

## INDEPENDENT AUDITORS' COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

July 31, 2017

To the Board of Directors  
Great Lakes Water Authority  
Detroit, Michigan

We have audited the financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the *Great Lakes Water Authority* (the "Authority") as of and for the year ended June 30, 2016, and have issued our report thereon dated July 31, 2017. Professional standards require that we advise you of the following matters relating to our audit.

### Our Responsibility in Relation to the Financial Statement Audit

As communicated in our engagement letter dated February 3, 2017, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements that have been prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Authority solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

We have provided our findings regarding internal control over financial reporting and compliance noted during our audit in a separate letter to you dated July 31, 2017. In addition, we noted certain other matters which are included in Attachment A to this letter.

### Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter and in our meeting about planning matters on February 10, 2017.

### Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, and our firm has complied with all relevant ethical requirements regarding independence.

## Qualitative Aspects of the Authority's Significant Accounting Practices

### *Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Authority is included in Note 1 to the financial statements.

As described in Note 1, Note 12 and Management's Discussion and Analysis, the Authority commenced operations on January 1, 2016 and its opening balances on that date were based on GASB 69 acquisition values from the City of Detroit.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

### *Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future.
- Acquisition value of the assets acquired and liabilities acquired by lease agreement from the City of Detroit.
- Allocation of the debt service responsibilities between the Authority and the City of Detroit.
- Shared services between the Authority and the City of Detroit are not yet finalized and amounts recorded are subject to negotiation.
- Management's estimate of the accrued compensated absences is based on current hourly rates and policies regarding payment of sick and vacation banks.
- Management's estimate of the allowance for uncollectible receivable balances is based on past experience and future expectation for collection of various account balances.
- Management's estimate of the insurance claims incurred but not reported is based on information provided by the entity's third party administrators and subsequent claims activity.

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units. In addition, the financial statements include a net pension liability and other pension-related amounts, which are dependent on estimates made by the City of Detroit General Employees' Retirement System. These estimates are based on historical trends and industry standards, but are not within the control of management.

#### *Financial Statement Disclosures*

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements relate to the acquisition value of assets acquired and liabilities assumed when the Authority was created. Independent experts provided estimates regarding the acquisition value of capital assets, useful lives of those assets and the related debt. See Note 8 for discussion of the lease from the City of Detroit that is the basis for the acquisition transaction.

#### **Significant Difficulties Encountered During the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

#### **Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. None of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

The schedule of adjustments passed is included with management's written representations in Attachment C to this letter, and summarizes uncorrected financial statement misstatements whose effects in the current and prior periods, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole and each applicable opinion unit.

#### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the Authority's financial statements or the auditors' report. No such disagreements arose during the course of the audit.

#### **Representations Requested from Management**

We have requested certain written representations from management, which are included in Attachment C to this letter.

### Management's Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that the same auditors for the City of Detroit were consultants on the accounting for the formation of the Authority due to the bifurcation impacting both entities, significantly. As part of the consultation, an "Accounting Playbook" was created to facilitate the accounting for the bifurcation of the Detroit Water and Sewerage Department balance sheet, but also for the Authority's ongoing operational items. Management informed us that, and to our knowledge, there were no other consultations with other accountants regarding auditing and accounting matters.

### Other Significant Matters, Findings, or Issues

In the normal course of our professional association with the Authority, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our appointment as the Authority's auditors.

### Other Information in Documents Containing Audited Financial Statements

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. We made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

### Upcoming Changes in Accounting Standards

Generally accepted accounting principles (GAAP) are continually changing in order to promote the usability and enhance the applicability of information included in external financial reporting. While it would not be practical to include an in-depth discussion of every upcoming change in professional standards, Attachment B to this letter contains a brief overview of recent pronouncements of the Governmental Accounting Standards Board (GASB) and their related effective dates. Management is responsible for reviewing these standards, determining their applicability, and implementing them in future accounting periods.

This information is intended solely for the use of the governing body and management of the *Great Lakes Water Authority* and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Lehmann Johnson LLC". The signature is written in a cursive, flowing style.

# GREAT LAKES WATER AUTHORITY

## Attachment A - Comments and Recommendations

For the June 30, 2016 Audit

During our audit, we became aware of certain other matters that are opportunities for strengthening internal control and/or improving operating efficiency. This memorandum summarizes our comments and recommendations regarding those matters. Our consideration of the Authority's internal control over financial reporting is described in our report, dated July 31, 2017, issued in accordance with *Government Auditing Standards*. This memorandum does not affect that report or our report dated July 31, 2017, on the financial statements of the Great Lakes Water Authority.

### Information Technology (IT) Matters

Processes and policies related to information technology were reviewed, and through related procedures, instances were identified that represent opportunities for management to improve upon the Authority's internal control structure. There were no high priority issues noted; however, the matters that were noted as moderate priority issues are as follows:

- ◆ *Back-up Processes Review* - Back-ups to the Storage Area Network (SAN) are currently retained on-site. We recommend utilization of an off-site storage solution for backups to ensure quick recovery of critical data.
- ◆ *Vendor Risk Assessment and Oversight* - The risk assessment process and monitoring of vendor performance is not formalized. Management should ensure that all vendor relationships are formally reviewed on a periodic basis depending on the risk they pose to the Authority. Management should ensure that a risk assessment is performed on all IT vendors that identifies and ranks the vendors based on overall risk as it relates to critical need to operations and access to internal information.
- ◆ *Procedures over Network Access Rights* - The Authority performs quarterly reviews for privileged access, but does not perform a periodic review of all system users. Such a review should confirm whether the rights to all user accounts are still appropriate, given shifting responsibilities.
- ◆ *Password Policies* - The Authority has software level password controls in place to secure BS&A, Domain, WAM, and Ceridian applications/systems; however, the password settings for each system vary and do not align with recommended best practice settings. We recommend that management implement best practice password settings to each system's capability including:
  - Minimum Length: 8 characters
  - Maximum Age: 45-90 days
  - Password History: 12-24 previous passwords
  - Complexity: Required special character or upper/lowercase
  - Invalid Lockout: 3 invalid attempts

### Fraud Hotline

The Authority does not currently have a fraud hotline in place to anonymously report fraudulent activity. We recommend the Authority implement a fraud hotline to encourage employees to report fraud.

### Capital Asset Tracking

The Authority tags its physical assets to facilitate counts and accurate recordkeeping of capital assets. Certain items that were examined during an on-site review had asset tags that did not match up with the entity's records. We recommend the Authority do a complete count and verify that assets are properly tagged.

# GREAT LAKES WATER AUTHORITY

## Attachment A - Comments and Recommendations

For the June 30, 2016 Audit

### Bank Accounts

The Authority has three bank accounts recorded totaling \$65,823 which are in the City of Detroit's name as of June 30, 2016. This is the result of those accounts not being transferred to GLWA at bifurcation. We understand that this is a matter being addressed in the Memorandum of Understanding discussions between DWSD, GLWA, and the City. It is recommended this matter be resolved.

### Journal Entry Review

We noted that general journal entries are reviewed by someone independent of the preparer in the financial accounting software. However, we noted one instance in which the same individual entered, approved and posted the transaction to the accounting records. We recommend that the reviewer and preparer be independent of each other in all instances and that review be properly documented.

### Purchasing Card Approval

We noted one instance in which a department manager signed off on an expense, but the "for finance" section was not completed. The financial services area should review all expenses to ensure proper recognition in the accounting records. We recommend that the form be completed in its entirety for all transactions.

### Salary Documentation

We noted one instance in which an employee's salary documentation was not available and another in which the pay rate being used did not agree to the approved pay rate in the employee's personnel records. This appears to be the result of pay rates carrying over from the City of Detroit without the supporting documentation. We recommend the Authority obtain and verify pay rates being used.

### Fire Remediation

In early 2016, a fire occurred at the water resources recovery facility. This fire damaged several pieces of equipment along with part of a building. The Authority did not record the capital asset impairment in its accounting records. This amount was not material to the financial statements, but was an event that required disclosure. We recommend the Authority conduct impairment tests on a regular basis to verify the assets in service are properly recorded.



# GREAT LAKES WATER AUTHORITY

## Attachment B - Upcoming Changes in Accounting Standards / Regulations

For the June 30, 2016 Audit

The following pronouncements of the Governmental Accounting Standards Board (GASB) have been released recently and may be applicable to the Authority in the near future. We encourage management to review the following information and determine which standard(s) may be applicable to the Authority. For the complete text of these and other GASB standards, visit [www.gasb.org](http://www.gasb.org) and click on the "Standards & Guidance" tab. If you have questions regarding the applicability, timing, or implementation approach for any of these standards, please contact your audit team.

### **GASB 74 ■ Postemployment Benefit Plans Other than Pension Plans**

*Effective 06/15/2017 (your FY 2017)*

This standard requires the calculation of a net other postemployment benefit (OPEB) liability based on an actuarial valuation of retiree healthcare and similar benefits administered by an OPEB trust. It mirrors the new accounting and financial reporting requirements of GASB 67 for pension plans. We do not expect this standard to have any significant effect on the Authority.

### **GASB 75 ■ Postemployment Benefits Other than Pensions**

*Effective 06/15/2018 (your FY 2018)*

This standard builds on the requirements of GASB 74 by requiring employers that provide other postemployment benefits (OPEB) to recognize a net OPEB liability on their statements of net position. It mirrors the new accounting and financial reporting requirements of GASB 68 for pension benefits. We do not expect this standard to have any significant effect on the Authority.

### **GASB 77 ■ Tax Abatement Disclosures**

*Effective 12/15/2016 (your FY 2017)*

This standard requires governments to disclose certain information about tax abatement agreements made to foster economic development or otherwise benefit the government or its citizens. Required disclosures include a brief description of the arrangement, the gross dollar amount of taxes abated in the current period, and any additional commitments made by the government as part of the agreement. We do not expect this standard to have any significant effect on the Authority.

### **GASB 78 ■ Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans**

*Effective 12/15/2016 (your FY 2017)*

This standard is an amendment to GASB 68, and provides guidance to governments that participate in non-governmental cost-sharing pension plans. We do not expect this standard to have any significant effect on the Authority.

# GREAT LAKES WATER AUTHORITY

## Attachment B - Upcoming Changes in Accounting Standards / Regulations

For the June 30, 2016 Audit

### **GASB 80 ■ Blending Requirements for Certain Component Units**

*Effective 06/15/2017 (your FY 2017)*

This standard is an amendment to GASB 14, *The Financial Reporting Entity*, and requires blending component units incorporated as not-for-profit corporations in which the government is the sole corporate member. We do not expect this standard to have any significant effect on the Authority.

### **GASB 81 ■ Irrevocable Split-Interest Agreements**

*Effective 12/15/2017 (your FY 2018)*

This standard addresses the accounting for split-interest agreements for which the government serves as the intermediary and/or the beneficiary. It requires governments to record assets, liabilities, and deferred inflows of resources at the inception of the agreement when serving as intermediary, or when the government controls the present service capacity of a beneficial interest. We do not expect this standard to have any significant effect on the Authority.

### **GASB 82 ■ Pension Issues**

*Effective 06/15/2017 (your FY 2017)*

This standard is an amendment to GASB 67/68 to clarify several issues related to pensions. We do not expect this standard to have any significant effect on the Authority.

### **GASB 83 ■ Certain Asset Retirement Obligations**

*Effective 06/15/2019 (your FY 2019)*

This standard addresses accounting and financial reporting for certain asset retirement obligations--legally enforceable liabilities associated with the retirement of a tangible capital asset. We do not expect this standard to have any significant effect on the Authority.

### **GASB 84 ■ Fiduciary Activities**

*Effective 12/15/2019 (your FY 2020)*

This standard establishes new criteria for determining how to report fiduciary activities in governmental financial statements. The focus is on whether the government is controlling the assets, and who the beneficiaries are. Under this revised standard, certain activities previously reported in agency funds may be reclassified in future periods. Due to the number of specific factors to consider, we will continue to assess the degree to which this standard may impact the Authority.



# GREAT LAKES WATER AUTHORITY

## Attachment B - Upcoming Changes in Accounting Standards / Regulations

For the June 30, 2016 Audit

### **GASB 85 ■ Omnibus 2017**

*Effective 06/15/2018 (your FY 2018)*

This standard includes a variety of small technical revisions to previously issued GASB statements. We do not expect this standard to have any significant effect on the Authority.

### **GASB 86 ■ Certain Debt Extinguishment Issues**

*Effective 06/15/2018 (your FY 2018)*

This standard provides guidance for reporting the in-substance defeasance of outstanding debt obligations using existing resources. Qualifying transactions will remove both the assets placed into trust and the related debt obligation from the government's statement of net position. We do not expect this standard to have any significant effect on the Authority.

### **GASB 87 ■ Leases**

*Effective 12/15/2020 (your FY 2021)*

This standard establishes a single model for reporting all leases (including those previously classified as operating and capital). Lessees will now report offsetting intangible lease assets and lease liabilities equal to the present value of future lease payments. Lessors will report offsetting lease receivables and deferred inflows of resources.



# GREAT LAKES WATER AUTHORITY

## Schedule of Adjustments Passed (SOAP)

For the June 30, 2016 Audit

In accordance with generally accepted auditing standards, we have prepared the following schedule of proposed audit adjustments, which we believe are immaterial both individually and in the aggregate. We are providing this schedule to both management and those charged with governance to receive their assurance that they agree that the amounts listed below are not material to the financial statements, either individually or in the aggregate, and do not need to be recorded.

	Effect of Passed Adjustment - Over(Under)Statement				
	Assets	Liabilities	Beginning Balance *	Revenues	Expenses/ Expenditures
<b>Water fund</b>					
Understated accounts receivable	\$ (1,645,252)	\$ (1,645,252)	\$ -	\$ -	\$ -
Overstated capital assets	907,545	-	-	-	(907,545)
Overstated accounts payable	-	92,789	92,789	-	-
Overstated compensated absences	-	2,066,456	2,066,456	-	-
Understated legal reserve	-	(130,650)	-	-	(130,650)
Overstated health care claims liability	-	500,000	-	-	500,000
Overstated long-term debt premium	-	1,000,000	-	-	1,000,000
<b>Total water fund</b>	<b>\$ (737,707)</b>	<b>\$ 1,883,343</b>	<b>\$ 2,159,245</b>	<b>\$ -</b>	<b>\$ 461,805</b>
<b>Sewage disposal fund</b>					
Understated long-term debt premium	\$ -	\$ (1,060,538)	\$ -	\$ -	\$ (1,060,538)
<b>Business-type activities</b>					
Cumulative effect of items noted above	\$ (737,707)	\$ 822,805	\$ 2,159,245	\$ -	\$ (598,733)
<b>Misstatement as a percentage of</b>					
<b>total expenses - business-type activities</b>	-0.2%	0.2%	0.5%	0.0%	-0.1%

\*GLWA was formed as an acquisition under GASB 69, and as a result any amount of the assets acquired that exceeded the liabilities assumed was recorded as a reduction to capital assets. Any amounts shown in the beginning balance are reflecting the passed overstatement or understatement of capital assets.