

Memorandum

To: Board of Water Commissioners Finance Committee, City of Detroit Water and Sewerage Department

From: Beth Bialy and Tim St. Andrew

Subject: Summary of audit observations and comments

Date: January 26, 2018

CC: Gary Brown and Thomas Naughton

We have recently completed our audit of the City of Detroit, Michigan, which included the Water Fund and Sewage Disposal Fund, as enterprise funds of the City. As part of that audit, we have communicated relevant matters to those charged with governance of the City. With the issuance of the separate Water Fund's and Sewage Disposal Fund's financial statements, we felt it appropriate to summarize the information contained in those communications that are relevant to the City of Detroit Water and Sewerage Department (the "DSWD" or the "Department").

Below is a summarized discussion of the observations and comments that are contained in our formal communications to the City of Detroit, Michigan (note that the finding numbers refer to the more comprehensive discussion to be found in the City's Report on Internal Control and Compliance). For a more complete understanding, we would refer you to those original documents. However, the two of us are available to discuss these concepts with the Board of Water Commissioners at its convenience.

It is important to understand that due to the financial environment in place, the DWSD is reliant on certain accounting procedures and controls of the City and GLWA. We include all such matters here, because we feel that in your oversight role, it is important to focus on all internal control issues that impact the DWSD.

Internal Control Matters

Finding No.	2017-001
Finding Type	Material weakness (repeat finding)
Finding	The DWSD should have a process in place to ensure proper recording and reconciling of general ledger activity throughout the year as well as identification and recording of all year-end closing entries in accordance with generally accepted accounting principles (GAAP) prior to the commencement of the audit. The DWSD's general ledger and underlying financial records were not reconciled and closed in a timely manner.
Finding No.	2017-002 (repeat finding)
Finding Type	Material weakness
Finding	There should be a procedure in place to reconcile bank activity on a timely basis and to ensure cash balances are properly stated as of the end of the year. The DWSD did not have procedures in place to ensure all bank accounts were fully reconciled to the general ledger on a timely basis. Also, it was noted through audit procedures that signer cards for certain bank accounts were not updated to remove the former CFO.
Finding No.	2017-003
Finding Type	Material weakness
Finding	The DWSD should have appropriate overall monitoring procedures in place over the general ledger and external financial reporting function to ensure timely and accurate financial statements. The DWSD lacked appropriate reconciliation procedures and overall monitoring of account balances during the year.

Audit Observations

Qualitative Aspects of Accounting Practices

Bifurcation Uncertainties

On January 1, 2016, the City of Detroit, Michigan effectuated a lease agreement with the Great Lakes Water Authority for the regional water and sewer system for a term of 40 years, to be extended automatically to coincide with the final maturity of any bonds issued to finance improvements to the regional or local water and sewer systems. The agreement and a corresponding lease of the regional water and sewer system collectively provide for an annual lease payment of \$50 million in exchange for a leasehold interest in certain assets of the systems held by the funds as of December 31, 2015, assignment of all revenue of the regional and local water and sewer systems, and the assumption of all DWSD bonded debt and certain liabilities.

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The DWSD has been in negotiations with the Great Lakes Water Authority since February 2016 regarding a multitude of open items related to the January 1, 2016 bifurcation of the DWSD. During 2017, as a result of continued negotiations on the allocation percentage of debt, the DWSD revised its obligation payable to GLWA in the amount of \$79,360,077 and \$64,026,310 in the Water Fund and Sewage Disposal Fund, respectively. These amounts, along with other bifurcation-related adjustments, are recognized as a special item (bifurcation loss) in the statement of revenue, expenses, and changes in net position.

Other Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Estimate	Basis for Estimate
Accrued claims and judgments	The estimated probable loss that will result from ongoing litigation involving general and automobile claims
Accrued workers' compensation	An actuarial report prepared by an independent third party. The report was based on certain assumptions pertaining to actual loss development patterns which are augmented with industry benchmark loss development patterns.
Allowance for doubtful accounts	Management's analysis of accounts receivable for water and sewer billings that are unlikely to be collected by the DWSD
Net pension liability, deferred inflows and outflows, and pension expense	Independent third-party actuary services. These valuations are based on certain assumptions pertaining to mortality, expected returns on plan assets, and future contributions from the City/DWSD.
Special item (loss) related to the change in the estimates surrounding the allocations between the DWSD and the Great Lakes Water Authority based on an anticipated final MOU surrounding the lease agreement	Based on DWSD management's understanding of the provisions that will ultimately be formalized in a Memorandum of Understanding (MOU). The MOU is still being negotiated between the City and GLWA.

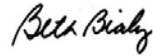
We evaluated the key factors and assumptions used to develop the estimates above in determining that they are reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were the long-term obligation disclosures included in Note 5, the risk management disclosures in Note 7, and the pension disclosures in Note 8.

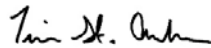
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We would like to take this opportunity to thank the DWSD's staff for the cooperation and courtesy extended to us during our audit. Their assistance and professionalism are invaluable. We welcome any questions you may have regarding the following communications and we would be willing to discuss any of these or other questions that you might have at your convenience.

Plante & Moran, PLLC



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