NIGRO NIGRO & WHITE, PC
(TEMECULA OFFICE)

Review Report

QUALITY CONTROL REVIEW

For the Firm's Audit of
ORCHARD ELEMENTARY SCHOOL DISTRICT
for the Fiscal Year Ended June 30, 2002

STEVE WESTLY
California State Controller

April 2006

STEVE WESTLY

California State Controller

April 12, 2006

Jeffrey Nigro
Nigro Nigro & White, PC
1 Ridgegate Drive, Suite 225
Temecula, CA 92590

Dear Mr. Nigro:

The State Controller's Office (SCO) completed a quality control review of Nigro Nigro & White, PC (Temecula office). We reviewed the audit working papers for the firm's audit of the Orchard Elementary School District for the fiscal year ended June 30, 2002.

A draft report was issued on September 15, 2005. The firm's response to the draft report is included in our final report.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

"original signed by"

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/jj:ams:vb

cc: Colleen B. Wilcox, Superintendent
Santa Clara County Office of Education
Lorna Horton, Superintendent
Orchard Elementary School District
Arlene Matsuura, Educational Consultant
School Fiscal Services Division
California Department of Education
Jeannie Oropeza, Program Budget Manager
Education Systems, Department of Finance

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Review Report

Summary

The State Controller's Office (SCO) completed a quality control review of Nigro Nigro & White, PC's (Temecula office) working papers for an audit of the Orchard Elementary School District for the fiscal year ended June 30, 2002. The last day of fieldwork was November 1, 2004.

The firm's audit was performed in accordance with the majority of the standards and requirements set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS); U.S. generally accepted auditing standards (GAAS); *Audits of States, Local Governments and Non-Profit Organizations*; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO. However, we noted the following exceptions: The firm did not comply with GAAS and GAGAS with regard to general and fieldwork standards, and the firm did not comply with K-12 Audit Guide requirements.

Background

A single audit of any governmental unit must be performed in accordance with the standards referred to in this report. According to OMB Circular A-133, the auditor's work is subject to a quality control review at the discretion of an agency granted cognizant or oversight status by the federal funding agency. In addition, *Education Code* Section 14504.2 authorizes the SCO to perform quality control reviews of working papers for audits of K-12 local educational agencies (LEAs) to determine whether audits are performed in accordance with U.S. General Accounting Office standards for financial and compliance audits.

Nigro Nigro & White, PC is an independent certified public accounting firm with an office located in Temecula, California. Fiscal year (FY) 2001-02 was the first year the firm served as independent auditor for the Orchard Elementary School District. During FY 2001-02, the district operated one school serving kindergarten through eighth grade, with a total average daily attendance (ADA) of 770.

The Orchard Elementary School District received a negative certification on its second interim budget report for FY 2002-03. *Education Code* Section 14504.2(c) requires the SCO to conduct a quality control review of the independent auditor who performed the audits of the LEA for the prior three years. Nigro Nigro & White, PC performed the audit of Orchard Elementary School District for one of the three prior years.

Objectives, Scope, and Methodology

The general objectives of our quality control review were to determine whether this audit was conducted in compliance with:

- GAGAS
- GAAS
- K-12 Audit Guide
- OMB Circular A-133

We conducted the quality control review at the office of Nigro Nigro & White, PC. We compared the audit work performed by the firm, as documented in the working papers, with the standards stated in the general objectives.

Conclusion

Nigro Nigro & White, PC's audit was performed in accordance with the majority of the standards and requirements set forth in GAGAS, GAAS, OMB Circular A-133, and the K-12 Audit Guide. However, we noted the exceptions discussed in the Findings and Recommendations section of this report.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Nigro Nigro & White, PC.

Views of Responsible Official

We issued a draft report on September 15, 2005. Jeffrey Nigro responded by letter dated February 10, 2006, agreeing with the majority of review results. The final report includes the firm's response as the Attachment.

No changes were made to the findings as a result of the firm's response. Our general comment regarding the firm's response is included in the Findings and Recommendations section.

Restricted Use

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.

"original signed by"

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

Findings and Recommendations

General

The Single Audit Act and the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO, require that audits be performed in accordance with U.S. generally accepted auditing standards (GAAS). These standards govern the quality of the audits performed by independent auditors and have been approved and adopted by the American Institute of Certified Public Accountants (AICPA). GAAS is divided into three areas: (1) general standards; (2) fieldwork standards; and (3) reporting standards. The three areas are divided into 10 specific standards. Auditors of governmental entities must also perform audits in accordance with generally accepted government auditing standards (GAGAS), which expands GAAS in several areas.

In the course of this quality control review, we found that Nigro Nigro & White, PC's audit did not comply with some elements of the GAAS and GAGAS standards. In addition, the firm did not adequately follow K-12 Audit Guide requirements.

Noncompliance With Fieldwork Standards for Financial Audits (GAAS, GAGAS)

FINDING 1—Internal control deficiencies

Our review disclosed the following internal control deficiencies.

- The firm's tests of the district's internal controls were not consistent with the firm's audit program and may not have been sufficient to plan the audit and determine the nature, timing, and extent of tests to be performed. The firm assessed control risk at maximum for cash disbursements and payroll. The audit program indicated that 60 transactions should be tested when control risk is assessed at maximum; however, the firm only tested 43 cash disbursement transactions and 25 payroll transactions. The audit program was not revised to reflect the reduction in testing, and the firm did not document the reason for the reduction in testing. In addition, the firm stated in the working papers that the payroll sample was randomly selected; however, the sampling methodology appeared to be either haphazard or judgmental.

- The firm noted deficiencies in the district's internal controls, but did not apply sound judgment in resolving the deficiencies. In a letter dated August 29, 2002, the firm communicated to the district superintendent several deficiencies that had been identified during interim fieldwork. Some of the deficiencies were presented as findings in the audit report; however, the following deficiencies were not reported as findings in the audit report nor were they reported in a separate management letter.

  - The district had no written purchasing procedures manual.

  - The district had no written policies addressing issues such as competitive bidding, related party transactions, conflicts of interest, vendor relationships, and general purchasing guidelines.

- The district did not make deposits to the cash clearing account on a consistent basis until November 2001.
- The district had no governing board policies for cash deposits and investments.
- The district did not provide quarterly reports regarding investments to the governing board in accordance with *Government Code* Section 53646.
- The district could not locate board minutes for several months; therefore, the firm could not determine that board approval was obtained for several decisions, such as approval of contracts, the bond election, and significant purchases.
- The district did not employ adequate safekeeping of blank warrants.
- The district made payments to vendors without evidence of receipt of goods or services.

The firm identified several deficiencies through internal control questionnaires; however, the firm did not resolve the following deficiencies or report as them as findings in the audit report or in a separate management letter.

- The district did not inspect materials and supplies for the condition in which they were received, nor did the district count them.
- The district did not prepare written receiving reports for all items received.
- The receiving department did not report shortages or rejections to purchasing department.
- The receiving department did not keep a permanent, chronological record of receipts.
- The district did not budget for interfund transfers.
- The district did not obtain authorizations for budget amendments.
- The district did not issue receipts for cash collections other than by mail.
- The district did not use a lockbox for cash receipts.
- The district did not mark invoices to prevent reuse.
- The district did not reconcile vendors' month-end statements periodically to record liabilities based on invoices accrued.
- The district did not reconcile the accounts payable trial balance to the control account.
- The district did not reconcile detailed subsidiary ledgers for accruals or other liabilities to the control accounts.

The firm's handling of the internal control deficiencies noted during the audit did not appear to be appropriate, based on the district's fiscal condition and an ongoing investigation by the District Attorney's Office. The district had received a negative budget certification and was in transition with a new administration; therefore, the firm should have reported the internal control deficiencies it noted as audit findings if it determined them to be reportable conditions. If the firm determined that the deficiencies in internal control were not reportable conditions, it should have communicated this in a management letter and referred to the letter in the report on internal control.

Subsequent to the SCO quality control field review, the firm responded:

> Our workpapers identified certain conditions which were documented as internal control weaknesses, but were not included in the audit report as audit findings. The inclusion of a management comment as a reportable condition in the audit report is a matter of professional judgment. Our application of professional judgment permitted us to exclude certain weaknesses from the audit report. None of the matters in question were items, in our opinion, that meet the AICPA definition of a reportable condition, not were they State compliance issues. Therefore, I believe that we did not deviate from professional standards. I will admit, however, that we could and will improve our documentation of such decisions.

AU 319.01 states, in part:

> A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing and extent of tests to be performed.

AU 319.02 states, in part:

> In all audits, the auditor should obtain an understanding of internal control sufficient to plan the audit by performing procedures to understand the design of controls relevant to an audit of financial statements and determining whether they have been placed in operation. . . .

AU 319.05 states:

> The auditor uses the understanding of internal control and the assessed level of control risk in determining the nature, timing and extent of substantive tests for financial statement assertions.

AU 350.39 states, in part:

> Sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. . . .

GAGAS 4.21.3 states:

> In planning the audit, auditors should document in the working papers (1) the basis for assessing control risk at the maximum level for assertions related to material account balances, transaction classes, and disclosure components of financial statements when such assertions are

significantly dependent upon computerized information systems, and (2) consideration that the planned audit procedures are designed to achieve audit objectives and to reduce audit risk to an acceptable level.

GAGAS 4.22 states, in part:

Safeguarding of assets and compliance with laws and regulations are internal control objectives that are especially important in conducting financial statement audits in accordance with GAGAS of governmental entities or others receiving governmental funds. Given the public accountability of stewardship of resources, safeguarding of assets permeates control objectives and components as defined by the AICPA standards and GAGAS. . . .

GAGAS 4.35 states:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

GAGAS 4.37 states, in part:

Working papers should contain:

a. The objectives, scope, and methodology, including any sampling criteria used; . . .

GAGAS 5.26 states:

Auditors should report deficiencies in internal control that they consider to be "reportable conditions" as defined in AICPA standards. The following are examples of matters that may be reportable conditions:

a. absence of appropriate segregation of duties consistent with appropriate control objectives;
b. absence of appropriate reviews and approvals of transactions, accounting entries, or systems output;
c. inadequate provisions for the safeguarding of assets;
d. evidence of failure to safeguard assets from loss, damage, or misappropriation;
e. evidence that a system fails to provide complete and accurate output consistent with the auditee's control objectives because of the misapplication of control procedures;
f. evidence of intentional override of internal control by those in authority to the detriment of the overall objectives of the system;
g. evidence of failure to perform tasks that are part of internal control, such as reconciliations not prepared or not timely prepared;
h. absence of a sufficient level of control consciousness within the organization;
i. significant deficiencies in the design or operation of internal control that could result in violations of laws and regulations having a direct and material effect on the financial statements; and
j. failure to follow up and correct previously identified deficiencies in internal control.

GAGAS 5.27 states, in part:

> In reporting reportable conditions, auditors should identify those that are individually or cumulatively material weaknesses. . . .

GAGAS 5.28 states:

> When auditors detect deficiencies in internal control that are not reportable conditions, they should communicate those deficiencies to the auditee, preferably in writing. If auditors have communicated other deficiencies in internal control in a management letter to top management, they should refer to that management letter when they report on internal control. All communications to the auditee about deficiencies in internal control should be documented in the working papers.

The accuracy of the auditor's opinion on the financial statements may be impaired when the auditor does not perform adequate testing and does not appropriately address internal control deficiencies.

Recommendation

The firm should ensure that tests of controls are consistent with the audit program. If the firm performs alternative procedures, it should revise the audit program to reflect the actual procedures performed and add an appropriate justification. In addition, the firm should document the reasons for any revisions in procedures. Also, the firm should ensure that control deficiencies are appropriately addressed throughout the audit. The firm should consider the fiscal condition of the entity and other pertinent factors when applying auditor judgment.

FINDING 2—Evidential matter–Financial and fund requirement deficiencies

The firm's working papers contained the following evidential matter deficiencies.

- The firm documented in correspondence dated August 29, 2002, and in the working papers that "Board minutes could not be located for July, August and September of 2001, nor for February 2002." However, the working papers included no documentation indicating that the deficiency had been resolved, and no finding was reported.

- The firm obtained one legal representation letter, dated November 15, 2002, subsequent to the audit report opinion dated October 18, 2002. In addition, the working papers contained a listing of three legal firms; however, only one legal representation letter was documented in the working papers. There was no evidence that the other two legal firms provided representation letters.

- The district did not conduct an annual inventory and did not maintain inventory records. The firm noted in the working papers, "Immaterial – Client doesn't track." However, the basis for this conclusion was not documented in the working papers.

Subsequent to the SCO quality control field review, the firm responded:

> It is true that the District did not conduct an annual inventory. It is common for small, one-school districts to expense all items purchased rather than coding them as inventory. Any unused materials on hand at June 30 would be clearly immaterial to the financial statements. We disagree that the audit opinion should have been qualified.

The district included 22,222 supplemental instruction hours on the Schedule of Average Daily Attendance; however, the schedule did not identify whether the supplemental hours were related to summer school attendance. If they were, it is likely that the district maintained a food services inventory at June 30. For the Special Revenue Fund, the firm identified $10,106 as material to the financial statements. The firm did not objectively analyze its statement that "Any unused materials on hand at June 30 would be clearly immaterial…" in relation to the level of materiality identified for the Special Revenue Fund.

- For the audit of the Child Development Fund, the firm did not document that minimum grant requirements, such as days of enrollment and days of operation, were met.

AU 326.09 states:

> Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

AU 326.13 states:

> The evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.

AU 326.16 states, in part:

> Accounting data alone cannot be considered sufficient support for financial statements; on the other hand, without adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted.

AU 326.21a. states:

> When evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity.

AU 326.22 states, in part:

> The independent auditor's objective is to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion. . . .

AU 337.07 states, in part:

> The audit normally includes certain other procedures undertaken for different purposes that might also disclose litigation, claims and assessments. Examples of such procedures are as follows:
>
> a. Reading minutes of meetings of stockholders, directors, and appropriate committees held during and subsequent to the period being audited. . . .

AU 337.08 states, in part:

> A letter of audit inquiry to the client's lawyer is the auditor's primary means of obtaining corroboration of the information furnished by management concerning litigation, claims, and assessments. . . .

AU 337.13 states, in part:

> A lawyer's refusal to furnish the information requested in an inquiry letter either in writing or orally would be a limitation on the scope of the audit sufficient to preclude an unqualified opinion. . . .

AU 339.01 states:

> The auditor should prepare and maintain working papers, the form and content of which should be designed to meet the circumstances of a particular engagement. The information contained in the working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters.

AU 339.03 states, in part:

> Working papers are records kept by the auditor of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in the engagement. . . .

AU 560.10 states, in part:

> There is a period after the balance sheet date with which the auditor must be concerned in completing various phases of his audit. This period is known as the "subsequent period" and is considered to extend to the date of the auditor's report. . . .

AU 560.12 states, in part:

> In addition, the independent auditor should perform other auditing procedures with respect to the period after the balance-sheet date. . . .These procedures should be performed at or near the completion of the field work. The auditor generally should: . . .
>
> d. Inquire of client's legal counsel concerning litigation, claims, and assessments.

GAGAS 4.35 states:

> Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

GAGAS 4.37 states, in part:

> Working papers should contain . . . (b) documentation of the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records. . . .

The accuracy of an auditor's opinion on financial statements may be impaired when evidential matter the auditor gathers is not sufficient and competent, and when the auditor does not appropriately address deficiencies. In addition, a lawyer's failure to provide a legal representation letter could result in a scope limitation.

Recommendation

The firm should ensure that it obtains and documents adequate evidential matter. In addition, the firm should ensure that any deficiencies it notes during the audit are resolved or reported as findings. Also, the firm should ensure that legal representation letters are received from all of the entity's legal counsel prior to issuance of the audit report.

FINDING 3—Qualifications and continuing professional education deficiencies

An auditor assisting in a significant portion of the audit did not meet Continuing Professional Education (CPE) requirements. The auditor in question conducted 67.5 hours of the total 258 audit hours, which represents 26% of the audit. The firm provided an agenda for 12 hours of in-house training offered on August 13 and 14, 2001. In addition, the firm provided an agenda for in-house training offered on March 11 and 12, 2002; however, it did not document the number of training hours offered. A partner in the firm conducted both training sessions. The firm stated that it did not require staff to use sign-in sheets for either of the training sessions. Therefore, we were unable to determine whether the auditor completed any of the required CPE.

AU 210.01 states:

> The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor.

AU 210.02 states:

> This standard recognizes that however capable a person may be in other fields, including business and finance, he cannot meet the requirements of the auditing standards without proper education in the field of auditing.

GAGAS 3.3 states:

> The staff assigned to conduct the audit should collectively possess adequate professional proficiency for the tasks required.

GAGAS 3.4 states:

> This standard places responsibility on the audit organization to ensure that each audit is conducted by staff who collectively have the knowledge and skills necessary for that audit. They should also have a thorough knowledge of government auditing and of the specific or unique environment in which the audited entity operates, relative to the nature of the audit being conducted.

GAGAS 3.6 states:

> To meet this standard, the audit organization should have a program to ensure that its staff maintain professional proficiency through continuing education and training. Thus, each auditor responsible for planning, directing, conducting, or reporting on audits under these standards should complete, every 2 years, at least 80 hours of continuing education and training which contributes to the auditor's professional proficiency. At least 20 hours should be completed in any 1 year of the 2-year period. Individuals responsible for planning or directing an audit, conducting substantial portions of the field work, or reporting on the audit under these standards should complete at least 24 of the 80 hours of continuing education in subjects directly related to the government environment and to government auditing. If the audited entity operates in a specific or unique environment, auditors should receive training that is related to that environment.

GAGAS 3.7 states:

> The audit organization is responsible for establishing and implementing a program to ensure that auditors met the continuing education and training requirements just stated. The organization should maintain documentation of the education and training completed.

The audit procedures applied and conclusions reached may not be adequate or valid if staff conducting substantial portions of the audit lack adequate training and proficiency.

Recommendation

The firm should ensure that all of its audit staff receive training in accordance with GAAS and GAGAS. In addition, the firm should assess the training and professional proficiency of its audit staff before assigning them to the audit.

Noncompliance With K-12 Audit Guide Requirements

FINDING 4—
State compliance deficiencies

The firm did not perform the minimum suggested audit procedures in the K-12 Audit Guide for attendance reporting, kindergarten continuation, and the California Public Schools Library Act. The firm did not justify its reasons for performing alternative procedures to those listed in the K-12 Audit Guide. In addition, the firm did not modify the report on state compliance to reflect that it performed alternative procedures, and did not note instances in which it performed no procedures.

The following deficiencies were noted.

Attendance Reporting

- Procedure 2c of the K-12 Audit Guide states:

> Select a representative sample of classes (teachers) and trace the monthly totals from the monthly report to the attendance registers, scantron summaries, etc. Foot and cross-foot attendance registers, scantron summaries, etc.

The firm's working paper S2-1 showed that the auditor "selected to test and from attendance reports randomly selected [25] students to trace to documentation." Therefore, the firm tested students, not classes as required. The firm did not provide a justification in the working papers for the alternative procedure. In addition, the firm did not provide documentation showing that a random sample was selected. The sample appeared to be haphazard. The firm did not accurately describe its sampling methodology in the working papers.

- Procedure 4 of the K-12 Audit Guide states, in part, " For each of the teachers selected in procedure 2c, test to determine if each of the teachers possessed a valid certification document. . . ." The firm did not identify the students sampled in procedure 2c by teacher; therefore, it was not clear whether this procedure was completed.

- The firm noted the following exception: "District cannot find backup to support hours claimed" for 22,222 supplemental hours claimed on the annual report of attendance. The firm documented that the exception would be addressed in a management letter. The firm crossed out the exception, noting, "documentation sent"; however, there was no documentation in the working papers identifying the tests and procedures the firm performed related to the missing documentation. The 22,222 supplemental hours were included on line 1 of the district's report of attendance.

  Procedure 1 of the K-12 Audit Guide states:

  > Determine whether the P2 (districts only) and annual (all LEAs) attendance reports submitted to the state reconcile to the supporting documents by verifying the LEA's ADA calculations for <u>each</u> reporting line item. . . .

  Subsequent to the SCO quality control field review, the firm responded:

  > . . . we did receive documentation supporting the 22,222 Supplemental Hours claimed on the Annual report of attendance. . . . It was reviewed and traced into the Annual attendance report without exceptions. The copies of the documentation were then discarded. We apparently failed to document this procedure properly.

Kindergarten Continuation

Procedure 1 of the K-12 Audit Guide states, in part:

> . . . obtain a list of kindergarten pupils enrolled . . . for the prior fiscal year and the current fiscal year. Compare the enrollment lists and identify those kindergarten pupils who are on both lists.

Instead, the firm tested 20% of the kindergarten pupils to determine the district's compliance with kindergarten continuation requirements. The firm did not modify its report on state compliance to explain the alternate procedures it performed.

In addition, the continuation form that was included in the firm's working papers did not contain the required language. The firm did not identify this as an audit finding and did not quantify the disallowed ADA and fiscal impact for the affected pupils.

California Public Schools Library Act

The firm did not perform procedures 3 and 4 in the K-12 Audit Guide because, as documented in the working papers, "the state audit guide programs that have received less than $5000 are not required to be audited. . . .District received $4943." However, its report on state compliance stated that all four procedures were performed.

The firm should have modified its report on state compliance to disclose that it did not audit the California School Library Act program.

AU 339.01 states:

> The auditor should prepare and maintain working papers, the form and content of which should be designed to meet the circumstances of a particular engagement. The information contained in the working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters.

AU 339.03 states, in part:

> Working papers are records kept by the auditor of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in the engagement.

GAGAS 4.35 states:

> Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

GAGAS 4.37 states:

> Working papers should contain: . . . (b) documentation of the work performed to support significant conclusions and judgements, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records.

Education Code Section 14503(a) states, in part:

> Every audit report shall specifically and separately address each of the state compliance program requirements included in the audit guide, stating whether or not the district is in compliance with those requirements. For each state program compliance requirement included in the audit guide, every audit report shall further state the suggested audit procedures included in the audit guide for that requirement were followed in the making of the audit, if that is the case, or, if not, what other procedures were followed. . . .

The firm's report on state compliance is misleading because it did not modify the report to reflect the procedures not performed, the alternate procedures performed, and the program not tested.

Recommendation

The firm should ensure that it performs, at a minimum, the suggested audit procedures as described in the K-12 Audit Guide. In addition, the firm should adequately document this in the working papers procedures it performs, and in the conclusions it reaches. If the firm performs alternative audit procedures, it should document this in the working papers, and it should modify the report on state compliance to reflect the actual procedures performed and any programs not tested. Furthermore, the firm should report all state compliance deficiencies as audit findings.

SCO's General Comment

In its response to the draft report (Attachment), the firm acknowledged that it concurred with the majority of the deficiencies identified as a result of the SCO's quality control review, and indicated that it has implemented the recommendations presented in this report. The SCO encourages the firm to comply with all elements of the applicable standards and requirements in audits it conducts in the future, and to ensure that the procedures performed and conclusions reached are adequately supported by the working papers.

Attachment—
Firm's Response to Draft Report

NIGRO NIGRO & WHITE, PC

A PROFESSIONAL ACCOUNTANCY CORPORATION

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California Association of School Business Officials

Community Associations Insitute

Licensed by the California State Board of Accountancy

February 10, 2006

Cassandra Moore-Hudnall
Chief, Financial Audits Bureau
State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, California 94250-5874

Dear Ms. Moore-Hudnall:

Enclosed please our firm's response to your draft report dated September 2005 related to your office's quality control review of Nigro Nigro & White, LLP (Temecula Office) for the audit of the Orchard Elementary School District for the fiscal year ended June 30, 2002. Please note that the firm changed its legal status from a limited liability partnership (LLP) to a professional corporation (PC) during 2004.

We kindly request that you contact us if any further revisions are made to the draft report before its final submission. We also understand that our comments will be included in the final report.

Please feel free to contact me if you should require any additional information or if you have any questions.

Sincerely,

Jeffrey Nigro, CPA
President/CEO

NIGRO NIGRO & WHITE, PC

A PROFESSIONAL ACCOUNTANCY CORPORATION

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Cassandra Moore-Hudnall
Chief, Financial Audits Bureau
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Dear Ms. Moore-Hudnall:

We are in receipt of your draft report dated September 2005 related to your office's quality control review of Nigro Nigro & White, LLP (Temecula Office) for the audit of the Orchard Elementary School District for the fiscal year ended June 30, 2002. Our responses to the findings noted in the report are below.

Finding 1 – Internal Control Deficiencies

The finding states two specific instances of deficiencies in this area. The first refers to the firm's tests of internal controls. We concur with SCO that the testing performed was not consistent with the audit program. Our audit programs have been subsequently revised to provide instructions to the auditor when controls are assessed at the maximum level and when circumstances warrant reduced testing. Our staff are also provided instruction to fully document all decisions regarding the testing of controls.

The second part of the finding relates to the firm's resolution of noted internal control deficiencies. We respectfully disagree with the statement that the firm "did not apply sound judgment in resolving the deficiencies". We do, however, agree that many of the internal control deficiencies should have been included in a separate management letter. We did include the weaknesses in a letter to management earlier in the audit, and the issues were discussed with both district management and members of the FCMAT team that were then assigned to the District. We do not believe that we avoided communicating the problems, only that we failed to report them in a separate management letter included in the audit report. We will ensure that all future audit engagements that note reportable conditions contain a separate management letter when those conditions are not included in the final audit report.

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Finding 2 – Evidential Matter – Financial and fund requirement deficiencies
This finding addresses four different points.

First, the absence of board minutes was noted as a deficiency during our audit, but as noted in Finding 1 above, it was not included in a management letter. Our firm will now either resolve those issues or include them in a management letter.

Second, we received only one legal representation letter of three legal firms. We will follow up in the future to ensure that all legal representation letters are received, or document in the working papers the alternative procedures performed when a letter is not received.

Third, the district did not report inventory in its financial statements at June 30, 2002. While our firm calculated materiality levels for purposes of expressing an opinion on the financial statements, we did not document in the working papers our justification for the decision to omit testing for inventory balances. In all future engagements, we will fully document our reasons for not performing tests of inventory balances when those balances are not material to the financial statements.

Fourth, we did not audit the minimum grant requirements for revenues received in the Child Development Fund. The minimum grant requirements for Child Development revenues are not included in the K-12 State Audit Guide, and so are not a required test for state compliance purposes. We fully understand that tests of compliance with applicable laws and regulations that are material to the financial statements are a requirement of an audit performed in accordance with Government Auditing Standards. However, we did not believe that the Child Development Fund revenues were of sufficient materiality that noncompliance would result in a material adjustment to the financial statements taken as a whole. We will, however, fully document our firm's decision in the working papers when such a judgment is made with respect to the Child Development program revenues.

Finding 3 – Qualifications and continuing professional education deficiencies
We respectfully disagree with the statement that the "auditor assisting in a significant portion of the audit did not meet CPE requirements". We do agree, however, that the firm did not maintain sufficient documentation for the CPE that was provided at the time under review. All audit staff are provided approximately 60 hours of in-house training annually, as well as opportunities for external professional education. We now maintain agendas, sign-in logs, and evaluation forms for all training that is done internally. We also maintain individual records for every auditor to ensure that they meet the new Yellow Book CPE requirements on an individual basis. Since the time of SCO's review, our external peer review has reviewed our professional education program and stated that it complies with all applicable professional standards.

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Finding 4 – State compliance deficiencies

The firm concurs that it failed to document in the working papers when alternative procedures were performed to those included in the State K-12 Audit Guide. The firm fully understands the importance of following the required audit procedures included in the Guide, and only departs from those procedures when alternative procedures are more efficient or effective. In addition for the instances cited in the SCO report, the firm has modified its procedures since the date of the review to more closely follow the specific audit procedures outlined in the Guide. The firm notes that it will ensure that it modifies its report on state compliance whenever alternate procedures are performed.

Conclusion

The firm of Nigro Nigro & White appreciates the comments made by the SCO during its review. We also wish to point out that the audit of the Orchard Elementary School District for the fiscal year ended June 30, 2002 was conducted over three years ago, and the firm has continually improved its processes and documentation policies since that date. Our most recent external peer review was completed during 2005, and we received an unmodified report from the peer review team, which was accepted by the California Society of Certified Public Accountants.

Sincerely,

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