

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: December 14, 2018

CC: Gary Brown and Thomas Naughton

We have recently completed our audit of the City of Detroit, Michigan (the "City"), 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 and Sewage Disposal Fund 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 the Great Lakes Water Authority (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. 2018-001

Finding Type Material weakness (repeat finding)

Finding The Detroit Water and Sewerage Department (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 general ledger and underlying financial records were not completely reconciled and closed in a timely manner. As a result, there were audit adjustments identified during the audit of the DWSD. If the DWSD had not recorded the auditor-identified entries, the financial statements would have been materially misstated.

Finding No. 2018-002

Finding Type Significant deficiency

Finding There should be a process in place to ensure that customer accounts are updated and billed at the appropriate rates for water and sewage consumption. The DWSD’s process to ensure that all customer accounts are updated and billed at the appropriate rates for water and sewage consumption did not properly update all customer accounts to the appropriate water and sewage billing rate when the rates were changed during the year. Without proper updates to customer accounts within the water and sewage billing systems, there is the potential for the DWSD to under- or over-bill customers throughout the year.

Audit Observations

Qualitative Aspects of Accounting Practices

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 that 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 or the DWSD.

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.

Significant Matters

The Department has continued to negotiate some of the final issues concerning the bifurcation, and a final agreement was executed during 2018. Certain estimates from prior years were adjusted as a result of the final agreement, including pre-effective date liabilities and related cash balances and the portion of the debt assumed by GLWA that was utilized for local system improvements, whose debt will continue to be funded by the Department. As a result of the negotiations, the Department has adjusted the recognition of the gain from the bifurcation in the current year by \$35,482,690 in the Water Fund and \$66,377,234 in the Sewage Disposal Fund.

Board of Water Commissioners Finance Committee
City of Detroit Water and Sewerage Department

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.

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