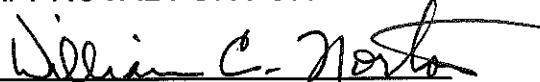


City of Calistoga

Staff Report

TO: Honorable Mayor and City Council
FROM: Bill Mushallo, Administrative Services Director
DATE: August 3, 2010
SUBJECT: Audit Services for June 30, 2010 Comprehensive Annual Financial Report

APPROVAL FOR FORWARDING:


William C. Norton, Interim City Manager

1 **ISSUE:** To consider a Resolution to appoint Terry Krieg, CPA, to audit the
2 City financial statements for the year end June 30, 2010.

3
4 **RECOMMENDATION:** To adopt the Resolution authorizing the City Manager
5 to accept the auditing and reporting services proposal from Terry Krieg, CPA for
6 the June 30, 2010 financial statements for an amount not to exceed \$20,000.

7
8 **BACKGROUND/DISCUSSION:** The City operates the budget and accounting
9 system on a fiscal year from July 1st to June 30th. The twelve months of financial
10 transactions are then reported, in summary form, in a Comprehensive Annual
11 Financial Report (CAFR). The report is required to comply with the generally
12 accepted accounting principles (GAAP) and the reporting requirements of the
13 Governmental Accounting Standards Board (GASB). In addition, if the City has
14 received certain Federal funds greater than \$500,000, then additional auditing
15 procedures are required under the Federal Single Audit rules.

16
17 Terry Krieg, CPA has provided accounting services and audited the financial
18 statements since 1990. He is well experienced with the City's accounting
19 system and has been asked to continue to provide these services to the City.
20 Attached is an engagement letter from Mr. Krieg for accounting, reporting and
21 auditing services relating to the June 30, 2010 CAFR. Included in these services
22 is preparation of the CAFR to continue to comply with new GASB accounting and
23 reporting standards. In addition, it is anticipated that the City will be subject to
24 the Federal Single Audit rules and require additional auditing and reporting.

25
26 There have been additional GASB requirements in reporting formats (Statement
27 #44), Post Employment Benefits Other Than Pensions (OPEB, Statement #45)

28 and Employee Termination Benefits (Statement #47). These issues will also
29 need to be addressed, as needed, in the June 30, 2010 CAFR.

30

31 This will be the seventh year of the new CAFR format and the June 30, 2010
32 CAFR will be completed and presented to the City Council by no later than
33 January, 2011.

34

35 **The Audit of the Financial Statements**

36

37 The CAFR and all of the backup detail are then required to be audited by a
38 qualified independent auditor according to generally accepted auditing standards
39 issued by GASB. The auditor's report also includes comments on compliance
40 with internal accounting controls, separate reports for transit funding and grants
41 and reviews of other special financial reports. The City is also required under
42 several State laws, many Federal and State grant programs, various bond
43 requirements and best financial management practices to have an independent
44 auditor review the financial transactions of the City.

45

46 The fee for the June 30, 2010 CAFR is \$14,000 for the audit services, which is
47 the same amount as the previous year, in spite of the additional requirements for
48 audit reviews and increased complexity of financial activity of the City. In
49 addition, there is a \$3,000 fee for assistance in the preparation of the City's
50 CAFR. In addition, if it is determined that the City is subject to the Federal Single
51 Audit requirements, there will be an additional fee of \$3,000 for the separate
52 report. The total of \$20,000 is the same as last year's fee.

53

54 It is recommended to appoint Mr. Krieg for the June 30, 2010 accounting,
55 reporting and audit services for an amount not to exceed \$20,000. Attached is
56 Mr. Krieg's proposal letter, which outlines the services and fees. In addition,
57 there is a schedule to produce the June 30, 2010 audited Comprehensive Annual
58 Financial Report by no later than December 31, 2010.

59

60 **FISCAL IMPACT:** Funds for the audit services are included in the adopted
61 budget for FY 10-11.

62

63 **ATTACHMENTS:**

64

- 65 1. Resolution appointing Terry Krieg, CPA for auditing services in
66 connection with the June 30, 2010 Comprehensive Annual Financial
67 Report (CAFR)
- 68 2. Engagement Letter from Mr. Krieg

RESOLUTION NO. 2010-_____

**RESOLUTION OF THE CITY COUNCIL OF THE CITY OF CALISTOGA,
COUNTY OF NAPA, STATE OF CALIFORNIA, AUTHORIZING THE CITY
MANAGER TO EXECUTE THE LETTER OF ENGAGEMENT WITH TERRY E.
KRIEG, CPA FOR AUDIT SERVICES IN CONNECTION WITH THE
JUNE 30, 2010 COMPREHENSIVE ANNUAL FINANCIAL REPORT**

Authorizing Agreement No. _____

WHEREAS, the City operates a finance system according to generally accepted accounting principals that are codified by the National Governmental Accounting Standards Board (GASB); and

WHEREAS, the City reconciles and closes the financial transactions as of June 30th of each year for the preceding twelve months; and

WHEREAS, the City has the year end Comprehensive Annual Financial Report audited by a qualified independent audit firm; and

WHEREAS, GASB has implemented new accounting and reporting standards which require significant changes to the accounting and reporting structures; and

WHEREAS, Terry E. Krieg, CPA, has been performing the audit services for a number of years and is qualified to perform the audit, reporting and accounting services needed to conform to various GASB statements.

NOW, THEREFORE BE IT RESOLVED that the City Council of the City of Calistoga authorizes the City Manager to execute the letter of engagement for reporting and accounting services and audit of June 30, 2010 Comprehensive Annual Financial Report with Terry E. Krieg, CPA, for an amount not to exceed \$20,000.

PASSED, APPROVED, AND ADOPTED by the City Council of the City of Calistoga at a regular meeting held this **3rd of August 2010** following vote:

AYES:

NOES:

ABSTAIN/ABSENT:

MICHAEL DUNSFORD, Vice Mayor

ATTEST:

SUSAN SNEDDON, City Clerk



Terry E. Krieg, CPA
Certified Public Accountant

May 1, 2010

Mr. Bill Mushallo
Director of Administrative Services
City of Calistoga
1232 Washington Street
Calistoga, California 94515

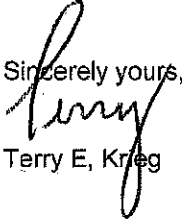
Dear Bill:

As we last discussed, I would be pleased to be able to continue on to serve as the independent financial statement audit firm for the City of Calistoga. In that regard, I have enclosed an audit services engagement letter covering the year ending June 30, 2010. I have in the engagement letter anticipated that the City will require a Federal Single Audit as I have presumed that Federal stimulus grant funds are to be made available and will be expended in fiscal 2010 in excess of \$500,000.

Please look it over and let me know if you have any concerns. Feel free to give me a call at (707) 888-1052 to review any concerns or issues

I look forward to the possibility of continuing to work with you and your staff..

Sincerely yours,


Terry E. Krieg



Terry E. Krieg, CPA
Certified Public Accountant

May 1, 2010

Mr. Bill Mushallo
Director of Administrative Services
City of Calistoga
1232 Washington Street
Calistoga, California 94515

Dear Mr. Mushallo:

I am pleased to submit this letter of engagement to provide auditing services to the City of Calistoga for the fiscal year ending June 30, 2010. I will audit the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information, which collectively comprise the basic financial statements of the City of Calistoga as of and for the fiscal year ending June 30, 2010. Accounting standards generally accepted in the United States of America provide for certain required supplementary information (RSI), such as the management's discussion and analysis (MD&A) to accompany the City's basic financial statements. As part of my engagement, I will apply certain limited procedures to the City of Calistoga's RSI. These limited procedures will consist principally of inquiries of management regarding the methods of measurement and presentation, which management is responsible for affirming to me in its representation letter. Unless I encounter problems with the presentation of the RSI or with procedures relating to it, I will disclaim an opinion on it. The following RSI is required by generally accepted accounting principles and will be subjected to certain limited procedures, but will not be audited:

1. Management's Discussion and Analysis (MD&A)
2. General Fund Budgetary Comparison Schedule and related reconciliation to GAAP Basis Financial Statement of Revenues and Expenditures
3. Major Special Revenue Fund (if any) Budgetary Comparison Schedules and related reconciliations.
4. Other post employment benefits schedule of funding progress, if the City provides post employment medical insurance benefits to City retirees.

Supplementary information other than RSI also accompanies the City of Calistoga's basic financial statements. I will subject the following supplementary information to the auditing procedures applied in my audit of the basic financial statements and will provide an opinion on them in relation to the basic financial statements.

1. Schedule of expenditures of federal awards
2. Combining non-major governmental fund financial statements and schedules and schedule of capital assets used in governmental activities

The following additional information accompanying the City's Comprehensive Annual Financial Report (CAFR) will not be subjected to the auditing procedures applied in my audit of the financial statements, and for which my auditor's report will disclaim an opinion:

1. Introductory section
2. Statistical section and related schedules

Mr. Bill Mushallo
May 1, 2010
Page 2

AUDIT OBJECTIVES

The objective of my audit is the expression of opinions as to whether your basic financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles and to report on the fairness of the additional information referred to in the first paragraph when considered in relation to the basic financial statements taken as a whole. The objective also includes reporting on:

- Internal control related to the financial statements and compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements in accordance with Government Auditing Standards.
- Internal control related to major programs and an opinion on compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.
- The reports on internal control and compliance will each include a statement that the report is intended solely for the information and use of management, the City Council, and federal awarding agencies, and if applicable, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

My audit will be conducted in accordance with auditing standards generally accepted in the United States of America unless a federal single audit is required; in that case, it shall also include the standards for financial audits contained in Government Auditing Standards (*only in those years in which a single audit is required which means years in which the City has expended more than \$500,000 in federal grant funds*), issued by the Comptroller General of the United States; the Single Audit Act Amendments of 1996; and the provisions of OMB Circular A-133, and will include tests of accounting records, a determination of major programs in accordance with OMB Circular A-133, and other procedures I consider necessary to express such opinions and to render the required reports. If my opinions on the basic or component unit financial statements or the Single Audit compliance opinions are other than unqualified, I will discuss the reasons with you in advance of issuing the resultant reports. If, for any reason, I am unable to complete the audit or are unable to form or have not formed opinions, I may decline to express opinions or to issue a report as a result of this engagement. However, I would discuss the reasons therefore with you in advance and would propose a suitable course of action to mitigate, if possible, any such extraordinary circumstances that would impair my ability to issue the aforementioned reports.

MANAGEMENT RESPONSIBILITIES

Management is responsible for the basic financial statements and accompanying information as well as all representations contained therein. Management is also responsible for preparation of the schedule of expenditures of federal awards in accordance with the requirements of OMB Circular A-133. As part of the audit, I will assist with the preparation of your financial statements, schedule of expenditures of federal awards and related notes. You are responsible for making all management decisions and performing all management functions relating to the financial statements, schedule of expenditures of federal awards, and related notes and for accepting full responsibility for such decisions.

Mr. Bill Mushallo
May 1, 2010
Page 3

You will be required to acknowledge in the management representation letter my assistance with the preparation of the basic financial statements and the schedule of expenditures of federal awards and that you have reviewed and approved the basic financial statements, schedule of expenditures of federal awards, and related notes prior to their issuance and have accepted responsibility for them. Further you are required to designate an individual with suitable skill, knowledge, and experience to oversee any non-audit services I provide and for evaluating the adequacy and results of those services and accepting responsibility for them. I understand that the City has appointed you, as its Director of Administrative Services, to be that person.

Management is responsible for establishing and maintaining internal controls, including internal controls over, and for monitoring ongoing activities, to help ensure appropriate goals and objectives are met. You are also responsible for the selection and application of accounting principles; for the fair presentation in the financial statements of the financial position of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of Calistoga, and the respective changes in financial position and where applicable, cash flows thereof in conformity with US generally accepted accounting principles; and for compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

Management is also responsible for making all financial records and related information available to me and for ensuring that management and financial information is reliable and properly recorded. Your responsibility also includes, identifying significant vendor relationships where the vendor has responsibility for program compliance and for the accuracy and completeness of that information. Your responsibilities include adjusting the financial statements to correct material misstatements and for confirming to me in the representation letter that the effects of uncorrected misstatements aggregated by me, if any, during the current audit, and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

You are responsible for the design and implementation of programs and controls to prevent fraud, and for informing me about all known or suspected fraud or illegal acts affecting the City involving (1) management, (2) employees who have significant roles in internal control, and (3) others where fraud or illegal acts could have a material effect on the financial statements. Your responsibilities include informing me of your knowledge of any allegations of fraud or suspected fraud affecting the City received in communications from employees, former employees, grantors, regulators, or others. In addition, you are responsible for identifying and ensuring that the City complies with applicable laws, regulations, contracts, agreements, and grants. Additionally, as required by OMB Circular A-133, it is management's responsibility to follow up and take corrective action on reported audit findings and to prepare a summary schedule of prior audit findings and a corrective action plan. The summary schedule of prior audit findings should be made available for my review no later than two weeks before we issue our resultant reports to you.

Management is responsible for establishing and maintaining a process for tracking the status of audit findings and recommendations. Management is also responsible for identifying for us previous financial audits, attestation engagements, performance audits, or other studies related to the objectives discussed in the Audit Objectives section of this letter. This responsibility includes relaying to me corrective actions taken to address significant findings and recommendations relating from those audits, attestation engagements, performance audits, or studies. You are also responsible for providing management's views on my current findings, conclusions, and recommendations, as well as your planned corrective actions, for the report, and for the timing and format for providing that information.

Mr. Bill Mushallo
May 1, 2010
Page 4

AUDIT PROCEDURES GENERAL

An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements; therefore, my audit will involve judgment about the number of transactions to be examined and the areas to be tested. I will plan and perform the audit to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the City or to acts by management or employees acting on behalf of the City. Because the determination of abuse is subjective, Government Auditing Standards do not expect auditors to provide reasonable assurance of detecting abuse.

Because an audit is designed to provide reasonable, but not absolute assurance and because I will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by me. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or major programs. However, I will inform you of any material errors and any fraudulent financial reporting or misappropriation of assets that comes to my attention. I will also inform you of any violations of laws or government regulations that come to my attention, unless clearly inconsequential. I will include such matters in the reports required for a Single Audit. My responsibility as auditor is limited to the period covered by my audit and does not extend to any later periods for which I am not engaged as auditor.

My procedures will include tests of documentary evidence supporting the transactions recorded in the accounts, and may include direct confirmation of receivables, cash, investments and other assets and liabilities by correspondence with selected individuals, creditors, and financial institutions. I will request written representations from your attorneys as part of the engagement, and they may bill you for responding to this inquiry. At the conclusion of my audit, I will require certain written representations from you about the financial statements and related matters.

AUDIT PROCEDURES-INTERNAL CONTROLS

My audit will include obtaining an understanding of the City and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Tests of controls may be performed to test the effectiveness of certain controls that I consider relevant to preventing and detecting errors and fraud material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. My tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in my report on internal control issued pursuant to Government Auditing Standards.

As required by OMB Circular A-133, I will perform tests of controls over compliance to evaluate the effectiveness of the design and operation of controls that I consider relevant to preventing or detecting material noncompliance with compliance requirements applicable to each major federal program. However, my tests will be less in scope than would be necessary to render an opinion on those controls and, accordingly, no opinion will be expressed in my report on internal control issued pursuant to OMB Circular A-133.

Mr. Bill Mushallo
May 1, 2010
Page 5

An audit is not designed to provide assurance on internal control or to identify significant deficiencies. However, during the audit, I will communicate to management and those charged with governance internal control related matters that are required to be communicated under AICPA professional standards, Government Auditing Standards, and OMB Circular A-133.

AUDIT PROCEDURES- COMPLIANCE

As part of obtaining reasonable assurance about whether the basic financial statements are free of material misstatement, I will perform tests of the City's compliance with applicable laws and regulations and the provisions of contracts and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and I will not express such an opinion in my report issued pursuant to Government Auditing Standards.

OMB Circular A-133 requires that I also plan and perform the audit to obtain reasonable assurance about whether the City has complied with applicable laws and regulations and the provisions of contracts and grant agreements applicable to major programs. My procedures will consist of tests of transactions and other applicable procedures described in the OMB Circular A-133 Compliance Supplement for the types of compliance requirements that could have a direct and material effect on each of the City's major programs. The purpose of those procedures will be to express an opinion on the City's compliance with requirements applicable to its major programs in my report on compliance issued pursuant to OMB Circular A-133.

AUDIT ADMINISTRATION, FEES AND OTHER MATTERS

We understand that your employees will prepare all cash, investment, accounts receivable, and other confirmations we request.

At the conclusion of this engagement, I will complete the appropriate sections of the OMB Data Collection Form that summarizes my audit findings. It is management's responsibility to submit the reporting package (including financial statements, schedule of expenditures of federal awards, summary schedule of prior audit findings, auditor's reports, and a corrective action plan) along with the Data Collection Form to the designated federal clearinghouse and, if appropriate, to pass through entities I will coordinate with you the electronic submission and certification. If applicable, I will provide copies of my reports for you to include with the reporting package you submit to pass-through entities. The Data Collection Form and the reporting package must be submitted within the earlier of 30 days after receipt of the auditors' reports or nine months after the end of the audit period.

The workpapers for this engagement are the property of Terry E. Krieg, CPA, and constitute confidential information. However, we may be requested to make certain workpapers available to Federal Awarding Agencies pursuant to authority given to it by law or regulation.

Mr. Bill Mushallo
May 1, 2010
Page 6

If requested, access to such workpapers will be provided under the supervision of Terry E. Krieg, CPA. Furthermore, upon request, we may provide photocopies of selected workpapers to federal agencies. These other federal agencies may intend, or decide, to distribute photocopies or information contained therein to others, including other governmental agencies.

The workpapers for this engagement will be retained for a minimum of seven years after the date the auditor's report is issued or for any additional period requested by the Federal Awarding Agencies or other appropriate federal agency. If we are aware that a federal agency or the City is contesting an audit finding, we will contact the contesting parties for guidance prior to destroying the workpapers.

We expect to perform the audit work during the following time periods and to issue our reports by December 1 of each year:

Description of Work	Date Scheduled
INTERIM WORK (City to provide customary pre-audit package)	
Review of minutes and resolutions	To be scheduled
Audit planning and identification federal & state grant programs	To be scheduled
Analytical Review work	To be scheduled
Significant revenue analysis	To be scheduled
Capital asset and depreciation schedule updates	To be scheduled
Analysis of cash disbursements and sample selection	To be scheduled
Preliminary trial balances and account reconciliations	To be scheduled
FINAL AUDIT WORK	
Final audit work balance sheet, revenues, and expenditures	To be scheduled
Final review of audit work	To be scheduled
Prepare draft financial statements and compliance reports	To be scheduled
Deliver drafts	To be scheduled
Revise draft reports	To be scheduled
Print, bind and deliver final reports	December 31 each year

Also, it is understood that the City will in fiscal year 2010 require that its financial statements be presented using the new financial reporting model as set forth in GASB Statement Number 34. The City will be responsible for such financial statements. We shall assist the City by drafting the City's GASB-34 financial statements and notes to the financial statements. However, it is clearly understood that the City is responsible for such financial statements, will review the drafts, provide corrections or material changes, and approve the draft financial statements.

It is also understood by the City that the General Accounting Office(GAO) has issued new auditor independence standards that are applicable in years in which the City may be required to have a Federal Single or Yellow Book Audit. To comply with those standards, it is expressly understood and agreed that the audit firm may provide assistance in the form of non-audit services such as providing proposed closing entries, adjusting entries, reclassification entries, and cash basis to accrual basis year end adjusting entries.

Mr. Bill Mushallo
May 1, 2010
Page 7

The City will be responsible for reviewing, approving, disapproving and entering any such closing entries, adjusting entries, reclassification entries, and cash basis to accrual basis year end adjusting entries. The City expressly agrees that the City maintains its own accounting system and that the City does in fact provide the audit firm with a year end trial balance of all funds and accounts for use in performing both interim and final audit fieldwork. The audit firm is in fact independent and does not maintain, prepare, or post transactions or adjustments to the City's trial balances and it does not perform any management functions.

The City agrees that the audit firm shall draft the City's year end financial statements and the notes to the financial statements and a Comprehensive Annual Financial Report (CAFR) While the audit firm may prepare its own trial balances of the City's accounts and funds, those trial balances are solely for the audit firm's use in maintaining its working papers, analysis, and performing its audit work. The City shall be responsible for such draft financial statements and the Comprehensive Annual financial Report (CAFR) and shall review the drafts, provide corrections and editorial changes, and shall approve such drafts and final versions.

Our fees for such services, which include our entire out of pocket expenses such as report reproduction, delivery, telephone, travel expenses and similar items, shall be as follows:

Audit Fees:		June30, 2010	
Basic fee for financial statement audit		\$17,000	
Additional fees, only if required for:			
Federal program single audit work if federal program expenditures exceed \$500,000 in the fiscal year		\$3,000	

In order to convert the City's financial statements to GASB 34 reporting formats, it will be necessary for the City to maintain fixed asset and depreciation schedules for the City's general capital assets. Those assets now accounted for in the general fixed asset account group. The City agrees to assign a depreciation method to those assets, assign a useful life to each asset, calculate depreciation on each asset, and identify assets to be added and to be deleted. In addition, the City shall also identify depreciation on those assets according to departmental functions such as police, fire, general government, etc.

Our invoices for such work will be rendered each month as the work progresses and are payable upon presentation. In accordance with standard practice, work may be suspended if your account becomes 30 days or more past due and may not be resumed until your account is paid in full.

The above fee is based upon anticipated cooperation from your personnel, the assumption that unexpected circumstances will not be encountered during the audit, and the assumption that this will be a normal governmental audit. If significant additional time is required because of extraordinary circumstances not anticipated by us or the City, we will discuss it with you and will not perform any such additional work until we have obtained the City's written approval to perform such additional work.

Upon completion, we shall provide the City with an unbound' Comprehensive Annual Financial Report (CAFR). The city shall provide all information for the introductory section and statistical sections of the CAFR and shall be responsible for reproduction and binding of the CAFR.

Mr. Bill Mushallo
May 1, 2010
Page 8

Government Auditing Standards require that I provide you with a copy of my most recent external peer review report and any letter of comment. My latest peer review report, dated January 16, 2008, letter of comment and my response to that letter accompanies this letter.

I appreciate this opportunity to serve the City of Calistoga and believe that this letter accurately summarizes the significant terms of the audit engagement. If you have any questions, please call me. If you agree with the terms of this engagement as described in this letter, please sign in the space provided below and return a signed copy to us as authorization to perform the work specified herein.

Sincerely yours,


Terry E. Krieg, CPA

Accepted/By: _____

Title: _____

Date: _____

HEIDENREICH & HEIDENREICH
CERTIFIED PUBLIC ACCOUNTANTS

12020 S. Warner-Elliott Loop #121
Phoenix, AZ 85044-2700
(480)704-6301 fax 785-4619

15545 Bear Valley Rd. #B
Hesperia, CA 92345
(760) 948-2899 fax 948-7712

January 16, 2008

To Terry E. Krieg
Certified Public Accountant

We have reviewed the system of quality control for the accounting and auditing practice of Terry E. Krieg, CPA (the firm) in effect for the year ended August 31, 2007. A system of quality control encompasses the firm's organizational structure, the policies adopted and procedures established to provide it with reasonable assurance of conforming with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of CPAs (AICPA). The firm is responsible for designing a system of quality control and complying with it to provide the firm reasonable assurance of conforming with professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance with its system of quality control based on our review.

Our review was conducted in accordance with standards established by the Peer Review Board of the AICPA. During our review, we read required representations from the firm, interviewed firm personnel and obtained an understanding of the nature of the firm's accounting and auditing practice, and the design of the firm's system of quality control sufficient to assess the risks implicit in its practice. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with the firm's system of quality control. The engagements selected represented a reasonable cross-section of the firm's accounting and auditing practice with emphasis on higher-risk engagements. The engagements selected included among others, engagements performed under Government Auditing Standards. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with firm management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the firm's accounting and auditing practice. In addition, we tested compliance with the firm's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of the firm's policies and procedures on selected engagements. Our review was based on selected tests therefore it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it. There are inherent limitations in the effectiveness of any system of quality control and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the system of quality control for the accounting and auditing practice of Terry E. Krieg, CPA in effect for the year ended August 31, 2007, has been designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA and was complied with during the year then ended to provide the firm with reasonable assurance of conforming with professional standards.

As is customary in a system review, we have issued a letter under this date that sets forth comments that were not considered to be of sufficient significance to affect the opinion expressed in this report.

Heidenreich & Heidenreich

Heidenreich & Heidenreich
Certified Public Accountants

HEIDENREICH & HEIDENREICH
CERTIFIED PUBLIC ACCOUNTANTS

12020 S. Warner-Elliott Loop #121
Phoenix, AZ 85044-2700
(480)704-6301 fax 785-4619

15545 Bear Valley Rd. #B
Hesperia, CA 92345
(760) 948-2899 fax 948-7712

January 16, 2008

To Terry E. Krieg
Certified Public Accountant

We have reviewed the system of quality control for the accounting and auditing practice of Terry E. Krieg, CPA in effect for the year ended August 31, 2007, and have issued our report thereon dated January 16, 2008. That report should be read in conjunction with the comments in this letter, which were considered in determining our opinion. The matters described below were not considered to be of sufficient significance to affect the opinion expressed in that report.

Comment - Statements on Quality Control Standards require that firms monitor their quality control system to provide assurance that the policies and procedures established by the firm are suitably designed and effectively applied. During our review, we noted that although the firm's policies and procedures require monitoring procedures, they were not performed on a regular basis. As a result, the firm was not in compliance with the monitoring element of the Quality Control Standards.

Recommendation - We recommend that the firm adhere to its quality control policies and procedures, which include monitoring procedures and the documenting of those procedures as they are completed. Procedures fulfilling this requirement include annual inspections or post-issuance reviews of engagements or a pre-issuance review by someone other than the engagement partner. These should address each element of quality control and should require the preparation of written communication summarizing deficiencies noted and appropriate corrective actions.

Heidenreich & Heidenreich

Heidenreich & Heidenreich
Certified Public Accountants



Terry E. Krieg, CPA
Certified Public Accountant

February 12, 2008

Peer Review Program
California Society of CPAs
1235 Radio Road
Redwood City, CA 94065-1217

COPY

Dear Ladies and Gentlemen:

This letter represents my response to the report and letter of comments issued in connection with the review of my accounting and auditing practice in effect for the year ended August 31, 2007. The matter discussed in this letter will receive special attention by me during the conduct of my practice.

Annual Monitoring and Documentation of Monitoring Procedures. The firm will comply with its requirement to conduct annual inspections and post-issuance reviews of a representative sample of engagements on a regular basis and to document those inspections. The annual monitoring inspections will address each element of quality control and will result in the preparation of a written document summarizing deficiencies noted and appropriate corrective actions. In addition, a separate binder will be established and maintained by fiscal year containing monitoring documentation consisting of at least a list of the engagements selected and the basis for selection, the actual review checklist that was used to conduct each inspection, a summary of the inspection results, planned corrective actions, and follow up actions on those matters.

I believe that these actions are responsive to the findings of the review.

Sincerely yours,

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Terry E. Krieg