

**INDEPENDENT AUDITOR'S REPORT**  
AUD-FM-15-11

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, 2014 and 2013, the related consolidated statements of net cost and changes in net position, 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 consolidated 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, 2014 and 2013, 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.

***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, 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 the Federal Accounting Standards Advisory Board, 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 the information 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 5, 2014, 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, 2014. 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.

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

Alexandria, Virginia  
December 5, 2014



## **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, 2014, and have issued our report thereon dated December 5, 2014. 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, 2014, USIBWC reported \$867 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 initially reported as a significant deficiency in our audit of USIBWC's FY 2012 financial statements. The individual deficiencies we identified are summarized as follows:

- Inufficient Construction Accounting Process – Beginning in FY 2009, as part of the American Recovery and Reinvestment Act initiative, USIBWC received \$220 million in funding to reconstruct aging flood control levee systems. The reconstruction involves several major levee segments that stretch hundreds of miles. Assets under construction should be tracked in the Construction-in-Progress (CIP) account until the construction reaches completion. Once a construction project is complete, USIBWC transfers the asset to the real property asset account, and the asset is depreciated over its estimated useful life. To ensure that the real property asset account was accurate, we tested costs of \$124 million that were transferred from CIP to real property during FY 2014. We found that costs were transferred from CIP to real property based on the completion of individual construction contracts or when significant vendor payments were made rather than when construction of major levee segments was substantially complete, as required. USIBWC did not have an effective process in place to share information on the substantial completion of projects between the engineering, accounting, and administrative offices, which would allow CIP costs to be appropriately transferred to real property. Additionally, USIBWC did not have a process to track and allocate construction-related costs by construction project. Without effective controls to track construction costs and project status, asset balances and depreciation expenses may be misstated. As a result of our audit, USIBWC analyzed construction activity relating to the levee systems and made significant adjustments to the real property and CIP accounts.
- Inaccurate Classification of Internal Use Software – Federal agencies use various types of software, such as applications for operating a program or administrative applications. These applications, called internal use software (IUS), can be purchased off the shelf from commercial vendors or can be developed internally or by external contractors. Agencies are required to report software as general property in the annual financial statements. We tested costs relating to USIBWC's reconstruction of its flood control levee systems and identified costs relating to the acquisition of IUS that were included in the costs of the levee reconstruction. Specifically, USIBWC purchased document management software, a general engineering tool that USIBWC uses to manage construction documents and drawings for multiple projects. USIBWC classified the IUS as real property in the trial balance rather than as personal property. USIBWC did not

have an effective process to ensure that acquisitions of software were properly identified and classified as IUS. Because the software purchase was classified as real property, the asset began depreciating over a 50-year useful life, resulting in the recording of erroneous depreciation expenses.

## **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.

The Office of Inspector General (OIG) annually performs an evaluation of the Department's information security program compliance with information technology (IT) provisions as required by the Federal Information Security Management Act (FISMA).

In FY 2013, we and OIG noted control structure limitations surrounding the general support system and financial management applications used by USIBWC, which we considered to be a significant deficiency. Although the Department had remediated deficiencies related to financial management applications used by USIBWC in FY 2014, OIG continued to identify weaknesses and vulnerabilities in the general support system maintained by the Department. When combined, we considered the control deficiencies impacting the general support system to be a significant deficiency.

Collectively, the control deficiencies noted by OIG in its FY 2014 FISMA report<sup>1</sup> for the Department represented a significant deficiency to enterprise-wide security as defined by OMB guidance. OIG reported that the most significant security deficiencies were related to the Department's risk management framework, continuous monitoring program, and the incident response and reporting program. These control weaknesses impacted the Department's general support system, which is used to access the applications utilized by USIBWC. Because of the deficiencies noted with the IT security program at the Department, USIBWC needs to implement additional controls to ensure that financial information is being processed accurately and completely by the Department.

Poor controls over IT security can affect the integrity of financial applications, which increases the risk that sensitive financial information could be accessed by unauthorized individuals or that financial transactions could be altered either accidentally or intentionally. IT weaknesses increase the risk that USIBWC will be unable to report financial data accurately.

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

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<sup>1</sup>*Audit of Department of State Information Security Program (AUD-IT-15-17, Nov. 2014).*

### Status of Prior Year Findings

In the Independent Auditor’s Report on Internal Control Over Financial Reporting included in the audit report on USIBWC’s FY 2013 and 2012 financial statements,<sup>2</sup> we noted several issues that were related to internal control over financial reporting. The statuses of the FY 2013 internal control findings are summarized in Table 1.

**Table 1. Prior Year Significant Internal Control Deficiencies**

Control Deficiency	FY 2013 Status	FY 2014 Status
<b>Property and Equipment</b>	Significant Deficiency	Significant Deficiency
<b>Information Technology</b>	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, *Government Auditing Standards*, and OMB Bulletin No. 14-02 in considering USIBWC’s internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.



Alexandria, Virginia  
December 5, 2014

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<sup>2</sup> *Independent Auditor’s Report on the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2013 and 2012 Financial Statements* (AUD-FM-14-12, Dec. 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, 2014, and have issued our report thereon dated December 5, 2014. 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 opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02.

During the audit, we noted certain additional matters involving compliance that we will report to USIBWC's management in a separate letter.

**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 5, 2014

**International Boundary and Water Commission,  
United States and Mexico, U.S. Section, Response**

INTERNATIONAL BOUNDARY AND WATER COMMISSION  
UNITED STATES AND MEXICO

December 22, 2014



OFFICE OF THE COMMISSIONER  
UNITED STATES SECTION

Mr. Norman P. Brown  
United States Department of State  
Assistant Inspector General for Audits  
Office of Inspector General  
Washington, D. C. 20520

Subject: Management Letter related to the audit of the United States Section, International Boundary and Water Commission, 2014 Financial Statements

Dear Mr. Brown:

We received and have reviewed the draft FY 2014 Independent Auditor's Report AUD-FM-11 of the, International Boundary and Water Commission, United States and Mexico, United States Section (USIBWC). Thank you for the opportunity to comment on your draft audit recommendations.

Below please find our responses to each of the recommendations as requested. Please advise if you have any questions or if we may be of any assistance.

Sincerely,

A handwritten signature in blue ink that reads "Edward Drusina".

Edward Drusina, P.E.  
Commissioner

The Commons, Building C, Suite 100 • 4171 N. Mesa Street • El Paso, Texas 79902-1441  
(915) 832-4100 • Fax: (915) 832-4190 • <http://www.ibwc.gov>

Independent Auditor's Report

AUD-FM-14-11

- Insufficient Construction Accounting Process - Beginning in FY 2009, as part of the American Recovery and Reinvestment Act initiative, USIBWC received \$220 million in funding to reconstruct aging flood control levee systems. The reconstruction involves several major levee segments that stretch hundreds of miles. Assets under construction should be tracked in the Construction-in-Progress (CIP) account until the construction reaches completion. Once a construction project is complete, USIBWC transfers the asset to the real property asset account, and the asset is depreciated over its estimated useful life. To ensure that the real property asset account was accurate, we tested \$124 million of costs that were transferred from CIP to real property during FY 2014. We found that costs were transferred from CIP to real property based on the completion of individual construction contracts or when significant vendor payments were made, rather than when construction of major levee segments was substantially complete, as required. USIBWC did not have an effective process in place to share information on the substantial completion of projects between the engineering, accounting, and administrative offices, which would allow CIP costs to be appropriately transferred to real property. Additionally, USIBWC did not have a process to track and allocate construction-related costs by construction project. Without effective controls to track construction costs and project status, asset balances and depreciation expenses may be misstated. As a result of our audit, USIBWC analyzed construction activity relating to the levee systems and made significant adjustments to the real property and CIP accounts.

**Management Response:**

USIBWC Financial Management and Engineering recognize the importance of improving its existing process and controls related to the transfer of expenditures from CIP to general PP&E, to ensure the transfers are accomplished as soon as the asset reaches the “substantial completion” phase. To assist with this effort, official written notifications are being drafted by the Engineering team and the Contracting Officer, to the Accounting Officer. The written notice provides the necessary information in order to account for substantial completion dates, identification of all associated contracts, levee segment it belongs to, etc. In addition, quarterly reviews and reporting will be accomplished between Contracting and Engineering teams to report upcoming projected transfers. We are confident that this process will account for agency responsibilities in properly and timely recording PP&E consistent with *Statement of Federal Financial Accounting Standards* (SFFAS) No. 6 states “in the case of constructed Property Plant & Equipment (PP&E), and in response to this NFR.

- Inaccurate Classification of Internal Use Software – Federal agencies use various types of software, such as applications for operating a program or administrative applications. These applications, called internal use software (IUS), can be purchased off the shelf from commercial vendors or can be developed internally or by external contractors. Agencies are required to report software as general property in the annual financial statements. We tested costs relating to USIBWC’s reconstruction of its flood control levee systems and identified costs relating to the acquisition of IUS that were included in the costs of the levee reconstruction. Specifically, USIBWC purchased document management software, a general

engineering tool that USIBWC uses to manage construction documents and drawings for multiple projects. USIBWC classified the IUS as real property in the trial balance rather than as personal property.

**Management Response:**

The IBWC has in place a process, which is designed to review all proposed procurements for both appropriations. The agency's subject matter experts are quite versed in Appropriation Law and understand the requirements for a single year S&E appropriation and those of a no-year Construction appropriation. However, in light of this incident, more in-depth reviews of proposed purchases is being conducted; Quarterly reviews between the two sections will be accomplished starting in FY 2015 to ensure the review process is operating as intended, and ensure that the acquisition of internal use software assets are procured under the correct appropriation.

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