

INDEPENDENT AUDITOR'S REPORT
AUD-FM-14-12

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, the related consolidated statements of net cost and changes in net position and the combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as the "consolidated financial statements").

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate under the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Consolidated Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of USIBWC as of September 30, 2013 and 2012, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 and Note 6 to the financial statements, in FY 2013, USIBWC adopted new accounting guidance issued by the Federal Accounting Standards Advisory Board (FASAB)—specifically, Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, condition assessments of Heritage Assets and Stewardship Land, Combining Schedule of Budgetary Resources, and Deferred Maintenance (hereinafter referred to as "required supplementary information") be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by OMB Circular A-136, *Financial Reporting Requirements*, and FASAB, which consider it to be an essential part of financial reporting for placing the consolidated 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 it for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audits of the consolidated 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards* and OMB Bulletin No. 14-02, we have also issued reports, dated December 20, 2013, on our consideration of USIBWC's internal control over financial reporting and on our tests of USIBWC's compliance with certain provisions of laws, regulations, and contracts for the year ended September 30, 2013. The purpose of those

reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 14-02, in considering USIBWC's internal control over financial reporting and compliance.



Alexandria, Virginia
December 20, 2013

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

We have audited the consolidated 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, 2013, and have issued our report thereon dated December 20, 2013. 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. 14-02, *Audit Requirements for Federal Financial Statements*.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered USIBWC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate under the circumstances for the purpose of expressing our opinion on the consolidated financial statements but not for the purpose of expressing an opinion on the effectiveness of USIBWC's internal control. Accordingly, we do not express an opinion on the effectiveness of USIBWC's internal control. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 14-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, 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 was for the limited purpose described in the preceding paragraphs and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Our audit was also not designed to identify deficiencies in internal control that might be significant. 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 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, 2013, USIBWC reported \$857 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 in our audit of USIBWC's FY 2012 financial statements. The individual deficiencies we identified are summarized as follows:

- Recording Construction-in-Progress Transactions – 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 found that 9 of 26 operating expenses tested were construction costs that should have been classified as CIP. After we identified these errors, USIBWC performed an analysis of operating expense activity and identified a number of additional instances in which CIP was improperly classified as operating expenses. Additionally, we identified a CIP project with a negative balance, which required a manual adjusting entry. As a result of audit work and USIBWC management's analysis, more than \$15.9 million in operating expenses were reclassified as CIP during FY 2013. Because USIBWC does not always process payments to construction vendors using system codes that will automatically record payments as CIP, USIBWC had implemented a process to manually review transactions recorded to CIP and operating expenses each quarter to identify and correct items that were not recorded correctly. However, because of the manual nature and timing of this review, not all transactions that were improperly recorded had been identified by the time of our audit. Due to the size of several active USIBWC CIP projects, significant amounts may be misclassified and not detected.
- Depreciation Expense Errors – Depreciation expense should be calculated through the systematic and rational allocation of the cost of property and equipment, less its estimated salvage or residual value, over the estimated useful life of an asset. During our review of depreciation expense, we identified unusual account activity, which USIBWC officials confirmed was erroneous. During FY 2013, USIBWC transferred property account balances between two appropriations. When the transfer was processed, the Global Financial Management System (GFMS) treated the assets as newly acquired, and depreciation expense was recorded back to the date that the assets were placed into service. However, the system had already recorded depreciation expense for the assets, which was not reversed when the assets were transferred. The error resulted in a \$7.3

million overstatement of expenses. Because USIBWC does not routinely transfer assets between appropriations, USIBWC officials were unaware of how GFMS would process the adjustment. Although USIBWC had a control in place to review and analyze account balances at the financial statement level, the control was not designed to identify and resolve errors in individual accounts, such as depreciation expenses. Without effective routine account-level reviews, errors, anomalies, or unexpected account fluctuations may go unidentified.

II. Information Technology

USIBWC uses key information systems maintained by the U.S. Department of State (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 a 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. Information technology was also reported as a significant deficiency in our audit of USIBWC's FY 2012 financial statements. 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 2013 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. OIG reported weaknesses in the areas of [Redacted] (b) (5) plans of action and milestones, and the continuous monitoring program. [Redacted] (b) (5)

¹ *Audit of the Department of State Information Security Program* (AUD-IT-14-03, Nov. 2013).

- Audit Logs for Financial Applications – During the audit of the Department’s FY 2012 financial statements, we performed risk-based testing 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 for suspicious behavior or malfunctions. For example, the Department did not have an effective process to log and independently monitor changes to the permissions granted to user accounts. In FY 2013, the Department took steps to remediate this condition. However, the Department had not completed several steps to effectively implement application monitoring controls. By not reviewing the audit logs on a regular basis, the Department did not have reasonable assurance that inappropriate access or changes to user accounts would be identified in a timely manner.

During the audit, we noted certain additional matters involving internal control over financial reporting that we will report to USIBWC’s management in a separate letter.

Summary of Significant Internal Control Deficiencies

In the Report on Internal Control included in the audit report on USIBWC’s FY 2012 financial statements,² we noted several issues that were related to internal control over financial reporting. The status of each issue is summarized in Table 1.

Table 1. Summary of Significant Internal Control Deficiencies

Control Deficiency	FY 2012 Status	FY 2013 Status
Property and Equipment	Significant Deficiency	Significant Deficiency
Budgetary Accounting	Significant Deficiency	Management Letter
Information Technology	Significant Deficiency	Significant Deficiency

USIBWC’s Response to Findings

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.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing and not to provide an opinion on the effectiveness of USIBWC’s internal control. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America,

² *Independent Auditor’s Report on the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2012 Financial Statements* (AUD-FM-13-10, Dec. 2012).



Government Auditing Standards, and OMB Bulletin No. 14-02 in considering the entity's internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is written in a cursive, flowing style.

Alexandria, Virginia
December 20, 2013

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH APPLICABLE
PROVISIONS OF LAWS, REGULATIONS, AND CONTRACTS**

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

We have audited the consolidated 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, 2013, and have issued our report thereon dated December 20, 2013. 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. 14-02, *Audit Requirements for Federal Financial Statements*.

Compliance

As part of obtaining reasonable assurance about whether USIBWC's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material impact on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02, that we determined were applicable. We limited our tests of compliance to these provisions and did not test compliance with all laws, regulations, and contracts applicable to USIBWC. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing and not to provide an opinion on the effectiveness of USIBWC's compliance. This report is an integral part of an audit performed in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Bulletin No. 14-02 in considering USIBWC's compliance. Accordingly, this report is not suitable for any other purpose.



Alexandria, Virginia
December 20, 2013



OFFICE OF THE COMMISSIONER
UNITED STATES SECTION

INTERNATIONAL BOUNDARY AND WATER COMMISSION
UNITED STATES AND MEXICO

December 23, 2013

Mr. Harold W. Geisel
United States Department of State
Deputy Inspector General
Office of Inspector General
Washington, D. C. 20520

Subject: Independent Auditor's Report to the audit of the United States Commissioner and the Inspector General of the International Boundary and Water Commission, United States and Mexico, U.S. Section

Dear Mr. Geisel:

We received and have reviewed the draft Independent Auditor's Report of the United States Section, International Boundary and Water Commission (IBWC), 2013 and 2012 financial statements. Thank you for the opportunity to comment on your audit recommendations.

Attached please find our responses to each of the recommendations as reported in the draft Independent Auditor's Report. Please advise if you have any questions or if we may be of any assistance.

Sincerely,

Edward Drusina, P.E.
Commissioner

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Independent Auditor's Report on Internal Control over Financial Reporting

Significant Deficiencies

I. Property and Equipment

Recording Construction-in-Progress Transactions – 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 found that 9 of 26 operating expenses tested were construction costs that should have been classified as CIP. After we identified these errors, USIBWC performed an analysis of operating expense activity and identified a number of additional instances in which CIP was improperly classified as operating expenses. Additionally, we identified a CIP project with a negative balance, which required a manual adjusting entry. As a result of audit work and USIBWC management's analysis, more than \$15.9 million in operating expenses were reclassified as CIP during FY 2013. Because USIBWC does not always process payments to construction vendors using system codes that will automatically record payments as CIP, USIBWC had implemented a process to manually review transactions recorded to CIP and operating expenses each quarter to identify and correct items that were not recorded correctly. However, because of the manual nature and timing of this review, not all transactions that were improperly recorded had been identified by the time of our audit. Due to the size of several active USIBWC CIP projects, significant amounts may be misclassified and not detected.

Response: Concur

The USIBWC Accounting Officer will work with the Department of State management officials responsible for the GFMS system to see if the posting logic for recording CIP transactions can be modified to require the project code for construction projects. Until the issue with the posting logic can be resolved, the USIBWC will review construction-in-progress and operating expense transactions prior to posting to ensure the transactions are posted with a project code.

If the requested modification to the GFMS posting logic cannot be implemented, USIBWC will ensure project codes are assigned for each capital project when the contract award and obligation are recorded and ensure all capital project payments are processed against the correct project code. Quarterly, the USIBWC will review the construction-in-progress projects and ensure the balances are appropriate as well as continue to review posted transactions to ensure they are recorded correctly.

Depreciation Expense Errors – Depreciation expense should be calculated through the systematic and rational allocation of the cost of property and equipment, less its estimated salvage or residual value, over the estimated useful life of an asset. During our review of depreciation expense, we identified unusual account activity, which USIBWC officials confirmed was erroneous. During FY 2013, USIBWC transferred property account balances between two appropriations. When the transfer was processed, the Global Financial Management System (GFMS) treated the assets as newly acquired, and depreciation expense was recorded back to the date that the assets were placed into service. However, the system had already recorded depreciation expense for the assets, which was not reversed when the assets were transferred. The error resulted in a \$7.3 million overstatement of expenses. Because USIBWC does not routinely transfer assets between appropriations, USIBWC officials were unaware of how GFMS would process the adjustment. Although USIBWC had a control in place to review and analyze account balances at the financial statement level, the control was not designed to identify and

resolve errors in individual accounts, such as depreciation expenses. Without effective routine account-level reviews, errors, anomalies, or unexpected account fluctuations may go unidentified.

Response: Concur

The transfer of assets from the S&E appropriation to the Construction appropriation was a nonrecurring, one-time event and USIBWC does not foresee doing this in the future except to correct an error. Going forward, all PP&E transactions will be funded by the Construction appropriation and there should be no need to make such a transfer in the future. In the event that such a transfer of PP&E is necessary, IBWC is now aware of the effect the transfer will have on depreciation and will make the necessary correcting entries to bring the depreciation expense back to the correct balance. USIBWC will conduct a review of all accounts involved prior to and after the transfer.

Additionally, USIBWC will conduct analytical reviews at the individual account level, in addition to the financial statement level, to identify errors in account balances that may not otherwise be identified.

II. Information Technology

Information Security Program – The Department’s OIG performed an audit of the Department’s information security program for FY 2013 in accordance with the Federal Information Security Management Act of 2002 (FISMA). OIG identified numerous weaknesses in the Department’s information security program, which, in aggregate, was reported as a FISMA significant deficiency. OIG reported weaknesses in the areas of [REDACTED] plans of action and milestones, and the continuous monitoring program.

[REDACTED]

Audit Logs for Financial Applications – During the audit of the Department’s FY 2012 financial statements, we performed risk-based testing 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 for suspicious behavior or malfunctions. For example, the Department did not have an effective process to log and independently monitor changes to the permissions granted to user accounts. In FY 2013, the Department took steps to remediate this condition. However, the Department had not completed several steps to effectively implement application monitoring controls. 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.

Response: Concur

The USIBWC will work with management officials from the Department of State over the general support system and financial applications to work closely in implementing compensating controls as recommended under this finding, [REDACTED] changes to user accounts in a timely manner.