

REPORT OF INDEPENDENT AUDITORS
AUD-FM-13-10

To the United States Commissioner
International Boundary and Water Commission,
United States and Mexico, U.S. Section

We have audited the accompanying consolidated balance sheet of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), as of September 30, 2012, and the related consolidated statements of net cost and changes in net position and combined statement of budgetary resources (hereinafter referred to as “the financial statements”) for the year then ended. These financial statements are the responsibility of USIBWC’s management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of USIBWC as of September 30, 2011, were audited by other auditors, whose report, dated May 4, 2012, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the FY 2012 financial statements referred to above, present fairly, in all material respects, the financial position of USIBWC, as of September 30, 2012, and its net cost of operations, changes in net position, and budgetary resources for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that Management’s Discussion and Analysis, the Combining Schedule of Budgetary Resources, and Deferred Maintenance be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by OMB Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board who consider it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the

information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on USIBWC's financial statements taken as a whole. Other Accompanying Information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have also issued reports, dated December 11, 2012, on our consideration of USIBWC's internal control over financial reporting and compliance and on our tests of its compliance with certain provisions of laws and regulations for the year ended September 30, 2012. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance, as well as the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, and should be considered in assessing the results of our audits.



December 11, 2012

REPORT ON INTERNAL CONTROL

To the United States Commissioner
International Boundary and Water Commission,
United States and Mexico, U.S. Section

We have audited the financial statements of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC) as of and for the year ended September 30, 2012, and have issued our report dated December 11, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Management of USIBWC is responsible for establishing, maintaining, and assessing internal control related to financial reporting and compliance.

In planning and performing our work, we considered USIBWC's internal control over financial reporting and compliance by obtaining an understanding of the design effectiveness of USIBWC's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of USIBWC's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not to provide an opinion on internal control. Accordingly, we do not express an opinion on the effectiveness of USIBWC's internal control over financial reporting and compliance or on management's assertion on internal control included in the Management's Discussion and Analysis section.

We limited our internal control testing to those controls necessary to achieve OMB Bulletin No. 07-04, as amended, control objectives that provide reasonable, but not absolute, assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in compliance with laws governing the use of budget authority, government-wide policies, and laws identified in Appendix E of OMB Bulletin No. 07-04, as amended, and other laws and regulations that could have a direct and material effect on financial statements. We did not test all internal controls relevant to operating objectives, as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls relevant to ensuring efficient operations.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable

possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting and compliance was for the limited purpose described in the preceding paragraphs and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. Therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over financial reporting and compliance that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control that we consider to be significant deficiencies. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the USIBWC's internal control to be significant deficiencies.

Significant Deficiencies

I. Property and Equipment

USIBWC owns a significant amount of diverse property and equipment. As of September 30, 2012, USIBWC reported \$848.5 million in property and equipment, which included real and personal property. Since USIBWC owns and maintains assets at multiple locations along the border between the United States and Mexico, it is essential for USIBWC to have controls in place to monitor and maintain these assets. We identified control deficiencies with USIBWC's property and equipment processes that, when aggregated, constituted a significant deficiency in internal control. Property and equipment was also reported as a significant deficiency by the prior auditor during the audit of the FY 2011 financial statements. The individual deficiencies we identified are summarized as follows:

- Completeness and Accuracy of Construction-in-Progress – Construction costs should be recorded as construction-in-progress (CIP) until the asset being constructed is placed in service, at which time the balance should be transferred to a general property and equipment account. We identified one CIP project that had a negative balance, which had been incorrectly recorded as an operating expense. Separate reviews by USIBWC identified further misclassifications of construction costs and operating expenses. In total, USIBWC identified \$16.4 million of costs improperly recorded as operating expenses that were reclassified as CIP. An additional \$5.3 million in CIP costs were identified as errors and reclassified as operating expenses. Because of known issues with the posting of certain construction costs in the Department of State's (Department) Global Financial Management System (GFMS), USIBWC had implemented a process to manually review transactions recorded to CIP and operating expenses to identify and correct items that were not recorded correctly. However, because of the manual nature of this review, not all transactions that had been improperly recorded as operating expenses were identified and corrected. Due to the size of several active CIP projects, significant amounts may be misclassified and not detected.

- Completeness of Real Property – Property and equipment should be recognized when the title passes to the acquiring entity or when the property or equipment is delivered to the entity. USIBWC did not maintain a complete inventory of all real property assets. We identified three pieces of real property that were not being capitalized in USIBWC’s accounting records. The acquisition cost of these assets totaled \$1.5 million. These assets had been incorrectly recorded as operating expenses in prior years. Although USIBWC corrected the specific items identified by the audit, the lack of a complete real property inventory limits USIBWC’s ability to fully account for and maintain sufficient stewardship of Federal property.
- Completeness of Personal Property – USIBWC’s personal property assets are tracked in the Department’s Integrated Logistics Management System, which interfaces with GFMS. This interface occurs quarterly, prior to the close of the quarterly accounting period. We identified three assets that were properly recorded as additions in the Integrated Logistics Management System by USIBWC but that were not entered until after the quarterly automated interface to GFMS. Although USIBWC performed a manual reconciliation of the assets listed in the two systems as of September 30, 2012, which identified these discrepancies, an adjustment was not made to record the assets in USIBWC’s financial statements, which understated property.

II. Budgetary Accounting

USIBWC used the Department’s budgetary accounting system for monitoring budgetary authority. The information from this system, along with the Department’s proprietary system, is used to compile USIBWC’s statement of budgetary resources. We identified control deficiencies that, when aggregated, constituted a significant deficiency in internal control over budgetary accounting. These individual deficiencies are summarized as follows:

- Timeliness of Obligations – Obligations are definite commitments that create a legal liability of the government for payment. USIBWC should record an obligation in the financial management system when it enters into an agreement, such as a contract or purchase order, to purchase goods or services. We identified two credit card purchases in which USIBWC created the obligation between 1 and 2 months after the purchases were made. In addition, we identified one contract modification that was processed to create a new obligation 5 days after the period of performance in the contract modification had expired. Further, USIBWC had not recorded payroll obligations at the beginning of the year or the beginning of each pay period. USIBWC did not have adequate policies or procedures in place to ensure the timely creation, approval, and recording of obligations. Obligations that are not recorded in a timely manner increase the risk that goods or services may be acquired and received prior to certifying the availability of funds, which may lead to misstatements in USIBWC’s financial statements and potential violations of the Antideficiency Act. In response to these findings, USIBWC has implemented policies for FY 2013 to ensure that valid obligations are in place prior to the expenses being incurred for both credit card and payroll transactions.

- Validity and Accuracy of Unliquidated Obligations – Unliquidated obligations (ULO) represent the cumulative amount of orders, contracts, and other binding agreements not yet outlaid. Although USIBWC conducted quarterly reviews for ULO validity, we identified invalid ULOs amounting to approximately \$522,000 that had not been identified by USIBWC’s review process. USIBWC did not focus its quarterly ULO reviews on specific ULOs that have a greater risk of being invalid, such as obligations with no recent activity. Additionally, staff turnover inhibited a timely review and deobligation of items. Invalid ULOs affect USIBWC’s ability to manage its funds and could result in inaccurate reporting by USIBWC in budgetary reports.
- Budgetary to Proprietary Account Reconciliation – Federal financial accounting standards require an entity to be able to reconcile its proprietary information to its budgetary information. We performed an analysis comparing USIBWC’s Unpaid Expended Authority balance (a budgetary account) to its Accounts Payable balance (a proprietary account). These two accounts should be reconcilable; however, we identified a significant variance for each line item related to the year-end accrual of accounts payable. When this accrual was recorded through a journal voucher, a related budgetary adjustment was not recorded. While USIBWC performs reconciliations of some budgetary and proprietary accounts, it did not reconcile all items. In addition, USIBWC had not implemented a sufficient process for recording its accounts payable accrual that would ensure that when a proprietary accrual is recorded the corresponding budgetary adjustment between Unexpended Obligation and Unpaid Expended Authority is also recorded. While this adjustment does not impact the presentation of the statement of budgetary resources, USIBWCs budgetary accounts are not properly reconciled as required.

III. Information Technology

USIBWC uses key information systems maintained by the Department, including the general support systems and applications for accounting, budget execution, procurement, and logistics. The Department is responsible for maintaining an adequate general and application control environment over these systems. We evaluated the Department’s internal control structure surrounding the general support system and key financial applications that are used by USIBWC. In general, our audit and an audit performed by the Office of Inspector General (OIG) found that the Department had not implemented effective standards, policies, processes, and procedures over its information security program and its financial applications.

We noted weaknesses and vulnerabilities in the general support system and several key applications maintained by the Department. These deficiencies are inherited by USIBWC and present risk to financial and other data, which, in aggregate, we consider to be a significant deficiency in internal control. While we noted that USIBWC had developed some processes and controls to compensate for the deficiencies identified in the Department’s systems, not all risks and deficiencies related to the systems shared with the Department were fully mitigated by those compensating controls. The following weaknesses, identified during Department audits, impact USIBWC:

- Information Security Program – The Department’s OIG performed an audit of the Department’s information security program for FY 2012 in accordance with the Federal Information Security Management Act of 2002 (FISMA).¹ OIG identified numerous weaknesses in the Department’s information security program, which, in aggregate, was reported as a FISMA significant deficiency. The OIG reported weaknesses in the areas of risk management strategy and security authorizations, security configuration management, plans of action and milestones, and the continuous monitoring program. A significant deficiency is the highest level of severity under FISMA. These control weaknesses impact the Department’s general support system, OpenNet. The key Department financial applications used by USIBWC reside on OpenNet, inheriting many of the systems controls.
- Audit Logs for Financial Applications – During the audit of the Department’s FY 2012 financial statements,² we performed risk-based test procedures of the Department’s financial applications. We identified deficiencies for GFMS, which is used by USIBWC as its core accounting system. Specifically, the Department did not regularly review audit logs and investigate significant events. We found that the Department did not have procedures in place that detailed the requirements for performing regular reviews of audit logs for the key financial management applications, including clearly assigning responsibility for the reviews. By not reviewing the audit logs on a regular basis, the Department does not have reasonable assurance that inappropriate access or changes to user accounts would be identified in a timely manner.
- Service and Application Accounts – Also during the audit of the Department’s FY 2012 financial statements, we identified issues relating to the Department’s account authorization practices for significant financial applications. The audit process identified 20 service or application accounts for which the Department was unable to provide documented management approval or business justification. In addition, the Department was unable to document that the service or application accounts had been regularly reviewed by management in order to recertify access permissions. Service accounts are computer accounts used to run background tasks, such as anti-virus software and software patching tools. Application accounts are similar to service accounts but are used to run temporary computer processes, such as interfaces and reports. Service and application accounts are not linked to an individual and are not regularly reviewed and approved by management, increasing the potential that unauthorized activities could occur without timely detection.

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¹ *Audit of the Department of State Information Security Program* (AUD-IT-13-03, Nov. 2012).

² *Independent Auditor’s Report on the U.S. Department of State 2012 and 2011 Financial Statements* (AUD-FM-13-08, Nov. 2012).

During the audit, we noted certain other matters that we will report to USIBWC management in a separate letter.

USIBWC management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of USIBWC management; those charged with governance; and others within OIG, OMB, the Government Accountability Office, and Congress. It is not intended to be and should not be used by anyone other than these specified parties.



December 11, 2012

REPORT ON COMPLIANCE

To the United States Commissioner
International Boundary and Water Commission,
United States and Mexico, U.S. Section

We have audited the financial statements of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC) as of and for the year ended September 30, 2012, and have issued our report dated December 11, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Management of USIBWC is responsible for compliance with laws and regulations.

As part of obtaining reasonable assurance about whether USIBWC’s financial statements are free of material misstatement, we performed tests of USIBWC’s compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, that we determined were applicable. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to USIBWC. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our testing disclosed no instances of noncompliance that were required to be reported under the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended.

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During the audit, we noted certain matters that we will report to USIBWC management in a separate letter.

USIBWC management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management’s response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of USIBWC management; those charged with governance; and others within the Office of Inspector General, OMB, the Government Accountability Office, and Congress, and it is not intended to be and should not be used by anyone other than these specified parties.



December 11, 2012

INTERNATIONAL BOUNDARY AND WATER COMMISSION
UNITED STATES AND MEXICO

January 5th, 2013



United States Department of State and the Broadcasting Board of Governors
Office of Inspector General
Attn: Evelyn R. Klemstine, Assistant Inspector General for Audits
2201 C. Street, N.W.
Washington, D.C. 20520-0308

Subject: Independent Auditor's report on the International Boundary and Water Commission financial statements for September 30th, 2012.

Dear Ms. Klemstine:

We are very pleased to receive the auditor's FY 2012 report as transmitted by the OIG on December 26th, 2012. This report is the culmination of many months work for both the independent auditor and IBWC teams.

We are also pleased with both the results and effectiveness of the independent auditor, and wish to extend our sincere gratitude for their timely completion of the FY 2012 reporting process.

Sincerely,

Edward Drusina, P.E.
Commissioner

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