



KPMG LLP
2100 Dominion Tower
999 Waterside Drive
Norfolk, VA 23510

October 1, 2004

The Honorable Members of the Board of Supervisors
County of James City, Virginia

Dear Members:

We have audited the financial statements of the County of James City, Virginia (the County) as of and for the year ended June 30, 2004, and have issued our report thereon dated October 1, 2004. Under generally accepted auditing standards, we are providing you with the following information related to the conduct of our audit.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS

We have a responsibility to conduct our audit in accordance with auditing standards generally accepted in the United States of America. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

In addition, in planning and performing our audit, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control.

INDEPENDENCE

With respect to the County, we are independent accountants within the meaning of Rule 101 of the Code of Professional Conduct of the American Institute of Certified Public Accountants.

SIGNIFICANT (UNUSUAL) ACCOUNTING POLICIES

The significant accounting policies used by the County are described in note 1 to the financial statements. We noted no transactions entered into by the County during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

MANAGEMENT JUDGMENTS AND ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. 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 Honorable Members of the Board of Supervisors
County of James City, Virginia
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SIGNIFICANT AUDIT ADJUSTMENTS

We proposed certain corrections to the financial statements, which have been recorded by the County.

There were no uncorrected misstatements to the financial statements.

DISAGREEMENTS WITH MANAGEMENT

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our report on the County's financial statements.

CONSULTATION WITH OTHER ACCOUNTANTS

To the best of our knowledge, management has not consulted with or obtained opinions, written or oral, from other independent accountants that were subject to the requirements of AU 625, *Reports on the Application of Accounting Principles*.

MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO RETENTION

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as the County's auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our acceptance.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no difficulties in dealing with management in performing our audit.

SIGNIFICANT WRITTEN COMMUNICATIONS BETWEEN THE AUDITOR AND MANAGEMENT

In accordance with the communication requirements of SAS No. 61, attached to our letter please find copies of the following material written communications between management and us:

- Engagement letter; and
- Management representation letter.

* * * * *

This report is intended solely for the information and use of the Board of Supervisors and management and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP



KPMG LLP
2100 Dominion Tower
999 Waterside Drive
Norfolk, VA 23510

Telephone 757 616 7000
Fax 757 616 7133

June 2, 2004

PRIVATE & CONFIDENTIAL

Mrs. Tara Woodruff
Accounting Supervisor
James City County
P.O. Box 8784
Williamsburg, VA 23187-8784

Dear Tara:

This letter will confirm KPMG LLP's (KPMG) understanding of our engagement to report upon our audit of the financial statements of James City County (the County) as of and for the year ending June 30, 2004, and the nature and scope of the services we will provide to enable the County to comply with the Single Audit requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

Objectives and limitations of services

Financial statement audit

We will conduct the audit in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of an audit carried out in accordance with such standards is the expression of an opinion as to whether the presentation of the financial statements conforms with accounting principles generally accepted in the United States of America. In conducting the audit, we will perform tests of the accounting records and such other procedures as we consider necessary in the circumstances to provide a reasonable basis for our opinion on the financial statements. We also will assess the accounting principles used and significant estimates made by management, as well as evaluate the overall financial statement presentation.

Our report will be addressed to the Board of Supervisors of the County. We cannot provide assurance that an unqualified opinion will be rendered. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our audit is planned and performed to obtain reasonable, but not absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or



KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.



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fraud. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, there is a risk that material errors, fraud (including fraud that may be an illegal act), and other illegal acts may exist and not be detected by an audit performed in accordance with auditing standards generally accepted in the United States of America. Also, an audit is not designed to detect matters that are immaterial to the financial statements.

In planning and performing our audit, we will consider the County's internal control in order to determine the nature, timing and extent of our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. The limited purpose of this consideration may not meet the needs of some users who require additional information about internal control. We can provide other services to provide you with additional information on internal control which we would be happy to discuss with you at your convenience.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the County's compliance with certain provisions of laws, regulations, contracts and grants violations of which could have a direct and material effect on the financial statements. However, our objective is not to provide an opinion on overall compliance with such provisions.

In accordance with *Government Auditing Standards*, we will prepare a written report, *Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* (GAS report), on our consideration of internal control and tests of compliance made as part of our audit of the financial statements. While the objective of our audit of the financial statement is not to report on the County's internal control and we are not obligated to search for reportable conditions as part of our audit this report will include any reportable conditions to the extent they come to our attention. Reportable conditions are significant deficiencies in the design or operation of internal control which could adversely affect the County's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements under audit. This report will also include all illegal acts and fraud and material violations of grants and contracts, and abuse. It will indicate that it is intended solely for the information and use of the Board of Supervisors and management of the County and federal awarding agencies and pass-through entities and that it is not intended to be and should not be used by anyone other than these specified parties.

In accordance with *Government Auditing Standards* we will also issue a management letter to communicate other deficiencies in internal controls that are not reportable conditions and other violations of grants and contracts, and abuse that come to our attention unless clearly inconsequential.



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In accordance with *Government Auditing Standards*, we are also required in certain circumstances to report fraud or illegal acts directly to parties outside the auditee.

OMB Circular A-133

We will also perform audit procedures with respect to the County's major federal programs in accordance with the provisions of OMB Circular A-133. OMB Circular A-133 includes specific audit requirements, mainly in the areas of internal control and compliance with laws, regulations, contracts and grants that exceed those required by *Government Auditing Standards*.

As part of our audit procedures performed in accordance with the provisions of OMB Circular A-133, we will perform tests to evaluate the effectiveness of the design and operation of internal controls that we consider relevant to preventing or detecting material noncompliance with laws, regulations, contracts and grants applicable to each of the County's major programs. The tests of internal control performed in accordance with OMB Circular A-133 are less in scope than would be necessary to render an opinion on internal control.

Compliance with laws, regulations, contracts and grants applicable to federal programs is the responsibility of management. We will perform tests of the County's compliance with certain provisions of laws, regulations, contracts and grants we determine to be necessary based on the *OMB Circular A-133 Compliance Supplement (Compliance Supplement)*. The procedures outlined in the *Compliance Supplement* are those suggested by each federal agency and do not cover all areas of regulations governing each program. Program reviews by federal agencies may identify additional instances of noncompliance.

As required by OMB Circular A-133, we will prepare a written report which (1) provides our opinion on the schedule of expenditures of federal awards in relation to the County's financial statements, (2) provides our opinion on compliance with laws, regulations, contracts and grant that could have a direct and material effect on a major federal program and (3) communicates our consideration of internal control over major federal programs. It will indicate that it is intended solely for the information and use of the Board of Supervisors and management of the County and federal awarding agencies and pass-through entities and that it is not intended to be and should not be used by anyone other than these specified parties.

Our responsibility to communicate with the Board of Supervisors

We will communicate to the Board of Supervisors verbally disagreements with management or other serious difficulties encountered in performance of our audit or review services. We believe verbal communication of matters such as those noted above is the appropriate forum to provide open and frank dialogue.



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We will report to you, in writing, the following matters:

- Audit adjustments arising from the audit that could, in our judgment, either individually or in aggregate, have a significant effect on the County's financial reporting process. In this context, audit adjustments, whether or not recorded by the entity, are proposed corrections of the financial statements that, in our judgment, may not have been detected except through the auditing procedures performed.
- Uncorrected misstatements aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in aggregate.
- Other matters required to be communicated by Statement on Auditing Standards No. 61, *Communication with Audit Committees*.

We will also read minutes of Board of Supervisors meetings for consistency with our understanding of the communications made to you and determine that you have received copies of all material written communications between ourselves and management. We will also determine that you have been informed of i) the initial selection of, or the reasons for any change in, significant accounting policies or their application during the period under audit, ii) the methods used by management to account for significant unusual transactions and iii) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

If, in performance of our audit procedures, circumstances arise which make it necessary to modify our report or withdraw from the engagement, we will communicate to you our reasons for withdrawal.

Management responsibilities

The management of the County is responsible for the fair presentation, in accordance with accounting principles generally accepted in the United States of America, of the financial statements and all representations contained therein. Management also is responsible for preventing and detecting fraud, for adopting sound accounting policies and establishing and maintaining effective internal controls and procedures for financial reporting to maintain the reliability of the financial statements and to provide reasonable assurance against the possibility of misstatements that are material to the financial statements. Management also is responsible for informing us of all reportable conditions, of which it has knowledge, in the design or operation of such controls. Management also is responsible for identifying and ensuring that the



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County complies with laws, regulations, contracts and grants applicable to its activities, and for informing us of any known material violations of such laws and regulations.

The County agrees that all records, documentation, and information we request in connection with our audit will be made available to us, that all material information will be disclosed to us, and that we will have the full cooperation of the County's personnel. As required by auditing standards generally accepted in the United States of America, we will make specific inquiries of management about the representations embodied in the financial statements and the effectiveness of internal control, and obtain a representation letter from management about these matters. The responses to our inquiries, the written representations, and the results of audit tests comprise the evidential matter we will rely upon in forming an opinion on the financial statements.

In addition to the OMB Circular A-133 requirements to maintain internal control and comply with provisions of laws, regulations, contracts and grants applicable to federal programs as discussed above, OMB Circular A-133 also requires the County to prepare a:

- Schedule of expenditures of federal awards;
- Summary schedule of prior audit findings;
- Corrective action plan; and
- Data collection form (Part I).

While we may be separately engaged to assist you in the preparation of these items, preparation is the responsibility of the County.

Certain provisions of OMB Circular A-133 allow a granting agency to request that a specific program be selected as a major program provided that the federal granting agency is willing to pay the incremental audit cost arising from such selection. The County agrees to notify KPMG of any such request by a granting agency and to work with KPMG to modify the terms of this letter as necessary to accommodate such a request.

In accordance with *Government Auditing Standards*, as part of our planning of the audit we will consider the results of previous audits and follow up on known significant findings and recommendations that directly relate to the objectives of the audit. To assist us, management agrees to identify previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of the audit being undertaken and to identify corrective actions taken to address significant findings and recommendations prior to July 15, 2004.



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Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to us in the representation letter that the effects of any unrecorded misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements being reported upon. Because of the importance of management's representations to the effective performance of our services, the County agrees to release KPMG LLP and its personnel from any claims, liabilities, costs and expenses relating to our services under this letter attributable to any misrepresentations in the representation letter referred to above.

Management is also responsible for providing us with written responses in accordance with *Government Auditing Standards* to the findings included in the GAS report within 15 days of being provided with draft findings.

Management is responsible for the distribution of the reports issued by KPMG. In accordance with *Government Auditing Standards*, the reports issued citing *Government Auditing Standards* are to be made available for public inspection.

Offering documents

Should the County wish to include these financial statements in a document offering securities and request that we agree to include our report on these financial statements in the offering document, we would consider agreeing to the inclusion of our report at that time.

Other matters

This letter shall serve as the County's authorization for the use of e-mail and other electronic methods to transmit and receive information, including confidential information, between KPMG and the County and between KPMG and outside specialists or other entities engaged by either KPMG or the County. The County acknowledges that e-mail travels over the public Internet, which is not a secure means of communication and, thus, confidentiality of the transmitted information could be compromised through no fault of KPMG.

Further, for purposes of the services described in this letter only, the County hereby grants to KPMG a limited, revocable, non-exclusive, non-transferable, paid up and royalty-free license, without right of sublicense, to use all names, logos, trademarks and service marks of the County solely for presentations or reports to the County or for internal KPMG presentations and intranet sites.

KPMG is a limited liability partnership comprising both certified public accountants and certain principals who are not licensed as certified public accountants. Such principals may participate in the engagements to provide the services described in this letter.



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Work paper access by regulators and others

The work papers for this engagement are the property of KPMG. Pursuant to *Government Auditing Standards*, we are required to make certain work papers available in a full and timely manner to regulatory agencies upon request for their reviews of audit quality and for use by their auditors. In addition, we may be requested to make certain work papers available to regulators pursuant to authority given to it by law or regulation. Access to the requested work papers will be provided under supervision of KPMG personnel. Furthermore, upon request, we may provide photocopies of selected work papers to regulatory agencies. These regulatory agencies may intend, or decide, to distribute the photocopies or information contained therein to others, including other government agencies.

In the event KPMG is requested pursuant to subpoena or other legal process to produce its documents relating to this engagement in judicial or administrative proceedings to which KPMG is not a party, the County shall reimburse KPMG at standard billing rates for its professional time and expenses, including reasonable attorney's fees, incurred in responding to such request.

Additional reports

In addition, we expect to issue as part of this engagement the following reports:

- Data Collection Form;
- An agreed-upon procedures report on evaluating management's assertion about whether the Comparative Report Transmittal Forms comply with the requirements of the *Uniform Financial Reporting Manual* (\$1,500 fee); and
- An agreed-upon procedures report on evaluating the Local Government Financial Test Worksheet in accordance with the Federal Register (40CFR Part 258, Subpart G) Criteria for Municipal Solid Waste Landfills – Financial Assurance Criteria (\$1,300 fee) and;
- An agreed-upon procedures report on evaluating the County's compliance with the *Code of Virginia* Section 58.1-3813.1 for enhanced E-911 service taxes (\$850 fee).

Other Government Auditing Standards matters

As required by *Government Auditing Standards*, we have attached a copy of KPMG's most recent peer review report and letter of comments.



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We will also assist management in drafting the financial statements and notes. In accordance with *Government Auditing Standards*, we are required to confirm that management accepts responsibility for the financial statements and notes and, therefore, has a responsibility to be in a position in fact and appearance to make an informed judgment about them and that management will:

- Designate a qualified management-level individual to be responsible and accountable for overseeing the drafting of the financial statements.
- Establish and monitor the performance of the engagement to ensure that it meets management's objectives.
- Make any decisions that involve management functions related to the engagement and accept full responsibility for such decisions.
- Evaluate the adequacy of the financial statements and notes.

Fees for services

Based upon our discussions with management and representations as to the level of assistance the County will provide, we estimate that our fees will approximate \$45,100. This estimate is based on the level of experience of the individuals who will perform the services. Circumstances encountered during the performance of these services that warrant additional time or expense could cause us to be unable to complete the audit within the above estimates. We will endeavor to notify you of any such circumstances as they are assessed. We propose billing our audit fee in four installments as follows:

<u>Amount</u>	<u>Billing Period</u>
\$ 11,275	July 1, 2004
\$ 11,275	August 1, 2004
\$ 11,275	September 1, 2004
\$ 11,275	upon delivery of report



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We shall be pleased to discuss this letter with you at any time. For your convenience in confirming these arrangements, we enclose a copy of this letter. Please sign and return it to us.

Very truly yours,

KPMG LLP

Elizabeth P. Foster

Elizabeth P. Foster
Partner

EPF/chm

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ACCEPTED:

James City County

[Handwritten Signature]

Authorized Signature

Accounting Supervisor

Title

July 19, 2004

Date

PricewaterhouseCoopers LLP
500 Campus Drive
P.O. Box 805
Florham Park NJ 07932
Telephone (973) 236 7000
Facsimile (973) 236 7200

To the Partners of KPMG LLP
and the SEC Practice Section Peer Review Committee:

We have reviewed the system of quality control for the accounting and auditing practice of KPMG LLP (the firm) in effect for the year ended March 31, 2002. A system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of complying with professional standards. The elements of quality control are described in the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (the AICPA). The design of the system, and compliance with it, are the responsibilities of the firm. In addition, the firm has agreed to comply with the membership requirements of the SEC Practice Section of the AICPA Division for CPA Firms (the Section). Our responsibility is to express an opinion on the design of the system, and the firm's compliance with that system and the Section's membership requirements based on our review.

Our review was conducted in accordance with standards established by the Peer Review Committee of the Section and included procedures to plan and perform the review that are summarized in the attached description of the peer review process. Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it or with the membership requirements of the Section since it was based on selective tests. Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. Also, 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 that 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 KPMG LLP in effect for the year ended March 31, 2002, 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 complying with professional standards. Also, in our opinion, the firm complied during that year with the membership requirements of the Section in all material respects.

As is customary in a peer review, we have issued a letter under this date that sets forth comments relating to certain policies and procedures or compliance with them. The matters described in the letter were not considered to be of sufficient significance to affect the opinion expressed in this report.

PricewaterhouseCoopers LLP

October 28, 2002

Description of the Peer Review Process

Overview

Member firms of the AICPA SEC Practice Section (the Section) must have their system of quality control periodically reviewed by independent peers. These reviews are system and compliance oriented with the objective of evaluating whether:

- The reviewed firm's system of quality control for its accounting and auditing practice has been designed to meet the requirements of the Quality Control Standards established by the AICPA.
- The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of complying with professional standards.
- The reviewed firm was complying with the membership requirements of the Section in all material respects.

The Section's Peer Review Committee (PRC) establishes and maintains review standards. At regular meetings and through report evaluation task forces, the PRC considers each peer review, evaluates the reviewer's competence and performance, and examines every report, letter of comments, and accompanying response from the reviewed firm that states its corrective action plan before the peer review is finalized. The Transition Oversight Staff (formerly the staff of the Public Oversight Board), an independent oversight body, plays a key role in overseeing the performance of peer reviews working closely with the peer review teams and the PRC.

Once the PRC accepts the peer review reports, letters of comments, and reviewed firms' responses, they are maintained in a file available to the public. In some situations, the public file also includes a signed undertaking by the firm agreeing to specific follow-up action requested by the PRC. That file also includes the firm's annual report which contains information regarding the number of firm offices, firm professionals, and SEC clients for which the firm is principal auditor-of-record.

Planning the Review

To plan the review of KPMG LLP, we obtained an understanding of (1) the nature and extent of the firm's accounting and auditing practice, and (2) the design of the firm's system of quality control sufficient to assess the inherent and control risks implicit in its practice. Inherent risks were assessed by obtaining an understanding of the firm's practice, such as the industries of its clients and other factors of complexity in serving those clients, and the organization of the firm's personnel into practice units. Control risks were assessed by obtaining an understanding of the design of the firm's system of quality control, including its audit methodology, and monitoring procedures. Assessing control risk is the process of evaluating the effectiveness of the reviewed firm's quality control system in preventing the performance of engagements that do not comply with professional standards.

Performing the Review

Based on our assessment of the combined level of inherent and control risks, we identified practice units and selected engagements within those units to test for compliance with the firm's quality control system. The engagements selected for review included audits of clients that are SEC registrants, audits performed under the Government Auditing Standards, audits performed under FDICIA, multi-office audits, and audits of employee benefit plans. The engagements selected for review represented a cross-section of the firm's accounting and auditing practice with emphasis on higher-risk engagements. The engagement reviews included examining work paper files and reports and interviewing engagement personnel. We also reviewed the supervision and control of portions of engagements performed outside the United States.

The scope of the peer review also included examining selected administrative and personnel files to determine compliance with the firm's policies and procedures for the elements of quality control pertaining to independence, integrity, and objectivity; personnel management; and acceptance and continuance of clients and engagements. In addition, we tested compliance with the membership requirements of the Section, including those pertaining to independence quality controls, concurring partner review, and foreign associated firms.

Prior to concluding the review, we reassessed the adequacy of scope and conducted an exit conference with firm management to discuss our findings and recommendations.



COUNTY ADMINISTRATION

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(757) 253-6605

E-MAIL: cadm@james-city.va.us
Fax: (757) 253-6833

October 1, 2004

KPMG LLP
2100 Dominion Tower
999 Waterside Drive
Norfolk, Virginia 23510

Ladies and Gentlemen:

We are providing this letter in connection with your audit of the financial statements of the County of James City, Virginia (the County) as of and for the year ended June 30, 2004. We understand that your audit was conducted for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the County and the respective changes in financial position and cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the basic financial statements of financial position, changes in financial position, and cash flows in conformity with accounting principles generally accepted in the United States of America. We are also responsible for establishing and maintaining effective internal control over financial reporting. Further, we understand that the purpose of your testing of transactions and records from the County's Federal programs was to obtain reasonable assurance that the County had complied, in all material respects, with the requirements of laws, regulations, contracts, and grants that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2004.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.
2. We have made available to you:
 - a. All financial records and related data.
 - b. All minutes of meetings of the Board of Supervisors or summaries of actions of recent meetings for which minutes have not yet been prepared.

3. There have been no:
 - a. Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
 - b. Violations or possible violations of laws or regulations, the effects of which should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
 - c. False statements affecting the County's financial statements made to you or other auditors who have audited entities under our control upon whose work you may be relying in connection with your audits.
4. There are no significant deficiencies in the design or operation of internal controls which could adversely affect the County's ability to record, process, summarize and report financial data, and we have identified no material weaknesses in internal controls. We interpret "significant deficiencies in the design or operation of internal controls" to be consistent with the concept of a "reportable condition," defined under standards established by the American Institute of Certified Public Accountants. Such standards define a "reportable condition" as a significant deficiency in the design or operation of internal control that could adversely affect the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. We understand that the term "material weakness in internal control" is a reportable condition for which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that could be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
5. There are no:
 - a. Unasserted claims or assessments that our lawyers have advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*.
 - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SFAS No. 5.
 - c. Material transactions that have not been properly recorded in the accounting records underlying the basic financial statements.
 - d. Events that have occurred subsequent to the date of the statement of financial position and through the date of this letter that would require adjustment to or disclosure in the basic financial statements.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud. We understand that the term "fraud" includes misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets. Misstatements arising from fraudulent financial reporting are intentional misstatements, or omissions of amounts or disclosures in financial statements to deceive financial statement users. Misstatements arising from misappropriation of assets involve the theft of an entity's assets where the effect of the theft causes the basic financial statements not to be presented in conformity with accounting principles generally accepted in the United States of America.
7. We have no knowledge of any fraud or suspected fraud affecting the entity involving:
 - a. Management,
 - b. Employees who have significant roles in internal control, or
 - c. Others where the fraud could have a material effect on the basic financial statements.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, short sellers, or others.
9. There are no uncorrected financial statement misstatements either individually or in the aggregate, to the financial statements for each opinion unit.
10. The County has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
11. Capital assets, including infrastructure assets, are properly capitalized, reported and, if applicable, depreciated. The County has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral, except as disclosed in the footnotes of the Comprehensive Annual Financial Report.
12. Deposits and investment securities are properly classified and reported.
13. The County is responsible for the identification of and compliance with all aspects of laws, regulations, contracts, grants, and donor restrictions that could have a material effect on the financial statements in the event of noncompliance and has disclosed those aspects of laws, regulations, contracts, grants, and donor restrictions to you.
14. The County has complied with all aspects of laws, regulations, contracts, and grants that would have a material effect on the basic financial statements in the event of noncompliance.

15. The following have been properly recorded or disclosed in the financial statements:
- a. Related party (such as key administrative, financial, and legislative personnel or businesses they represent or have an interest in) transactions including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments and amounts receivable from or payable to related parties. We understand that the term "related party" refers to affiliates of the organization; entities for which investments are accounted for by the equity method by the organization; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; management; members of the immediate families of management; and other parties with which the organization may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.
 - b. Guarantees, whether written or oral, under which the County is contingently liable including guarantee contracts and indemnification agreements pursuant to FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantee of Indebtedness of Others*.
 - c. Significant estimates and material concentrations known to management that are to be disclosed in accordance with the AICPA's Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. Significant estimates are estimates at the balance sheet date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which it is reasonably possible that events could occur which would significantly disrupt normal finances within the next year. Concentrations include material sources of financing, including off balance sheet arrangements and transactions with unconsolidated, limited purpose entities, and contingencies inherent in the arrangements, that are reasonably likely to affect the continued availability of liquidity and financing.
 - d. Off balance sheet activities, including accounting policies relating to non-consolidation and revenue recognition. Specifically, for those off balance sheet activities in which the County is a sponsor or transferor, the majority owners of the off balance sheet vehicle are independent third parties who have made and maintained a substantive capital investment in the vehicle, control the vehicle and have substantive risks and rewards of the assets of the vehicle, including residuals.
 - e. Significant affiliation relationships requiring disclosure.

- f. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and lines of credit or similar arrangements.
 - g. Agreements to repurchase assets previously sold, including sales with recourse.
 - h. Changes in accounting principle affecting consistency.
 - i. All assets and liabilities under the County's control.
 - j. Rights to the assets held by a recipient organization (unless the recipient organization was explicitly granted variance power) as either an interest in the net assets of the recipient organization, a beneficial interest or a receivable.
16. The County has no:
- a. Commitments for the purchase or sale of services or assets at prices involving material probable loss.
 - b. Material amounts of obsolete, damaged, or unusable items included in the inventories at greater than salvage values.
 - c. Loss to be sustained as a result of other-than-temporary declines in the fair value of investments.
17. The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the basic financial statements:
- a. Extent, nature, and terms of financial instruments with off-balance-sheet risk;
 - b. The amount of credit risk of financial instruments with off-balance-sheet credit risk and information about the collateral supporting such financial instruments; and
 - c. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments.
18. The County's financial statements include all entities that are component units of the County; the component units have been properly presented as either blended or discrete.
19. The financial statements properly classify all funds and activities.
20. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance reserves and designations are properly classified.

21. The County has complied with all tax and debt limits and with debt related covenants.
22. The County has presented all required supplementary information. This information has been measured and prepared within prescribed guidelines.
23. The County has complied with all applicable laws and regulations in adopting, approving and amending budgets.
24. The County is not responsible for determining the fair value of any of its financial instruments as required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, as amended by SFAS No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*. The amounts disclosed in the financial statements represent the Organization's best estimate of fair value of financial instruments required to be disclosed under the Statement. The Organization also has disclosed the methods and significant assumptions used to estimate the fair value of its financial instruments.
25. The County has elected to apply the option allowed in paragraph 7 of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, to the Enterprise Funds and, as a consequence, applies FASB Statements and Interpretations that do not conflict with GASB Statements and Interpretations.
26. We have received opinions of counsel upon each issuance of tax-exempt bonds that the interest on such bonds is exempt from federal income taxes under section 103 of the Internal Revenue Code of 1986, as amended. There have been no changes in the use of property financed with the proceeds of tax-exempt bonds, or any other occurrences, subsequent to the issuance of such opinions, that would jeopardize the tax-exempt status of the bonds. Provision has been made, where material, for the amount of any required arbitrage rebate.
27. Receivables reported in the financial statements represent valid claims arising on or before the balance-sheet date and appropriate provisions for uncollectible receivables have been properly identified and recorded.
28. All funds that meet the quantitative criteria in GASB Statement No. 34 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
29. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
30. Revenues are appropriately classified in the statement of activities within program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.

31. Interfund, internal and intra-entity activity and balances have been appropriately classified and reported.
32. Special and extraordinary items are appropriately classified and reported.
33. We have complied with all other material provisions of the Internal Revenue Code of 1986, as amended.
34. The County has appropriately grouped long lived assets together for purposes of assessing impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*. Provision has been made for any material adjustments to long lived assets and certain identifiable (amortizable) intangible assets.
35. The County has a reasonable basis for allocation of functional expenses.
36. The Company does not have any derivatives or hedging activities.
37. The County does participate in securities lending or repurchase transactions.
38. We agree with the findings of specialists in evaluating VRS and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.
39. We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting and disclosure purposes are appropriate in the circumstances.
40. In accordance with *Government Auditing Standards*, we have identified to you the significant findings and recommendations from previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of this audit and have accurately communicated to you the related corrective actions taken to address the findings.
41. The County is responsible for complying, and has complied, with the requirements of OMB Circular A-133.
42. The County has prepared the schedule of expenditures of federal awards in accordance with the requirements of OMB Circular A-133 and has included all expenditures made during the year ended June 30, 2004 for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance.

43. The County is responsible for complying, and has complied, with the requirements of laws and regulations, and the provisions of contracts and grant agreements related to each of its federal programs.
44. The County is responsible for establishing and maintaining effective internal control over compliance for federal programs that provides reasonable assurance that federal awards are administered in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on a federal program.
45. There are no reportable conditions in the design or operation of internal control which could adversely affect the County's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations and the provisions of contracts and grant agreements. Under standards established by the American Institute of Certified Public Accountants, a "reportable condition" is defined as a significant deficiency in the design or operation of internal control that could adversely affect the Organization's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations and the provisions of contracts and grant agreements. We understand that the term "material weakness in internal control" is a reportable condition for which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations and the provisions of contract and grant agreements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
46. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud in the administration of federal programs. We have no knowledge of any fraud or suspected fraud affecting the entity's federal programs involving:
 - a. Management, including management involved in the administration of federal programs
 - b. Employees who have significant roles in internal control over the administration of federal programs
 - c. Others where the fraud could have a material effect on compliance with laws and regulations, and provisions of contract and grant agreements related to its federal programs.
47. The County has identified and disclosed to you the requirements of laws, regulations and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major federal program.

48. The County has made available all contracts and grant agreements (including amendments, if any) and any other correspondence with federal agencies or pass-through entities related to major federal programs.
49. The County has identified and disclosed to you all known noncompliance with the requirements of federal awards, including the results of other audits or program reviews.
50. The County has made available all documentation related to the compliance requirements, including information related to federal financial reports and claims for advances and reimbursements for major federal programs.
51. Federal financial reports and claims for advances and reimbursements are supported by the accounting records from which the basic financial statements have been prepared.
52. The copies of federal financial reports provided to you are true copies of the reports submitted, or electronically transmitted, to the federal agency or pass-through entity, as applicable.
53. The County is responsible for, and has accurately prepared, the summary schedule of prior audit findings to include all findings required to be included by OMB Circular A-133.
54. The County has provided you with all information on the status of the follow-up on prior audit findings by federal awarding agencies and pass-through entities, including all management decisions.
55. The County has accurately completed Part I of the data collection form.
56. The County has advised you of all contracts or other agreements with service organizations.
57. The County has disclosed to you all communications from its service organizations relating to noncompliance at the service organizations.
58. The County is not aware of any noncompliance occurring subsequent to June 30, 2004.
59. The County has advised you of any changes in internal control over compliance or other factors that might significantly affect internal control including any corrective action taken by management with regard to reportable conditions (including material weaknesses) that have occurred subsequent to June 30, 2004.
60. We understand that your examination of the transmittal forms of the comparative report for the County was made for the purpose of expressing an opinion as to whether the transmittal forms are in conformity, in all material respects, with the specified requirements.

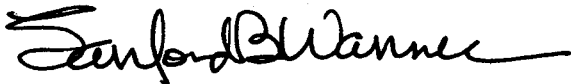
October 1, 2004

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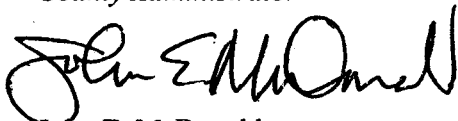
61. KPMG assisted management in drafting the financial statements and notes. In accordance with *Government Auditing Standards*, we confirm that we accept responsibility for the financial statements and notes and that we are in a position to make informed judgments about them. We also confirm that we
- a. Designated a qualified management level individual to be responsible and accountable for overseeing the drafting of the financial statements and notes.
 - b. Establish and monitored the performance of the drafting of the financial statements and notes to ensure it met our objectives.
 - c. Made all decisions that involve management functions and accept full responsibility for such decisions.
 - d. Evaluated the adequacy of the financial statements and notes.

Sincerely,

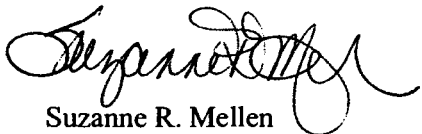
James City County, Virginia



Sanford B. Wanner
County Administrator



John E. McDonald
Manager of Financial and Management Services



Suzanne R. Mellen
Director of Budget and Accounting