

DETROIT PUBLIC SCHOOLS

Schedule of Findings and Questioned Costs

Year ended June 30, 2007

2007-08 Accounting for Contingencies – Legal Case Reserves

Finding Type: Internal Control over Financial Reporting – Significant Deficiency

Fiscal Year: July 1, 2006 to June 30, 2007

Requirement

Legal Reserve: Per FASB Statement 5, Accounting for Contingencies, when a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. A. Probable – The future event or events are likely to occur. B. Reasonably possible – The chance of the future event or events occurring is more than remote but less than likely. C. Remote – The chance of the future event or events occurring is slight. *Paragraph 8,* An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met: 1. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss. 2. *Paragraph 9,* Disclosure of the nature of an accrual made pursuant to the provisions of *Paragraph 8,* and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. *Paragraph 10,* If no accrual is made for a loss contingency because one or both of the conditions in *Paragraph 8* are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of *Paragraph 8,* disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted, and there is a reasonable possibility that the outcome will be unfavorable.

Condition

During our evaluation of legal reserves, we noted that upon our initial request of the Litigation Case Status Summary Report, the District did not provide proper documentation of an appropriate accounting assessment of legal reserves in accordance with FASB Statement No. 5.

Possible Asserted Cause and Effect

The internal control procedures related to evaluating and recording legal reserve is not properly designed to ensure that all reserves are recorded in accordance with FASB Statement 5. Therefore, reserves were not properly reviewed prior to our audit inquiries on such matters.

Recommendation

We recommend that management assess contingent liabilities based on the criteria contained in FASB Statement No. 5 and record accounting entries as appropriate.

Views of Responsible Officials

We understand and agree with the noted observation and are working toward corrective actions.

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Corrective Action Plan

Signature

Date