income generated during the Fiscal Year, and the fund balance.
3. The Government of the Federated States of Micronesia may invest part or all of the DAEF in low-risk instruments such as certificates of deposit, money market funds and Treasury bills, provided asset liquidity is not compromised. Any earnings from such investments shall be reinvested into the DAEF.
4. Funds from this account may be withdrawn only after the President of the Federated States of Micronesia or his designee officially declares a state of emergency justifying use of the DAEF and the United States Ambassador or Charge d'Affaires concurs as to the use and the amount of the withdrawal.
5. The funds shall be used to protect the immediate health and safety of the residents of the Federated States of Micronesia in the event of a disaster resulting in the declaration of a state of emergency, as referred to in paragraph 4, and for the rehabilitation and reconstruction of public property damaged in the disaster.
6. The Government of the Federated States of Micronesia shall provide the Joint Economic Management Committee (JEMCO) with a written report on the use of the DAEF within thirty days of any withdrawal.