

MANAGEMENT LETTER
AUD-FM-16-13

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

Kearney & Company, P.C. (referred to as “we” hereafter), has 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, 2015, and has issued our report thereon dated December 4, 2015.¹ In planning and performing our audit of the USIBWC consolidated financial statements, we considered USIBWC’s internal control over financial reporting and compliance with certain provisions of laws, regulations, and contracts. Our auditing procedures were designed for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurances on internal control or compliance. Accordingly, we do not express an opinion on the effectiveness of USIBWC’s internal control over financial reporting or on USIBWC’s compliance with certain provisions of laws, regulations, and contracts.

During our audit, we noted a matter related to internal control over financial reporting that we considered to be a significant deficiency under 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 Bulletin No. 15-02, “Audit Requirements for Federal Financial Statements.” This item is not repeated in this letter, as it is explained in detail in our report on USIBWC’s FY 2015 financial statements.

Our procedures were designed primarily to enable us to form an opinion on the USIBWC consolidated financial statements and therefore may not have identified all internal control weaknesses and instances of noncompliance that may exist. Although not considered to be material weaknesses, significant deficiencies, or reportable instances of noncompliance, we noted certain other matters involving internal control, operations, and compliance. These findings and recommendations, which are summarized in Appendix A, are intended to assist USIBWC in strengthening internal control and improving operating efficiencies.

We appreciate the courteous and professional assistance provided by USIBWC personnel during our audit. These findings and recommendations have been discussed with appropriate USIBWC officials. Comments from USIBWC management on this report are presented in Appendix B.

¹ OIG, *Independent Auditor’s Report on the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2015 and 2014 Financial Statements* (AUD-FM-16-12, Dec. 2015).



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

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

Alexandria, Virginia
February 9, 2016

MANAGEMENT LETTER COMMENTS**COMMENTS REPEATED FROM PRIOR YEAR**

During the audit of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), FY 2014 financial statements, Kearney & Company, P.C. (referred to as “we” hereafter), identified matters that were reported in an internal control report¹ and a management letter.² During the audit of the FY 2015 financial statements, we assessed the status of the deficiencies reported during FY 2014. The severity of issues related to property and equipment reported in the FY 2014 internal control report had decreased sufficiently for us to include the issue in this management letter rather than the FY 2015 report on internal control. One issue included in the FY 2014 management letter related to untimely disbursements of payments to vendors remained open. Additionally, the severity of one issue related to obligation validity included in the FY 2014 management letter decreased, and we consider the item closed.

I. Property and Equipment**Insufficient Controls Over Real Property Accounting**

USIBWC manages flood control systems, as well as dams and hydroelectric power plant facilities along the U.S. and Mexican border. All real property, such as the flood control systems and administration buildings for the hydroelectric power plants, is owned and constructed by USIBWC. All construction projects should be tracked in the Construction-in-Progress (CIP) account until the project 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. If an asset is demolished, the asset is recorded as a disposal and removed from the accounting records along with any liabilities associated with the property, such as asbestos abatement costs.³

We evaluated the status of 15 active CIP projects, as well as the existence of real property assets at 3 field sites, and noted the following exceptions:

- One CIP project was substantially complete in FY 2014, but was not transferred to the real property account until FY 2015.
- One real property asset was demolished in FY 2015; however, the asset remained in the accounting records as of June 30, 2015. Additionally, the asset had an associated liability for estimated asbestos abatement cost, which remained in the accounting records as of June 30, 2015.

¹ OIG, *Independent Auditor’s Report on the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2014 and 2013 Financial Statements* (AUD-FM-15-11, Dec. 2014).

² OIG, *Management Letter Related to the Audit of the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2014 Financial Statements* (AUD-FM-15-12, Feb. 2015).

³ Asbestos abatement cost is the estimated cost for the agency to remove and dispose of asbestos material found within a building.

- One CIP project was terminated by USIBWC in FY 2015; however, a balance relating to the project remained in the CIP account as of June 30, 2015.

USIBWC's engineering division did not effectively provide information on the substantial completion of one CIP project and the demolition of one facility to the accounting division. Because USIBWC did not effectively communicate these events, the accounting records were not updated timely. As part of the demolition, USIBWC abated the asbestos material contained within the facility, but this information was not reported to the accounting division and, thus, the abatement liability was not removed from the general ledger.

Additionally, the accounting transaction for the disposal of one terminated CIP project was not fully recorded because two separate contracts were used to construct the asset. The accounting division only removed costs attributable to one of the two contracts.

The untimely transfer of the CIP project to the real property account resulted in an understatement of the FY 2014 depreciation expense. The demolished facility was fully depreciated in the accounting records; however, the asbestos abatement liability was overstated as of June 30, 2015. The untimely disposal of the terminated CIP project resulted in an overstatement of the property account as of June 30, 2015. USIBWC made accounting adjustments at year-end for financial reporting purposes, but control weaknesses over real property accounting could result in misstated financial statements.

Recommendation

We recommend that USIBWC:

- develop a process to improve communication between the engineering office and the accounting office regarding the substantial completion of construction projects and the demolition of facilities, and
- develop a process to identify all amounts attributable to terminated construction projects and ensure that the amounts are removed from the asset accounts.

Inaccurate Recording of Capital Upgrade

USIBWC manages waste water treatment plants in San Diego, CA, and Nogales, AZ. The infrastructure of the waste water treatment facilities uses a supervisory control and data acquisition (SCADA)⁴ information system package to maintain plant operations and remotely monitor equipment activities.

During our testing of operations and maintenance expenditures, as of June 30, 2015, we identified disbursements to upgrade the SCADA system at the Nogales waste water treatment plant. The upgrade to the SCADA system should have been capitalized and reported as an asset.

⁴ SCADA systems provide information to engineers and plant operations managers to ensure equipment is operating properly and effectively.

USIBWC did not have an effective process to ensure that capitalizable upgrades are identified and classified as a property asset in the financial statements.

As of June 30, 2015, USIBWC's operating expense was overstated and the property account was understated by the amount of the SCADA upgrade. USIBWC made an accounting adjustment at year-end for financial reporting purposes, but the control weakness related to the classification of capitalizable system upgrades could result in future misstatements of the financial statements.

Recommendation

We recommend that USIBWC develop and implement a process to identify and account for system upgrades that qualify as capital assets.

II. Compliance With Laws and Regulations

Untimely Disbursements of Payments to Vendors Pursuant to the Prompt Payment Act

USIBWC is subject to the Prompt Payment Act (PPA).⁵ The PPA generally requires that Federal agencies pay commercial vendors within 30 days of the receipt of a proper invoice. When timely payments are not made, the PPA requires that agencies calculate and include interest penalties in the vendor payment. Interest penalties represent additional and avoidable costs that decrease the amount of funds available for other needs. USIBWC uses its financial management system, the Global Financial Management System (GFMS), to process vendor invoices.

During our testing of non-payroll operating expenditures, we identified untimely payments. Of a sample of 30 items subject to PPA, we identified 5 invoices (17 percent) that were not paid within the required 30 days. In addition, USIBWC paid the incorrect amount of interest for two of the five invoices that were not paid timely, both of which were payments to utility companies.

We found that USIBWC did not have sufficient controls in place to ensure that payments were made in a timely manner. USIBWC management stated that delays in the invoice receipt and disbursement processing resulted in one of the sampled invoices being paid in an untimely manner. For two additional invoices, which were paid untimely, USIBWC management stated that funding was not obligated to the contract due to funding delays. Once the funds were available and obligated, the invoices were paid by USIBWC with interest. USIBWC incurred multiple late payment penalties for the same utility vendor due to delays in properly recording obligations in GFMS. USIBWC management stated that miscommunication between its Financial Services and Budget Divisions resulted in the obligation and disbursement delays.

When processing the two sampled utility invoices, USIBWC did not have a process to ensure that the invoices were identified as "Utility" in GFMS. A "Utility" designation exempts an invoice from GFMS's automatic PPA calculation and requires the user to manually apply the vendor's imposed rate. Because USIBWC did not have a process to ensure utility invoices were

⁵ Code of Federal Regulations, Title 5, Chapter III, Subchapter B, Part 1315, "Prompt Payment."

exempted from PPA calculations in GFMS, the invoices were paid with interest amounts computed based on PPA requirements, rather than the utility vendor's significantly higher late payment penalty rate.⁶

By not paying all invoices within the required 30 days, USIBWC has incurred unnecessary interest and penalties. In addition, if USIBWC does not remit the proper amount of interest penalties to vendors as required, USIBWC is not in compliance with the PPA.

Recommendation

We recommend that USIBWC:

- improve communication between the Financial Services Division and Budget Division to ensure that available funds are obligated for routine services in a timely manner, and
- develop and implement a process to ensure that invoices for utility services are properly entered into the financial system to enable accurate late payment fees as required by utility vendors.

NEWLY IDENTIFIED COMMENT

During the audit of the USIBWC FY 2015 financial statements, an additional matter came to our attention that was not previously reported in the FY 2014 internal control report or management letter.

III. Property and Equipment

Insufficient Construction-in-Progress Accrual Process

In the event that capitalizable construction services have been received but not invoiced by vendors at the end of the fiscal year, USIBWC estimates amounts to report as CIP and Accounts Payable. USIBWC's Financial Services Division relies on USIBWC's Acquisitions Division to provide an estimate of construction services received but not yet billed to record on its annual financial statements. The Acquisitions Division estimates the extent of unbilled construction activity relating to each active USIBWC contract. USIBWC's Engineering Division is responsible for managing construction activity.

During our testing of CIP expenditures relating to capital construction projects made during the first 9 months of FY 2015, we identified five expenditures for construction services that occurred in the fourth quarter of FY 2014. These transactions should have been reported as CIP and Accounts Payable on the FY 2014 financial statements.

⁶ The PPA states that "all utility payments...are subject to the Act." However, where "state, local or foreign authorities impose generally applicable late payment rates for utility payments, those rates shall take precedence."

In FY 2014, the Acquisitions Division stated that no unbilled services were incurred prior to year-end for several active construction projects. USIBWC’s Financial Services Division did not have an effective process to review and verify the year-end CIP unbilled services information provided by the Acquisitions Division, such as comparing the estimate to a list of known ongoing construction contracts or corroborating the estimate with the Engineering Division.

USIBWC’s CIP and Accounts Payable balances were each understated in FY 2014. By not having a process to review and validate the accrual estimates, USIBWC’s financial statements are at an increased risk of misstatement.

Recommendation

We recommend that USIBWC develop and implement a process to review and validate the Construction-in-Progress accrual estimate, such as reviewing a list of open construction contracts to confirm that all contracts are considered during the estimation process or confirming the estimate with the Engineering Division.

STATUS OF PRIOR YEAR MANAGEMENT LETTER FINDINGS

The current status of findings reported in the management letter related to the audit of the USIBWC FY 2014 financial statements is summarized in Table 1.

Table 1. Current Status of Prior Year Management Letter Findings

FY 2014 Management Letter Findings	FY 2015 Status
Obligation Validity	Closed
Untimely Disbursements of Payments to Vendors	Repeat

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



INTERNATIONAL BOUNDARY AND WATER COMMISSION
UNITED STATES AND MEXICO
UNITED STATES SECTION

February 3, 2016

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 Report of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), FY 2015 Financial Statements

Dear Mr. Brown:

We are in receipt of and thank you for providing us the opportunity to review the draft report Management Letter Related to the Audit Report of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), FY 2015 Financial Statements.

We have reviewed the report and do not have any additional comments to submit. We appreciate the annual reviews of our financial operations.

Sincerely,

Edward Drusina, P.E.
Commissioner