

MANAGEMENT LETTER
AUD-FM-18-09

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, 2017, and has issued our report thereon dated December 20, 2017.¹ 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 certain matters related to internal control over financial reporting that we considered to be significant deficiencies 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. 17-03, “Audit Requirements for Federal Financial Statements.” These items are not repeated in this letter, as they are explained in detail in our report on USIBWC’s FY 2017 financial statements.

Our procedures were designed primarily to enable us to form an opinion on USIBWC’s 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 noncompliance. These findings are summarized in Appendix A and are intended to assist USIBWC in strengthening internal controls and improving operating efficiencies.

We appreciate the courteous and professional assistance provided by USIBWC personnel during our audit. These findings 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, 2017 and 2016 Financial Statements* (AUD-FM-18-08, February 2018).



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, VA
March 13, 2018

MANAGEMENT LETTER COMMENTS

STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS

During the audit of the International Boundary and Water Commission, United States and Mexico, U.S. Section’s (USIBWC) FY 2016 financial statements, Kearney & Company, P.C. (referred to as “we” hereafter), identified matters that were reported in a management letter.¹ As described in Table 1, the severity of the two issues included in the FY 2016 management letter has decreased, and we consider these items closed.

Table 1: Current Status of Prior Year Management Letter Findings

FY 2016 Management Letter Findings	FY 2017 Status
Inaccurate Recording of Capital Upgrade	Closed
Validity and Accuracy of Unliquidated Obligations	Closed

NEW MANAGEMENT LETTER COMMENT

During the audit of USIBWC’s FY 2017 financial statements, two matters came to our attention that were not previously reported in the FY 2016 Report on Internal Controls or the management letter.

I. Property and Equipment

Timeliness and Accuracy of Personal Property Acquisitions and Disposals

USIBWC owns a significant amount of capitalized² property, including equipment, buildings, vehicles, and land. Specifically, as of September 30, 2017, USIBWC reported \$885.5 million in capitalized property, plant, and equipment, which was 85 percent of USIBWC’s total assets. USIBWC uses the Integrated Logistics Management System (ILMS) to track, manage, and record property transactions. ILMS is a commercial, off-the-shelf system owned by the Department of State. ILMS periodically interfaces with USIBWC’s accounting system, the Global Financial Management System.

Our FY 2017 testing identified several errors related to capitalized personal property.³ Specifically,

¹ OIG, *Management Letter Related to the Audit of the International Boundary and Water Commission, United States and Mexico, U.S. Section, 2016 Financial Statements* (AUD-FM-17-13, March 2017).

² Capitalize is an accounting concept that allows an organization to recognize the expense related to an asset over the life of the asset (instead of recognizing the expense in the year of acquisition).

³ Personal property is essentially any property other than real estate. The distinguishing factor is that personal property is not fixed permanently to one location, such as vehicles or equipment.

- We tested a sample of 12 personal property acquisitions recorded in FY 2017 and identified 6 (50 percent) that were recorded inaccurately or untimely—the cost of 2 of the items was incorrect, and 4 items had the incorrect in-service date.
- We tested a sample of three personal property disposals recorded in FY 2017 and identified one transaction (33 percent) that was not processed until 6 months after the disposal date.
- One (3 percent) of 37 assets tested at USIBWC’s field offices was no longer in use. USIBWC was unable to produce sufficient documentation related to the disposal.
- We recalculated depreciation⁴ for the 281 reported assets and determined that the depreciation for 3 assets (1 percent) exceeded salvage value.

The errors we identified occurred because USIBWC’s processes to ensure that personal property was recorded in a complete, timely, and accurate manner were ineffective. Specifically, property management officials were not always following USIBWC’s procedures and did not receive training to ensure that procedures were understood and implemented. We also found that data entered into ILMS was not subject to a quality control review.

The lack of effective controls results in the loss of accountability for asset custodianship, which could lead to undetected theft or waste. In addition, the untimely and inaccurate processing of property transactions resulted in immaterial misstatements to USIBWC’s financial statements. Although the errors identified were immaterial, additional errors are likely to occur unless effective property management procedures are implemented.

II. Liabilities

Recognition of Contingent Liabilities

USIBWC is responsible for providing flood protection to U.S. residents and ensuring the efficient conveyance, utilization, and accounting of boundary and transboundary river waters. Accordingly, USIBWC operates and maintains flood control systems and continues efforts to evaluate and improve deficient levee segments and associated structures. USIBWC uses contractors to construct and maintain flood control levees, canals, and dams. Some vendors have claimed costs exceeding contract award amounts.

The Department of Justice established the Judgment Fund to pay certain court judgements and settlements of lawsuits against the U.S. Government. Agencies are required to recognize a contingent liability for legal filings against a Federal entity when management believes it is more likely than not that the filing will be settled in favor of the claimant. However, Federal accounting standards direct agencies to remove contingent liabilities from their financial records when it is determined that the Judgment Fund will pay for judgements and settlements.

Certain events or transactions that affect the financial statements may occur after the end of the reporting period but before the financial statements for that period are issued. These situations

⁴ Depreciation is the accounting method used to recognize expenses for a capitalized asset.

are called subsequent events. Depending on the event, the item may or may not require disclosure in the financial statements that were for the prior reporting period but that had not yet been issued. Specifically, organizations are required to include information on the effect of all subsequent events that provide additional information about conditions in existence as of the balance sheet date. For example, if events take place prior to the balance sheet date that lead to a lawsuit being filed after the end of the reporting period, the financial statements should be updated to reflect the subsequent event.

We performed procedures to determine whether contingent liabilities were properly recorded in USIBWC's financial statements. Specifically, on December 6, 2017, we met with USIBWC's Chief Legal Counsel to obtain an understanding of the status of any litigation faced by USIBWC that existed as of September 30, 2017, including any events that occurred through the date of our meeting. During that time period, USIBWC was notified that the Judgment Fund would cover a vendor's claim related to one levee construction lawsuit. However, USIBWC had recognized this claim as a contingent liability in the draft financial statements as of September 30, 2017. USIBWC should have removed its contingent liability when it determined that the Judgment Fund would pay for the claim.

Although USIBWC was tracking the status of potential contingent liabilities for purposes of its financial statements, we found that USIBWC did not have a process to properly remove liabilities to be funded by the Judgment Fund. In addition, USIBWC did not have a process in place for reviewing events or transactions that may have a significant impact on the financial statements subsequent to the reporting period. As a result of our audit work, USIBWC properly adjusted its financial statements and removed the amount that will be paid by the Judgment Fund. If we had not identified the issue, USIBWC's financial statements would have incorrectly reported its contingent liabilities.



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

March 9, 2018

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 International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), FY 2017 Financial Statements

Dear Mr. Brown:

Thank you for providing us the opportunity to respond to the draft report Management Letter Related to the Audit of the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), FY 2017 Financial Statements.

We have reviewed the report and have provided responses to the two findings included in this letter. We appreciate the review and feedback of our operations, which assist us in improving and strengthening internal controls of our operations.

Sincerely,



Edward Drusina, P.E.
Commissioner



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

I. Property and Equipment: Timeliness and Accuracy of Property and Acquisitions and Disposals

USIBWC management concurs with the findings reported in the Management Letter. In response to these findings and those of management, steps were taken in September 2017 to initiate a comprehensive reconciliation between the Department of State's Integrated Logistics Management System (ILMS) and the agency's personal property inventory. The review and reconciliation considers personal property non-capitalized non-IT; IT; and capitalized. The reconciliation, which is still underway, will provide a cross-walk of all discrepancies between the two systems. Once the reconciliation is concluded, the only system of record that the USIBWC will use going forward, is the Department's ILMS system. In addition, training sessions will be held with each of the field offices – management and designated personnel – which will include the full scope of federal requirements, agency policy and procedures and their respective roles and responsibilities. The training will be held within 45 days of the completion of the personal property reconciliation. The training is expected to respond to the timeliness and accuracy of acquired and disposed assets.

II. Liabilities: Recognition of Contingent Liabilities

USIBWC's financial managers are fully aware of Federal accounting standards in accounting for and recording changes on the status of contingent liabilities in the agency's financial records. A formal process will be developed that tracks, reviews, and records events and the status of such events that may potentially impact on the financial statements subsequent to the reporting period. The review will assist in tracking and correctly recording contingent liabilities in a timely. This effort will be accomplished in coordination with the Legal Office.