City of Alexandria, Virginia

MEMORANDUM

DATE: FEBRUARY 3, 2012

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: RASHAD M. YOUNG, CITY MANAGER

SUBJECT: RECEIPT OF AUDITOR'S REPORT TO THOSE CHARGED WITH GOVERNANCE – FISCAL YEAR ENDED JUNE 30, 2011

The Code of Virginia §15.2-2511 requires the City's external auditor to present a detailed written report to a locality's governing body at a public session by December 31 following the fiscal year end. The auditor's opinion concerning the City's financial statements was presented to Council on November 9, 2011, along with the City's Comprehensive Annual Financial Report. The auditor must also communicate any matters addressed, if any, in a separately issued management letter. The City did not receive a management letter for FY 2011. The City also did not receive any audit findings.

The auditor's report provided by our auditors, KPMG, LLP, is being presented as a follow up to the audited FY 2011 CAFR and KPMG's unqualified opinion. This is the fourth year the auditors have provided this report as part of their audit procedures. The report relates to the audit that was substantially concluded on November 1 and presented to the City on November 9, 2011. This was after final reviews, including those relating to the requirements under the American Recovery and Reinvestment Act.

The attached report includes several standard components, plus the following:

- KPMG's required letter to the City Council concerning the conduct of the audit;

- KPMG's letter to the Director of Finance confirming their understanding of the engagement to provide professional services to the City;

- KPMG's request for contract modification to cover additional audit programs relating to the audit of Stimulus Funds as required under the American Recovery and Reinvestment Act; and

- Brochure on KPMG's System of Quality Controls.

Generally accepted Auditing Standards in the United States of America require that the auditors communicate all significant deficiencies in writing, including material weaknesses, to those charged with governance. As reported in November, the City did not have any matters considered to be material weaknesses. The auditor's review of internal controls also included a review of the City's compliance with selected laws and regulations.

ATTACHMENT: City of Alexandria, Virginia: Report to Those Charged with Governance, June 30, 2011.

STAFF: Laura B. Triggs, Acting Chief Financial Officer
Debbie Kidd, Acting Director of Finance

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

January 30, 2012

The Members of the Alexandria City Council
City of Alexandria, Virginia

Ladies and Gentlemen:

We have audited the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Alexandria, Virginia, (the City) as of and for the year ended June 30, 2011, and have issued our report thereon dated November 23, 2011. Under our professional standards, we are providing you with the accompanying information related to the conduct of our audit.

Our Responsibility Under Professional Standards

We have a responsibility to conduct our audit of the financial statements in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and the *Specifications for Audits of Counties, Cities, and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. 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. Our audit does not relieve the City's management or the City Council of their responsibilities.

In addition, in planning and performing our audit of the financial statements, we considered internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

We also have a responsibility to communicate significant matters related to the financial statement audit that are, in our professional judgment, relevant to the responsibilities of management and the City Council in overseeing the financial reporting process. We are not required to design procedures for the purpose of identifying other matters to communicate to you.

We also performed an audit, under the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996, of the federal financial assistance programs that the City participated in during the year. Accordingly, we had the additional responsibility of issuing reports on:

- The schedule of expenditures of federal awards in relation to the basic financial statements taken as a whole.
- The City's compliance with laws, regulations, contracts, and grant agreements that, if not complied with, could have a material effect on the federal awards programs.
- Our consideration of internal control over major federal awards programs.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the City's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We have, however, read the other information included in the City's Communication with those charged with Governance, and no matters came to our attention that cause us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

Accounting Policies and Practices

Significant Accounting Policies

The significant accounting policies used by the City are described in note 1 to the basic financial statements. These policies and practices are considered most important to the portrayal of the City's financial condition and results of operations, and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain. We have discussed with management our assessment of management's disclosures regarding such policies and practices, the reasons why these policies and practices are considered critical, and how current and anticipated future events impact those determinations. The accounting policies followed by the City in fiscal year 2011 were consistent with the accounting policies followed in fiscal year 2010. We noted the City adopted GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, effective July 1, 2010.

Unusual Transactions

We are not aware of any transactions entered into by the City during the year that were 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.

Critical Accounting Policies and Practices

We are not aware of any critical accounting policies and practices used by the City during the year that would require management's most difficult, subjective, or complex judgments resulting from a need to make estimates about matters that are inherently uncertain.

Qualitative Aspects of Accounting Practices

We have discussed with management our judgments about the quality, not just the acceptability, of the City's accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of the City's accounting policies and their applications, and the understandability and completeness of the City's basic financial statements and required supplementary information, which include related disclosures.

Management Judgments and Accounting Estimates

The preparation of the financial statements requires management of the City to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The following describes the more significant management estimates and judgments included in the financial statements:

- Evaluating the likelihood of an unfavorable outcome to the City with respect to pending litigation and claims.
- Management relies on actuarial valuations prepared by professional actuaries to compute the annual required contributions to pension plans and other post-employment benefits, as well as to compile certain required supplementary information in accordance with U.S. generally accepted accounting principles. The actuarial valuations are based on significant assumptions regarding such factors as investment returns, salary increases, employee turnover, and mortality and disability rates. We reviewed the key factors and assumptions used to prepare the City's actuarial valuations and determined that the related disclosures are reasonable in relation to the financial statements taken as a whole.

- Management also estimates depreciation expense on fixed assets and the allowance for uncollectible accounts receivable.

Uncorrected and Corrected Misstatements

In connection with our audit of the City's basic financial statements, we did not identify any difference that would require us to propose an audit adjustment. In addition, we have not identified any significant financial statement misstatements that have not been corrected in the City's books and records as of and for the year ended June 30, 2011.

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 auditors' report on the City'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 during the year ended June 30, 2011.

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 you and management each year prior to our retention by you as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Significant Difficulties Encountered During the Audit

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

Significant Written Communications Between the Auditor and Management

Attached to this report please find copies of the following material written communications between management and us:

1. Engagement Letter; and
2. Management Representation Letter

Independence

Our professional standards require that we communicate to you in writing, at least annually, all relationships between our firm and the City that, in our professional judgment, may reasonably be thought to bear on our independence. This section is intended to comply with such reporting requirements and provide confirmation that we are independent accountants with respect to the City.

We are not aware of any additional independence-related relationships between our firm and the City under all relevant professional and regulatory standards.

Confirmation of Audit Independence

We hereby confirm that as of January 30, 2012, we are independent accountants with respect to the City under all relevant professional and regulatory standards.

KPMG's System of Quality Control and Related Matters

The enclosed document entitled *KPMG – Our System of Quality Controls*, including the attached addendum, is being provided to communicate to you matters related to KPMG's system of quality control.

* * * * * * *

This letter to the Members of the Alexandria City Council is intended solely for the information and use of the City Council 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
2001 M Street, NW
Washington, DC 20036

Telephone 202 533 3000
Fax 202 533 8500
Internet www.us.kpmg.com

April 6, 2011

City of Alexandria, Virginia
100 North Pitt Street, Suite 305
Alexandria, VA 22314

Attention Ms. Laura Triggs, Director of Finance

Dear Ms. Triggs

This letter amends our engagement letter dated March 11, 2010, confirming our understanding to provide professional audit services to the City of Alexandria, VA by substituting the attached Appendix I for the Appendix I originally attached to our engagement letter.

The attached Appendix I lists the services to be rendered and related fees to provide each specified service for the identified time period. Except as specified in this letter and in the Appendix I attached to this letter, all provisions of the aforementioned engagement letter remain in effect until either Management or we terminate this agreement or mutually agree to the modification of its terms.

KPMG member firms located outside the United States and other third-party service providers operating under our supervision may also participate in providing the services describe in this letter

In accordance with your instructions, we have forwarded a copy of this letter to City Council.

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 in the space provided and return the copy to us.

Very truly yours,

KPMG LLP

John E. Reagan, III
Partner

Enclosures

ACCEPTED:

City of Alexandria, Virginia

____
Authorized Signature

Director of Finance
____
Title

4/18/11
____
Date

Appendix I

Fees for Services

Based upon our discussions with the representations of the City, our fees for services we will perform are estimated as follows:

• Basic financial statement audit and single audit of the City of Alexandria, Virginia, including the agreed upon procedures for the Comparative Transmittal Forms as of June 30, 2011	$288,352
• Basic financial statements for the Alexandria City Public Schools as of June 30, 2011	$69,891
• Basic financial statements for the Alexandria Library as of June 30, 2011	$41,759

Circumstances encountered during the performance of these services that warrant additional time or expense could cause us to be unable to deliver them within the above estimates. We will endeavor to notify you of any such circumstances as they are addressed.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Telephone 202 533 3000
Fax 202 533 8500
Internet www.us.kpmg.com

May 23, 2011

Ms. Laura Triggs
Director of Finance
City of Alexandria, VA
301 King Street, Room 1600
Alexandria, VA 22314

Dear Ms. Triggs:

The American Recovery and Reinvestment Act (ARRA), which was passed in February 2009, significantly impacts the financial management of all local governments receiving and expending such funds. These ARRA funds are subject to the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.*

Similar to 2010, we analyzed the programs expending ARRA funds to determine which of these programs would need to be audited as major programs under OMB Circular A-133 during fiscal year 2011. Based on this determination, the following programs are required to be audited during the fiscal year 2011 single audit that would not have otherwise been audited:

- Title 1 Part A Cluster- CFDA #**84.010**, **84.389**
- School Improvement Cluster Grant - CFDA #**84.377**
- Special Education Cluster - CFDA #**84.173, 84.391, 84.027**
- Block Grant for Community Mental Health - CFDA #**93.958**
- School Improvement Cluster Grant - CFDA #**84.377**
- Educational Technology State Grants Cluster **- CFDA #84.318 an 84.386**
- 2 more programs to be determined

We consider the audit of these additional programs to be a significant change in audit scope which was not contemplated at the time of our proposal response to you. Accordingly we are asking for a modification to our contract to permit us to audit, and be reimbursed for the cost of auditing, these additional programs. We have included as an attachment to this letter an analysis of the additional costs that we expect to incur in performing these procedures.

Please provide me with the appropriate contract modifications to execute this change in audit scope. Also, please feel free to contact me with any questions that you may have about this contract modification request.

Very truly yours,

John E Reagan III
Partner

Attachment

City of Alexandria, Virginia
Request for Scope Modification
Additional Single Audit Programs Required to be Audited due to ARRA
June 30, 2011

Additional Programs to be Audited

- Title 1 Part A Cluster- CFDA #**84.010**, **84.389**
- School Improvement Cluster Grant - CFDA #**84.377**
- Special Education Cluster - CFDA #**84.173, 84.391, 84.027**
- Block Grant for Community Mental Health - CFDA #**93.958**
- Child Care and Development Block Grant Cluster - CFDA #**93.575, 93.596 and 93.713**
- School Improvement Cluster Grant - CFDA #**84.377**
- ARRA Social Services Block Grant- CFDA **#93.667**
- Educational Technology State Grants Cluster - CFDA #**84.318 an 84.386**
- 3 more programs to be determined

Total Programs to be Audited	8
Hours Required to Audit Each program	100
Total Additional Audit Hours	500
Rate per Hour for Additional Audit Work per Contract	$ 155
Total Additional Fees Requested	$ 124,000

DEPARTMENT OF FINANCE
P.O. Box 178 – City Hall
Alexandria, Virginia 22313
alexandriava.gov/finance

Phone 703.746.3900

Fax 703.838.4987

November 1, 2011

KPMG LLP
2001 M Street NW
Washington, DC 20036

Ladies and Gentlemen:

We are providing this letter in connection with your audit of the financial statements of the City of Alexandria, Virginia, as of and for the year ended June 30, 2011, for the purpose of expressing opinions as to whether the financial statements present fairly the financial position of the governmental activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the City of Alexandria, Virginia (the City), and the respective changes in financial position, and, where applicable, cash flows thereof in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, changes in financial position, and cash flows in conformity with U.S. generally accepted accounting principles. 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 City's federal programs (A-133 audit) was to obtain reasonable assurance that the City 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, 2011.

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(s):

1. The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles.

2. We have made available to you:

   a. All financial records and related data.

b. All minutes of the meetings of the Alexandria City Council or summaries of actions of recent meetings for which minutes have not yet been prepared.

3. Except as disclosed to you in writing, there have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

4. There are no:

   a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

   b. 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.*

   c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SFAS No. 5.

   d. Material transactions, for example, grants and other contractual arrangements, that have not been properly recorded in the accounting records underlying the financial statements.

   e. Events that have occurred subsequent to the date of the statement of net assets and through the date of this letter that would require adjustment to or disclosure in the financial statements.

5. We believe that the effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the financial statements for each respective opinion unit.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent, deter, 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 financial statements not to be presented in conformity with U.S. generally accepted accounting principles.

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 over financial reporting, or

   c. Others where the fraud could have a material effect on the 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, regulators, or others.

9. The City has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

10. We have no knowledge of any officer or Council member of the City, or any other person acting under the direction thereof, having taken any action to fraudulently influence, coerce, manipulate, or mislead you during your audit.

11. The following have been properly recorded or disclosed in the financial statements:

    a. Related party transactions including sales, purchases, loans, transfers, leasing arrangements, guarantees, ongoing contractual commitments, and amounts receivable from or payable to related parties.

       The term "related party" refers to affiliates of the enterprise; entities for which investments in their equity securities would be required to be accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise 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 City is contingently liable.

    c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and lines of credit or similar arrangements.

    d. Agreements to repurchase assets previously sold, including sales with recourse.

    e. Changes in accounting principle affecting consistency.

    f. The existence of and transactions with joint ventures and other related organizations.

12. The City 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.

13. The City has complied, in all material respects, with applicable laws, regulations, contracts, and grants that could have a material effect on the financial statements in the event of noncompliance.

14. Management is responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to the City. Management has identified and disclosed to you all laws, regulations, and provisions of contracts and grant agreements that have a direct and material effect on the determination of financial statement amounts.

15. We have disclosed to you all deficiencies in the design or operation of internal control over financial reporting of which we are aware, which could adversely affect the City's ability to initiate, authorize, record, process, or report financial data. We have separately disclosed to you all such deficiencies that we believe to be significant deficiencies or material weaknesses in internal control over financial reporting, as those terms are defined in Statement on Auditing Standards No. 115, *Communicating Internal Control Related Matters Identified in an Audit.*

16. The City's reporting entity includes all entities that are component units of the City. Such component units have been properly presented as either blended or discrete. Investments in joint ventures in which the City holds an equity interest have been properly recorded on the statement of net assets. The financial statements disclose all other joint ventures and other related organizations.

17. The financial statements properly classify all funds and activities, including governmental funds, which are presented in accordance with the fund type definitions in GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions.

18. All funds that meet the quantitative criteria in GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, for presentation as major are identified and presented as such, and all other funds that are presented as major are considered to be particularly important to financial statement users by management.

19. The City has not elected to apply the option allowed in paragraph 7 of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, to the internal funds.

20. Interfund, internal and intra-entity activity and balances have been appropriately classified and reported.

21. Receivables reported in the financial statements represent valid claims against debtors arising on or before the date of the statement of net assets and have been appropriately reduced to their estimated net realizable value.

22. Deposits and investment securities are properly classified and reported.

23. The City is responsible for determining the fair value of certain investments as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* as amended. The amounts reported represent the City's best estimate of fair value of investments required to be reported under the Statement. The City also has disclosed the methods and significant assumptions used to estimate the fair value of its investments, and the nature of investments reported at amortized cost.

24. 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 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.

25. We believe that all material expenditures or expenses that have been deferred to future periods will be recoverable.

26. Capital assets, including infrastructure assets, are properly capitalized, reported and, if applicable, depreciated.

27. The City has properly applied the requirements of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets,* including those related to the recognition of outlays associated with the development of internally generated computer software.

28. The City 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.

29. The City has complied with all tax and debt limits and with all debt related covenants.

30. 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.

31. We believe that the actuarial assumptions and methods used to measure financial statement liabilities and costs associated with pension and other post-employment benefits and to determine information related to the City's funding progress related to such benefits for financial reporting purposes are appropriate in the City's circumstances and that the related actuarial valuation was prepared in conformity with U.S. generally accepted accounting principles.

32. Provision has been made in the financial statements for the City's pollution remediation obligations. We believe that such estimate has been determined in accordance with the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and is reasonable based on available information.

33. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance components (nonspendable; restricted; committed; assigned; and unassigned) are properly classified and, if applicable, approved.

34. 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.

35. The City has identified and properly accounted for all nonexchange transactions.

36. 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.

37. Special and extraordinary items are appropriately classified and reported.

38. The financial statements disclose all of the matters of which we are aware that are relevant to the entity's ability to continue as a going concern, including significant conditions and events, and our plans.

39. We have disclosed to you all accounting policies and practices we have adopted that, if applied to significant items or transactions, would not be in accordance with U.S. generally accepted accounting principles (GAAP). We have evaluated the impact of the application of each such policy and practice, both individually and in the aggregate, on the City's current period financial statements and our assessment of internal control over financial reporting, and the expected impact of each such policy and practice on future periods' financial reporting. We believe the effect of these policies and practices on the financial statements and our assessment of internal control over financial reporting is not material. Furthermore, we do not believe the impact of the application of these policies and practices will be material to the financial statements in future periods.

40. The City has presented all required supplementary information. This information has been measured and prepared within prescribed guidelines.

41. The City has complied with all applicable laws and regulations in adopting, approving, and amending budgets.

42. In accordance with *Government Auditing Standards*, we have identified to you all previous audits, attestation engagements, and other studies that relate to the objectives of this audit, including whether related recommendations have been implemented.

43. Management has reviewed, approved, and taken responsibility for accrual adjustments.

44. Management has taken timely and appropriate steps to remedy fraud, illegal acts, violation of provisions of contract or grant agreements or abuse that have been reported.

45. Management has a process to track the status of findings and recommendations.

46. The City is responsible for complying, and has complied with the requirements of OMB Circular A-133.

47. The City has prepared the schedule of expenditures of federal awards (SEFA) in accordance with the requirements of OMB Circular A-133 and has included all expenditures made during the year ended for the year ended June 30, 2011 for all awards provided by federal agencies in the form of grants, awards under the American Recovery and Reinvestment Act (ARRA), federal cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance. The City has appropriately identified and separated all ARRA awards, if any, within the SEFA.

48. The City is responsible for complying, and has complied, in all material respects, with the requirements of laws and regulations, and the provisions of contracts and grant agreements related to each of its federal programs. The City has disclosed to you any interpretations of any compliance requirements that have varying interpretations.

49. The City is responsible for establishing and maintaining, and has established and maintained, 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.

50. We have communicated to you all significant deficiencies and material weaknesses in the design or operation of internal control over compliance that we have identified which could adversely affect the City'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 deficiency in internal control over compliance exists when the design or

operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct on a timely basis noncompliance with a type of compliance requirement of a federal program. A "material weakness" is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. A "significant deficiency" is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that, is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

51. 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.

52. The City 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.

53. The City 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.

54. The City has identified and disclosed to you all questioned costs and any known noncompliance with the requirements of federal awards, including the results of other audits or program reviews.

55. The City 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.

56. The City is in compliance with documentation requirements contained in the requirements promulgated by the sponsoring Federal agencies (e.g. the Department of Health and Human Services' 45 CFR part 74, appendix E) for all costs charged to federal awards, including both direct costs and indirect costs charged through indirect cost proposals. Costs charged to Federal awards, are considered allowable under these same requirements.

57. The City is in compliance with documentation requirements contained in OMB Circular A-87, "Cost Principles for State, Local and Tribal Governments" for all costs charged to federal awards, including both direct costs and indirect costs charged through cost allocation plans or indirect cost proposals. Costs charged to federal awards are considered allowable under the applicable cost principles contained in OMB Circular A-87.

58. Federal financial reports and claims for advances and reimbursements are supported by the accounting records from which the financial statements have been prepared.

59. 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.

60. If applicable, the City has monitored subrecipients to determine that they have expended pass-through assistance in accordance with applicable laws and regulations and have met the requirements of OMB Circular A-133. If applicable, the City has issued management decisions on a timely basis after receipt of subrecipient audit reports that identified non-compliance with laws, regulations, or the provisions of contracts or grant agreements and has ensured that subrecipients have taken appropriate and timely corrective action on such findings.

61. If applicable, the City has considered the results of subrecipient audits and has made any necessary adjustments to its own accounting records.

62. The City 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.

63. If applicable, the City 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.

64. The City has accurately completed Part I of the data collection form.

65. The City has advised you of all contracts or other agreements with service organizations.

66. If applicable, the City has disclosed to you all communications from its service organizations relating to noncompliance at the service organizations.

67. The City has disclosed any known noncompliance occurring subsequent to the period for which compliance is audited.

68. The City has disclosed whether 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 significant deficiencies (including material weaknesses), have occurred subsequent to the date as to which compliance is audited.

Very truly yours,

City of Alexandria, Virginia

Laura Triggs
Acting Chief Financial Officer

Raymond J. Welch, Jr.
Comptroller

KPMG

cutting through complexity™

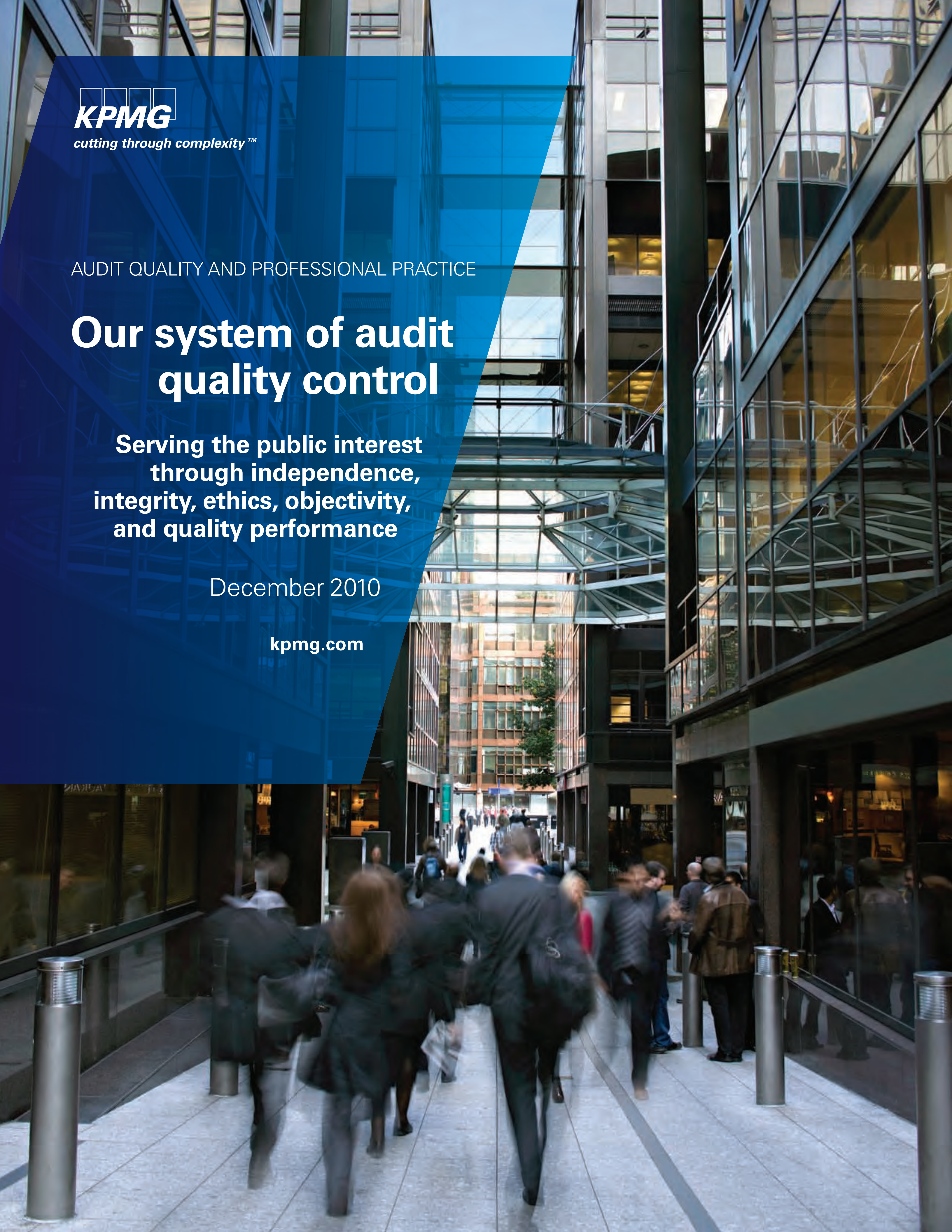
AUDIT QUALITY AND PROFESSIONAL PRACTICE

Our system of audit quality control

Serving the public interest through independence, integrity, ethics, objectivity, and quality performance

December 2010

kpmg.com



Our system of audit quality control

Serving the public interest through independence, integrity, ethics, objectivity, and quality performance

December 2010

Contents

Our quality statement
Promise of Professionalism

Our *Promise of Professionalism* to our people, our clients, and the capital markets we serve is the basis for everything we do at KPMG LLP (KPMG) and the foundation for our strategic priorities of *Professionalism and Integrity, Employer of Choice, Quality Growth,* and *Global Strength and Consistency.*

Our operating and leadership structure is designed to enable KPMG to provide outstanding client service and be responsive to the evolving economic and regulatory environment in which we compete. It is designed to support our one-firm approach to our business and the proper safeguards and monitoring of our business practices to meet the needs of the marketplace, reinforce our sense of partnership, and deliver on our *Promise of Professionalism*—to each other, to our clients, and to the capital markets we serve. Our operating structure separates risk management, operations, and compliance at the highest levels of the firm to help ensure appropriate checks and balances in our governance. We have assigned roles and responsibilities to specific committees within this structure to help ensure that we fulfill our professional obligations. Clearly, our professionals are the most important component of the quality service we provide, and it is essential that we support them with a system of quality control designed to help them succeed.

We have designed a system of audit quality control that incorporates components that are implemented and operated by our Audit practice and components that are administered by other firm functions, including Risk Management and Legal and Compliance.

The key components of our system of audit quality control embedded within our Audit practice are:

- KPMG International's Global Services Centre, which develops the methodologies and supporting technology tools used in our audit service processes
- Audit Quality and Professional Practice Network, the components of which are described below, supports the firm's professionals in meeting their responsibilities in the areas of accounting and financial reporting, Securities and Exchange Commission (SEC) reporting matters, auditing and attestation standards, continuous improvement in audit quality, and internal and external inspection processes
- Department of Professional Practice, which provides technical guidance to engagement teams on engagement-related issues, develops and disseminates topic-specific guidance on emerging technical and professional issues, and assists with firm and individual issues pertaining to compliance with regulatory and professional standards
- Professional practice partners, who provide professional practice and audit quality leadership in their respective geographies and assist engagement teams with consultations regarding technical accounting and auditing matters
- Issue Council, which provides input to and oversight of the Audit Quality and Process Monitoring Group with respect to issue identification, analysis, and remediation relating to the most significant matters relative to audit quality and our system of audit quality control
- Audit Quality and Process Monitoring Group, which accumulates and analyzes information relative to audit quality, participates in the development of remedial action plans, and monitors the timely implementation, execution, and effectiveness of those plans
- Inspections Group, which executes our annual internal inspection program, the Quality Performance and Compliance Program, for the Audit practice and liaises closely with the Audit Quality and Process Monitoring Group

The key components of our system of audit quality control administered by functions outside the Audit practice are:

- KPMG's Code of Conduct, which defines the values and standards by which KPMG fulfills its professional obligations and outlines the resources available to help partners and employees achieve compliance with them
- Independence policies supported by systems to facilitate firm and personnel compliance with applicable independence requirements
- The Risk Management Group-Audit and Firm Processes, which is responsible for oversight, monitoring, and/or participation in our Audit practice's and certain firmwide processes to manage risk
- The Professional Practice Committee, which is primarily responsible for overseeing the establishment and monitoring of appropriate risk management policies and procedures
- The Legal and Compliance Committee, which oversees the firm's ethics and compliance initiatives and maintenance of its Ethics and Compliance program

- The Professional Practice, Ethics and Compliance Committee of the Board, which promotes a firm culture committed to the highest standards of professional practice, ethics, and compliance and which monitors the activities and processes that facilitate KPMG's adherence to ethical business practices and its compliance with laws, rules, regulations, and professional standards
- Management Review Panel, which coordinates and monitors the implementation of disciplinary actions and determines sanctions for violations of the firm's independence policies as well as violations of requirements related to training, continuing professional education (CPE) fulfillment, and licensing
- An ombudsman, who serves as one of several designated channels of communication through which KPMG professionals may raise issues that they believe have not been adequately addressed at the engagement team level to a more senior level within the firm
- Internal Audit, which is responsible for the development and execution of a risk-based audit plan, designed to monitor compliance with key quality control policies and procedures

Our system of audit quality control

KPMG maintains a system of quality control for its Audit practice that is designed to meet or exceed the requirements of applicable professional standards issued by the Public Company Accounting Oversight Board (PCAOB) and the American Institute of Certified Public Accountants (AICPA).

KPMG's system of audit quality control encompasses the following:

- Leadership responsibilities for quality within the firm (the "tone at the top")
- Engagement performance
- Relevant ethical requirements
- Human resources
- Acceptance and continuance of client relationships and specific engagements
- Monitoring

Our vice chair of Audit, who reports to the deputy chairman and chief operating officer, has ultimate responsibility for our Audit practice, which includes our system of audit quality control. Our national managing partner of Audit Quality and Professional Practice, who reports to the vice chair of Audit, is responsible for the day-to-day operations of our system of audit quality control and processes to continuously improve audit quality. In this role, the national managing partner of Audit Quality and Professional Practice has ultimate responsibility for, including evaluating the performance of, the Department of Professional Practice (DPP), the Audit Quality and Process Monitoring Group, the Inspections Group, and our regional and business unit professional practice partners (collectively, Audit Quality and Professional Practice Network).

Audit Quality and Professional Practice Network

The Audit Quality and Professional Practice Network consists of more than 130 partners, directors, senior managers, and other professionals who support the firm's professionals in meeting their responsibilities in the areas of auditing and attestation, accounting and financial reporting, SEC reporting matters, continuous improvement in audit quality, and internal and external inspection processes.

Department of Professional Practice

DPP provides technical guidance to engagement teams on engagement-related issues and by assisting in communications with audit committee members and client management on those issues, developing and disseminating topic-specific guidance on emerging technical and professional issues, and consulting on and assisting with firm and individual issues pertaining to compliance with regulatory and professional standards. Through liaisons with the SEC and PCAOB, as well as active participation in the standards-setting processes at the Financial Accounting Standards Board (FASB), the Governmental Accounting Standards Board, the AICPA, the Emerging Issues Task Force (EITF), the Auditing Standards Board of the AICPA, the International Auditing and Assurance Standards Board, and other similar organizations, DPP professionals develop and represent KPMG's positions on current topics being addressed by regulatory and other standard-setting bodies.

Professional practice partners

The Audit practice is managed nationally, supported by two regional leadership teams, each with a designated regional professional practice partner. These senior partners provide professional practice and quality leadership and direct adherence to firm policies and professional standards within their respective regions. These regional professional practice partners are supported in their roles by a network of Audit partners who serve as professional practice partners for their business units and other partners and senior managers devoted to assisting engagement teams with consultations regarding technical accounting and auditing matters. The roles of our professional practice partners are to (1) support and advise the partners on client-related matters, (2) assimilate information pertaining to the professional risks of the firm, (3) provide reasonable assurance that firm policies and professional standards are followed, and (4) continuously review and seek to improve firm policies and processes.

Issue Council

The Issue Council, chaired by the national managing partner of Audit Quality and Professional Practice, provides input to and oversight of the Audit Quality and Process Monitoring Group with respect to issue identification, analysis, and remediation relating to the most significant matters relative to audit quality and our system of audit quality control.

Audit Quality and Process Monitoring Group

The Audit Quality and Process Monitoring Group is responsible for:

- Accumulating information relative to audit quality matters on a timely and consistent basis
- Analyzing such information and identifying common themes and related root causes
- Participating in the development of appropriately focused remedial actions in response to those root causes
- Monitoring the timely implementation, execution, and effectiveness of the remedial action plans

In addition, the Audit Quality and Process Monitoring Group provides support for purposes of identifying particular characteristics of our audit engagement portfolio for which proactive risk assessment plans may be developed (e.g., entities or industry sectors exhibiting higher risk characteristics).

Inspections Group

The Inspections Group executes our annual internal inspection program, the Quality Performance and Compliance Program (QPCP), for the Audit practice and liaises closely with the Audit Quality and Process Monitoring Group. In addition, this group coordinates the firm's external quality review programs for the Audit practice and also is the firm's primary liaison with the PCAOB inspection staff.

Audit quality control elements

Professional practice, risk management, and quality control are the responsibilities of every KPMG partner and employee, who are expected to understand, apply, and adhere to KPMG's policies and associated procedures at all times.

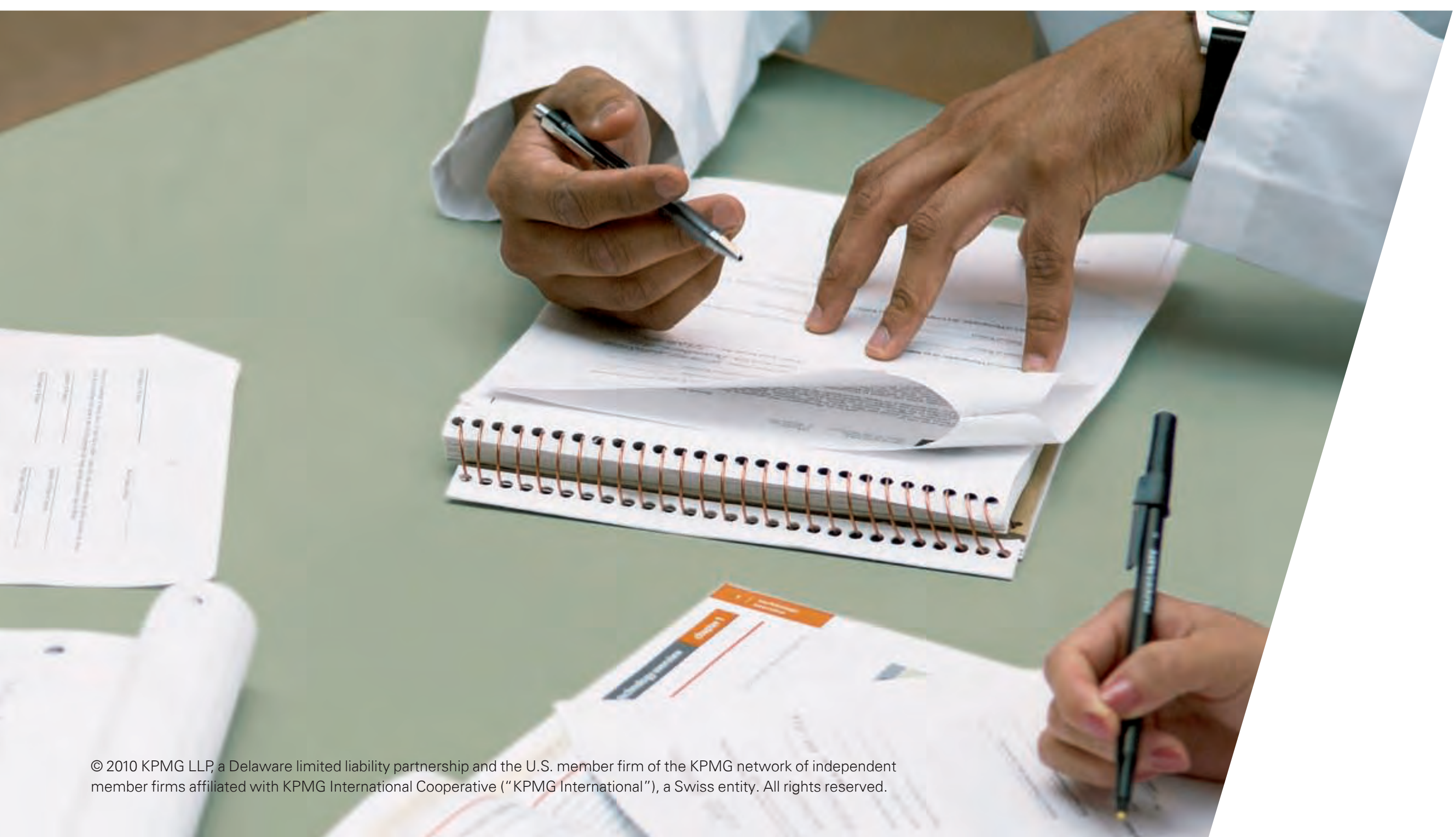
Our policies reflect individual quality control elements to help KPMG partners and employees act with integrity and objectivity, perform their work with diligence, and comply with applicable laws, regulations, and professional standards. This section summarizes those policies and procedures specific to our system of audit quality control.

Engagement performance

Fundamental to our audit quality is our system of audit quality control, which is embedded throughout the firm's audit engagement process and includes policies and guidance to enable engagement personnel to perform work that meets applicable professional standards, regulatory requirements, and the firm's standards of quality. Engagement performance encompasses all aspects of the design and execution of an audit engagement, including the firm's audit methodology and the review, supervision, consultation, documentation, and communication of audit results.

The KPMG Audit

KPMG International's Global Services Centre comprises professionals who develop and regularly update the methodologies that constitute the global audit process, in cooperation with KPMG International's Global Quality and Risk Management and International Standards Group and the U.S. firm's Department of Professional Practice. The KPMG Audit serves as the foundation of our integrated audit model and is facilitated by Training and Methodology Teams, a group of partners, senior managers, and managers who provide direct guidance on audit methodology to engagement teams in their geographic regions.



The KPMG Audit is, where applicable, an integrated audit model, which incorporates both the audit of an issuer's financial statements and the audit of internal control over financial reporting. Our integrated audit is enhanced through timely communications with the audit committee and management throughout the audit process.

In an integrated audit, we use our knowledge and experience to identify a number of different risks (e.g., inherent risk, control risk, fraud risk, and risk of failure of a control). We assess each of these risks within a continuous range from low to high. The higher the risk, the more persuasive the audit evidence needs to be to mitigate that risk. We exercise professional skepticism throughout the audit in gathering and objectively evaluating the competency and sufficiency of audit evidence obtained.

The following discussion is a highly summarized depiction of our audit methodology work flow:

Risk assessment

- Obtain an understanding of the entity and its environment, including internal control (i.e., evaluate the design and implementation of relevant controls)
- Perform risk assessment procedures and related activities
- Identify and assess risks of material misstatement
- Design audit responses to address the assessed risks of material misstatement

Testing

- Test operating effectiveness of selected controls
- Plan and perform substantive procedures

Completion

- Perform completion procedures, including overall review of financial statements
- Document significant findings and issues
- Consider if audit evidence obtained is sufficient and appropriate
- Form an audit opinion
- Communicate to the audit committee or those charged with governance our responsibilities under applicable auditing standards, an overview of the planned scope and timing of the audit, and significant findings from the audit

The KPMG Audit addresses both manual and automated controls and includes integration of the firm's information technology professionals and other specialists into the core audit engagement team when appropriate. Our audit also includes procedures aimed at detecting and responding to fraud risks.

The KPMG Audit also guides the conduct of audits of financial statements comprised of two or more components (group audits) and clearly delineates responsibilities relative to managing group audits and the involvement of the group engagement team in the work performed by the component auditor. Our audit methodology includes policies and guidance related to those matters that merit special consideration in performing group audits, including identifying significant components, evaluating groupwide controls, evaluating aggregation risk, establishing group and component materiality, and communicating with the component auditor.

Supervision, review, and support for the engagement team

Supervision entails directing the efforts of professionals who are involved in accomplishing the objectives of the audit and determining whether those objectives are accomplished. Elements of supervision include instructing and guiding professionals, keeping informed of significant issues, reviewing the work performed, reconciling issues, and agreeing on appropriate conclusions. KPMG's supervision and review guidelines for audit work include:

- Tracking the progress of an engagement
- Considering the capabilities and competencies of individual members of an engagement team
- Identifying matters for consultation or consideration by more experienced engagement team members during an engagement
- Reviewing and approving engagement planning and risk assessment prior to the start of significant fieldwork
- Reviewing all audit documentation by a KPMG professional other than the preparer; the engagement partner's responsibilities include review of audit documentation related to critical areas of judgment, significant findings and issues, and significant risks at the financial statement level and the relevant assertion level with respect to significant accounts and disclosures, including work performed by KPMG specialists relative to these significant risks
- Involving an engagement quality control review partner on all financial statement and integrated audit engagements
- Preparing planning and completion documentation that summarize significant issues, which are approved by various parties, including the engagement partner and engagement quality control review partner
- Performing in-depth technical reviews in certain situations, led by the engagement quality control review partner

Engagement quality control review

The engagement quality control review partner has no responsibilities on the engagement other than those relating to performing an objective review of the financial statements, auditors' reports, and certain audit documentation. All partners who perform engagement quality control reviews of public company audits have received internal training and credentials to serve as SEC reviewing partners; these individuals are the firm's top technical partners and are knowledgeable and experienced in SEC accounting and reporting matters and PCAOB professional standards.

Engagement quality control review partners review certain audit documentation, the appropriateness of the financial statements and related disclosures, the key conclusions of the engagement team with respect to the audit, and the auditors' reports to be issued. Completion of an engagement quality control review is documented when the engagement quality control review partner is satisfied that all significant questions raised have been satisfactorily resolved.

Confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation

KPMG's policies and Code of Conduct require its personnel to maintain the confidentiality of client or former client information, including privacy of personally identifiable information, in accordance with professional standards and privacy-related laws. The firm also requires its professionals to affirm that they understand and will comply with the firm's policies related to privacy and confidentiality at commencement of employment and as part of its annual compliance confirmation. Additionally, the firm mandates privacy training for new partners, principals, and employees, and engages in an annual Privacy and Safe Harbor Certification program. Furthermore, to help protect the confidentiality of client information and KPMG proprietary data, the firm has installed encryption software on its personal computers to prevent unauthorized access to computer files or data.

In addition, our audit professionals are required to apply appropriate and reasonable controls to:

- Clearly determine when and by whom audit documentation was created, changed, or reviewed
- Protect the integrity of information throughout the audit, especially when the information is shared within the engagement team or transmitted to other parties via electronic means
- Prevent unauthorized changes to audit documentation
- Allow access to documentation by an engagement team and other authorized parties as necessary to properly discharge their responsibilities

Retention of engagement documentation

The firm's formal document retention policy governs matters such as the retention period for audit documentation and other records relevant to an engagement in accordance with the relevant SEC and PCAOB rules as well as other applicable regulatory bodies' standards and regulations.

Consultation and differences of opinion

Internal consultation with others is encouraged and in certain circumstances, required. Technical support for each engagement team comes from a network that includes DPP as well as the professional practice partners.

The firm has established protocols for consultation regarding, and documentation of, significant accounting and auditing matters, including procedures to resolve differences of opinion on engagement issues. Consultation with a team member at a higher level of responsibility than either of the differing parties usually resolves such differences. In circumstances where partners involved in the audit are unable to resolve an issue, the matter may be elevated through the chain of responsibility for resolution by DPP.

Independence

KPMG's independence policies require that the firm, its partners and management group, and the personnel assigned to each audit engagement must be free from financial interests in and prohibited relationships with the client, its management, its directors, and its significant owners. KPMG monitors compliance with its independence policies for financial interests through an independence compliance system (KICS), as well as through a compliance audit process.

This system contains an inventory of SEC registrants and the securities they have issued. KPMG's SEC audit clients are marked "restricted" in KICS. Before purchasing a security or securing a loan or other financial relationship, partners and managers are required to use KICS to determine if the entity is restricted and to report all of their investments in the tracking system, which automatically notifies professionals if their investments become restricted.

The firm also requires all professionals to complete independence training every year and affirm their independence using an electronic confirmation system. This confirmation is completed upon commencement of employment at the firm, every year thereafter, and at key promotions.

KPMG has established processes to communicate independence policies and procedures to our personnel. The firm requires adherence to applicable independence requirements and ethical standards, which meet or exceed the standards promulgated by the PCAOB, SEC, AICPA, Government Accountability Office (GAO), and all other applicable regulatory bodies. These policies and procedures, which cover areas such as personal independence, postemployment relationships, partner rotation, and approval of audit and nonaudit services, are monitored continuously to keep abreast of current developments.

Some of these policies include:

Personal independence

- Each professional is responsible for maintaining his or her personal independence.
- Partners, managers, and those providing professional services to an audit client may not have direct or material indirect investments in an audit client or its affiliates.
- Certain other financial relationships with audit clients or affiliates of audit clients (e.g., loans, credit cards, insurance products, and brokerage accounts) are either prohibited or subject to limitations.
- Close family members of certain KPMG partners and employees may not hold certain accounting or financial reporting roles with audit clients or their affiliates.

Postemployment relationships

- KPMG professionals are required to report promptly to the firm any discussions or contacts between them and an audit client regarding possible employment.
- KPMG professionals engaged in discussions or negotiations regarding possible employment with an audit client are immediately removed from the audit engagement.
- If a professional accepts employment with a client, the ongoing engagement team gives active consideration to the appropriateness or necessity of modifying the audit procedures to adjust for risk of circumvention by the former professional of the firm.
- For certain SEC audit clients, a former member of the audit engagement team may not accept employment in a financial reporting oversight role until the required "cooling-off" period has expired.

Partner rotation

Under the Sarbanes-Oxley Act of 2002 and the SEC's independence rules, the firm's Audit partners are subject to specific rotation requirements that limit the number of consecutive years an individual partner may provide services to an SEC audit client. To monitor compliance with these requirements, the firm uses its Partner Rotation System, which assists in monitoring partner assignments and initiating partner changes on SEC audit clients. Additionally, Risk Management-Audit and Firm Processes must approve any proposed change of a lead audit engagement partner or engagement quality control review partner for an SEC audit client, if the change is for any reason other than independence, required partner rotation, or normal partner retirement. Our monitoring system also aids in the development of timely transition plans that help the firm to deliver consistent quality service to our clients. The process of monitoring and tracking service time and partner rotation is subject to compliance testing as part of our QPCP.

Approval of audit and nonaudit services

The lead audit engagement partner evaluates all nonaudit services provided to SEC audit clients and their affiliates and also obtains preapproval of permitted services from the audit committee. For engagements subject to GAO standards, the firm requires approval by the lead audit engagement partner before commencement of such services. The firm's system, Sentinel™, facilitates compliance with these policies and, at the same time, is used to identify and manage potential conflicts of interest within and across member firms in the KPMG International network. Together with our policies, Sentinel helps the firm resolve any potential conflicts of interest, prevent the provision of prohibited services to SEC and certain nonpublic audit clients, and determine that permitted services are properly preapproved.

Ethics and integrity

KPMG is committed to doing the right thing, in the right way, for our people, for our clients, and for the capital markets we serve. It is this commitment that underlies our values-based compliance culture, in which individuals are encouraged to raise their hands to voice concerns when they see behaviors or actions that are inconsistent with our values or professional responsibilities. In this culture, they know that the concern will be constructively reviewed and considered, and then consistent and appropriate action will be taken. Individuals who raise their concerns at KPMG are recognized for delivering on our promise of professionalism and their commitment to ethics and integrity.

The firm's Code of Conduct is the central tool that articulates the values and principles embodied in KPMG's policies and underscores KPMG's commitment to ethics and integrity. The Code of Conduct details the values and standards of behavior expected of all KPMG partners and employees. All personnel complete stand-alone ethics training on relevant Code of Conduct topics biannually, and each year acknowledge that they understand and agree to comply with the firm's Code of Conduct. Additionally, the firm seeks to embed ethics and compliance training in its technical and leadership training to reinforce relevant standards of behavior.

Complaints and allegations (Ethics and Compliance Hotline)

To further our commitment to integrity and ethical culture, KPMG maintains an Ethics and Compliance Hotline that allows both phone and Web reports to be made through an independent third-party provider. The firm encourages use of the hotline when KPMG partners and employees feel uncomfortable reporting concerns about possible illegal, unethical, or improper conduct through normal channels or when the normal channels of communication are impractical or perceived as ineffective. The hotline is available to external parties as well, and any person, including clients, vendors, and professionals from other KPMG International member firms working on engagements with U.S.-based clients, also may file reports by calling the toll-free number, 1-877-576-4033,[1] or by submitting a report via the Web at www.kpmgethics.com.

Reports filed through the hotline are directed to the firm's chief compliance officer for review and, if necessary, assignment of appropriate firm resources for investigation and resolution. Generally, reports that involve an SEC audit client or certain other professional practice matters are investigated either by the firm's ombudsman or the Office of General Counsel. The firm's chief compliance officer manages, on a day-to-day basis, all personnel matters under investigation. Reports are handled confidentially (to the extent allowable by law and consistent with the needs of a thorough investigation) and anonymously, if requested, and retaliation or retribution of any kind for good-faith reporting is prohibited.

A KPMG International Hotline also is available for KPMG International personnel; partners, employees, and clients of KPMG International member firms; and other parties to confidentially report possible illegal, unethical, or improper conduct in violation of KPMG International's Code of Conduct.

Compliance testing

The Ethics and Compliance Group is responsible for testing and monitoring compliance with certain firm policies. To confirm our professionals' and the firm's independence, in FY 2010, the group audited the financial relationships of more than 500 individuals subject to the independence requirements and performed monthly audits of the firm's financial interests.

Objectivity

Independence, integrity, ethics, and objectivity are the pillars of our firm. Thus, we work diligently to avoid even the appearance of a conflict of interest. KPMG personnel are vigilant to recognize actual and potential conflicts of interest, identifying them at the earliest opportunity to resolve, manage, or avoid the conflict. Conflicts of interest may preclude KPMG from accepting a client or an engagement.

Conflict check system

The firm's system, Sentinel, is used to identify and manage potential conflicts of interest within and across member firms in the KPMG International network. When a potential conflict of interest is identified, a member of Risk Management determines how to resolve the potential conflict after appropriate consultations, if needed, with the Office of General Counsel. Generally, before agreeing to pursue the engagement, the parties involved in the professional service are notified of the potential conflict of interest, and if it is resolved, the engagement is subject to the firm's normal engagement acceptance process.

If the engagement is accepted, it may be necessary to establish "ethical dividers" with respect to the professionals assigned and to communicate with appropriate parties. If a potential conflict cannot be resolved, the engagement or prospective client is declined.

Human resources

The firm's personnel management system encompasses the areas of:

- Recruitment and hiring
- Determining capabilities and competencies
- Assignment of engagement teams
- Professional development
- Performance evaluation, advancement, and compensation

Recruitment and hiring

Prior to receiving an offer of employment, all candidates for professional positions complete and submit an application for employment and an authorization for release of information, which authorizes the firm to conduct a background investigation on a candidate. Candidates are interviewed and are subject to background checks for which information provided is verified through independent sources. Prior to their start date, candidates are provided access to the firm's independence guidelines to ascertain and confirm their independence. Situations involving independence or conflicts of interest are to be resolved before the individual can begin employment with KPMG. Upon joining the firm, personnel are also required to complete training programs on independence, ethics, respect and dignity, and security, in addition to any practice-related modules.

1 This number can only be dialed within the United States and Canada. If dialing outside the United States and Canada, www.kpmgethics.com provides dialing instructions.

Determining capabilities and competencies

The appropriate capabilities and competencies of an audit engagement team as a whole include the following:

- An understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation
- An understanding of professional standards and legal and regulatory requirements
- Technical skills, including knowledge of relevant information technology and other specialized areas of accounting or auditing
- Knowledge of relevant industries in which the client operates
- Ability to apply professional judgment
- An understanding of KPMG's audit quality control policies and procedures

KPMG requires that client service professionals who are eligible to hold a certified public accountant (CPA) license (i.e., who have passed the CPA exam and met applicable state educational and experience requirements) be licensed to practice in the states where their home offices are located and that they meet all CPA licensing requirements in any other state(s) in which they practice public accounting. The firm closely monitors license expiration and renewal for its professionals using a database that automatically generates a notification prior to license expiration. Professionals who fail to obtain or renew a license on a timely basis or fail to provide accurate and complete licensing information to the firm on a timely basis may be subject to disciplinary action, up to and including separation from the firm.

Our process for admission to the partnership is rigorous and thorough, involving the appropriate members of KPMG leadership. Each candidate for the partnership, whether via direct-entry hire or internal nomination, undergoes a background check and is interviewed by several members of firm leadership, including a professional practice or risk management partner and a Board member. Furthermore, an extensive review for each internal partner candidate is completed by a number of departments, including the Ethics and Compliance Group, Audit Quality and Professional Practice, Risk Management, and the Office of General Counsel.

Assignment of engagement teams

Individuals are assigned to specific engagements based on their skill sets, relevant professional and industry experience, and the nature of the assignment or engagement. Engagement partner and engagement quality control review partner assignments are approved by business unit leadership and may also be approved by regional and national leadership based on the individual characteristics of the audit client.

Professional development

Our policies require our professionals to maintain their technical competence and to comply with applicable regulatory and professional requirements. The firm provides continuous learning opportunities to help our professionals meet their CPE requirements as well as their own professional development goals. Training and development programs include course prerequisites, proficiency tests, and varied delivery methods that enable our professionals to take self-study courses; attend classroom courses at the national, business unit, and local levels; and participate in Web-based seminars in real time. KPMG also maintains a system that helps professionals monitor compliance with their CPE requirements.

Audit quality and professional skepticism is continually emphasized to KPMG professionals through timely training and communication of accounting, auditing, and reporting matters. The firm's training includes programs designed to enhance professionals' ability to make judgments by employing a standardized framework that addresses how biases impact decision making and how to recognize and overcome biases in making judgments and applying appropriate professional skepticism. In addition, the firm requires all professionals to complete KPMG's annual training on independence standards and biannual training on the ethical standards embedded in our Code of Conduct. The firm also encourages professionals to stay abreast of technical updates by attending industry-specific training programs and conferences as well as reviewing pertinent bulletins and periodicals.

The firm also has developed a Career Architecture program that helps partners and employees understand their career opportunities through expansion of their skills, experiences, and networks within KPMG.

Performance evaluation, advancement, and compensation

All professionals, including partners, undergo annual goal setting and performance evaluations conducted by people management leaders, who are trained in the KPMG performance management process and are familiar with the professionals' performance. Each professional is evaluated on his or her attainment of agreed-upon goals, demonstration of skills/behaviors, and adherence to KPMG values. Skills/behaviors evaluated include quality focus and professionalism, technical knowledge, accountability, business and strategic focus, leading and developing people, continuous learning, and relationship building.

The firm's performance evaluation model has been developed to provide a consistent framework by which leadership and performance management leaders may discuss performance relative to goals and objectives and career development aspirations. The results of the annual performance evaluation directly affect compensation of KPMG personnel, including partners, and in some cases, their continued association with the firm.

Audit partner compensation is determined annually by Audit leadership and approved by the Management Committee and Board of Directors. The professional practice partners have significant involvement in evaluating Audit partner performance and compensation. Partner compensation is based on a targeted allocation, which considers a partner's responsibilities and performance. Audit quality performance is a significant factor in evaluating and compensating Audit partners. One of the factors considered in the compensation of Tax and Advisory partners who participate in audit engagements includes achievement of appropriate audit quality goals. Our policies for setting compensation amounts do not allow an Audit partner, as defined by the SEC, to be compensated for the sale of nonaudit services to his or her audit client.

Acceptance and continuance of client relationships and specific engagements

KPMG recognizes that rigorous client and engagement acceptance and continuance policies are vitally important to the firm's ability to provide high-quality professional services and has established policies and procedures for deciding whether to accept or continue a client relationship and whether to perform specific services for a particular client.

Prospective client/engagement evaluation processes

Prior to accepting a new audit engagement, a partner performs an evaluation of the entity and its principals, its business, and engagement-related matters, as appropriate. This evaluation includes a background investigation of the entity and selected senior management personnel.

Factors considered during the acceptance process include, but are not limited to:

- Client-related matters (financial strength, reputation, accounting policies and practices, and character and competency of management personnel)
- Business-related matters (industry, products, and competitors)
- Service-related matters (firm and engagement team competency and technical risk associated with services requested)
- Independence-related matters (employment-related matters, financial relationships, investments, loans, and nonaudit services)

In addition to conducting public background checks on the prospective client and selected senior management employed by the prospective client, the firm evaluates potential independence issues and conflicts of interest. Engagement teams proposing to perform a new audit engagement are required to perform a series of procedures including a review of nonaudit services provided to the potential audit client. Any potential independence issues and conflicts identified are resolved in consultation with other parties, and the resolution of all matters is documented. Resolution of potential conflicts requires approval from a second party, which could include the professional practice partner, Sentinel resolver, or the functional risk management group, before signing the initial audit engagement letter.

If a potential independence issue or conflict cannot be resolved satisfactorily, in accordance with professional and firm standards, the prospective client or engagement is declined.

Prospective audit engagement evaluations require approval of the professional practice partner and the business unit partner in charge. New SEC audit engagements require additional approvals by the regional professional practice partner, and certain other entities also require the approval of Risk Management-Audit and Firm Processes.

Continuance process

Engagement partners are required to review and evaluate their existing audit and attestation clients with their professional practice partner at least annually. A client continuance evaluation is a process of formal approvals by various parties, including the regional professional practice partner in certain situations. The objective of these reviews is to identify those clients where the firm should consider implementing additional safeguards to address audit risk and those instances where we should discontinue our professional association with the client.

In addition, certain factors that require additional evaluation procedures to be conducted include, but are not limited to:

- New legal, regulatory, or professional requirements that alter our reporting responsibilities and professional risks
- A significant change in the nature, size, or structure of a client's business
- A significant change in ownership
- A significant change in client management, directors, principal owners, or other key personnel
- A significant, adverse change in the perceived integrity of current management or principal owners
- A significant, adverse change in the financial performance of the client
- Particular audit findings (e.g., material weaknesses in internal control not being addressed by management or material proposed adjustments to financial statements)
- An existing nonpublic audit client plans to become an SEC registrant

- A restatement of financial statements
- Investigation of the client by a regulatory body or its audit committee that involves a current member of management

KPMG uses a tool, known as CLEAS, to manage, control, and document its client and engagement acceptance and continuance processes.

Monitoring

Monitoring procedures involve ongoing consideration and evaluation by the firm of the following matters:

- Relevance and adequacy of the firm's policies and procedures
- Appropriateness of the firm's guidance materials and practice aids
- Effectiveness of professional development activities
- Compliance with professional and firm standards, policies, and procedures
- Effectiveness of action plans developed to address recurring findings related to all engagement reviews (QPCP, peer review, PCAOB inspections, or Department of Labor inspections)

Internal inspection processes

Along with other monitoring activities previously described, KPMG meets the profession's monitoring requirement through the implementation of our internal inspection processes, including the QPCP and the Risk Compliance Program.

Components of the internal inspection processes include:

- A central, full-time review team that resides in the Inspections Group of Audit Quality and Professional Practice and consists of partners and managers, supplemented by other individuals with applicable industry and technical knowledge
- Regular reviews of audit engagements of individual partners following a three-year rotating schedule
- Reviews of audit engagements of selected individual managers in a lead role for an SEC audit client
- Reviews of general and functional controls, including independence, client acceptance and continuance, personnel evaluations, CPE compliance, and document retention
- Frequent, timely reporting of firmwide inspection results
- Training and guidance that communicates to audit professionals common inspection findings, those areas where audit quality can be improved, and where appropriate, the tools needed to achieve improvements in audit quality

Regulatory external reviews

The enactment of the Sarbanes-Oxley Act in 2002 resulted in the creation of the PCAOB, the mission of which is to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. To assist it in fulfilling its mission, the PCAOB conducts periodic inspections of registered firms. KPMG is subject to annual inspection by the PCAOB. The most recent PCAOB inspection report on KPMG is accessible through the PCAOB's Web site at http://pcaobus.org/Inspections/Reports/Documents/2010_KPMG_LLP.pdf. The PCAOB plays an important role in improving audit quality, and the PCAOB's inspection process serves to assist us in identifying areas where we can improve our performance and strengthen our system of audit quality control.

External peer review

To comply with licensing requirements of state boards of accountancy and the GAO, KPMG undergoes a triennial external peer review conducted by another Big Four firm. The firm's most recent peer review report was issued by PricewaterhouseCoopers LLP (PwC) in December 2008 on KPMG's system of audit quality control for its nonpublic accounting and auditing practice. The firm received a peer review rating of *pass* for the year ended March 31, 2008. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*.

The peer review report and the AICPA's acceptance letter are accessible through the AICPA's peer review public file Web site at http://peerreview.aicpaservices.org/publicfile/DocDefault.aspx.

Risk management and other elements of quality control

To enhance our system of quality control, KPMG separates the responsibility for risk management and oversight of quality control monitoring from the responsibility for managing the firm's business and professional practice activities. KPMG's vice chair – Risk Management has ultimate responsibility for firmwide risk management. The vice chair is supported by a national partner in charge (NPIC) – Risk Management-Audit and Firm Processes, NPIC – Risk Management-Tax, NPIC – Risk Management-Advisory, NPIC – Washington National Tax, and partner in charge – Independence.

Professional Practice Committee

The Professional Practice Committee, chaired by the firm's vice chair – Risk Management, oversees the development and monitoring of policies and the dissemination of guidance designed to enhance the firm's professional practice, risk management, and quality control processes. This committee also includes the vice chair – Legal and Compliance, national managing partner of Audit Quality and Professional Practice, national partners in charge of each of the Risk Management groups (Audit and Firm Processes, Advisory, and Tax), a regional professional practice partner for Audit, certain field risk management partners for Tax and Advisory, national managing partners of Advisory and Tax, national partner in charge of Washington National Tax, partner in charge of Independence, and General Counsel.

Risk Management groups (Audit and Firm Processes, Tax, and Advisory)

The Risk Management groups (Audit and Firm Processes, Tax, and Advisory) consist of partners and other professionals charged with oversight of quality control and monitoring risk for the Audit, Tax, and Advisory practices, respectively.

Risk Management-Audit and Firm Processes is an essential and integral component to successfully achieving our firm's priorities through oversight, monitoring, and/or participation in the Audit practice's and certain firmwide processes to manage risk. This group is responsible for developing risk management policies, including those relating to client and engagement acceptance and continuance, and for oversight of our audit QPCP. The firm's risk management systems, including CLEAS (Client/Engagement Acceptance System) and the Partner Rotation System, also fall under the responsibilities of this group. In addition, this group is responsible for a firmwide privacy assessment program, which is an important part of the firm's overall efforts to protect personally identifiable information and comply with the applicable laws, regulations, professional standards, firm policies, and agreements in the area of privacy.

Risk Management-Tax oversees compliance with the professional standards and requirements established by the firm, the AICPA, the Internal Revenue Service, and other governmental authorities governing the U.S. Tax practice. This group develops risk management policies specific to our Tax practice and also seeks to mitigate risk with frequent guidance and training; approval of new Tax engagements at inception; and close monitoring of compliance, including its year-round Tax QPCP. Risk Management-Tax is supported by business unit and national service line risk management partners.

Risk Management-Advisory develops risk management policies specific to our Advisory practice. This group monitors compliance with our Advisory risk management policies and procedures and also reviews new advisory service offerings. Risk Management-Advisory brings forward significant new advisory service offerings to the Professional Practice Committee for their approval of related risk management protocols. Risk Management-Advisory is supported by a network of national and service line risk management partners.

Washington National Tax

Washington National Tax provides leadership and support to maintain consistency in the overall quality and depth of tax services provided to clients by the firm. This group issues guidance on existing and emerging tax rules and regulations, participates in the development of firmwide tax positions, and consults with tax professionals on client-related matters. Through these activities, Washington National Tax helps our tax professionals understand and comply with the firm's policies and procedures.

Independence Group

The Independence Group is responsible for the firm's policies, practices, and controls with respect to independence matters, including those relating to Sentinel and KICS, and is assisted by the business unit independence partners and professional practice partners.

Legal and Compliance

In addition to professional practice and risk management, ethics and compliance are also an integral part of the firm's quality control process. Reporting directly to the firm's chairman and CEO, the vice chair – Legal and Compliance is responsible for the firm's Ethics and Compliance program as well as legal affairs, public affairs, and litigation strategy management and resolution. In addition to serving as the firm's chief legal officer, this role chairs the firm's Legal and Compliance Committee. The chief compliance officer, Office of General Counsel, Office of Government Affairs, Internal Audit Group, Communications, and Firmwide Security report directly to the vice chair – Legal and Compliance.

Ombudsman

KPMG has an ombudsman who serves as one of several designated channels of communication through which KPMG professionals may raise issues that they believe have not been adequately addressed at the engagement team level to a more senior level within the firm. The ombudsman is responsible for resolving all such issues and coordinates with the senior risk management partners in Audit, Tax, and Advisory in doing so. The ombudsman operates under the firm's principles of confidentiality and nonretaliation. In this role, the ombudsman reports directly to the firm's chairman and CEO and also provides reports on ombudsman matters to the Legal and Compliance Committee and the Professional Practice, Ethics and Compliance Committee of the Board.

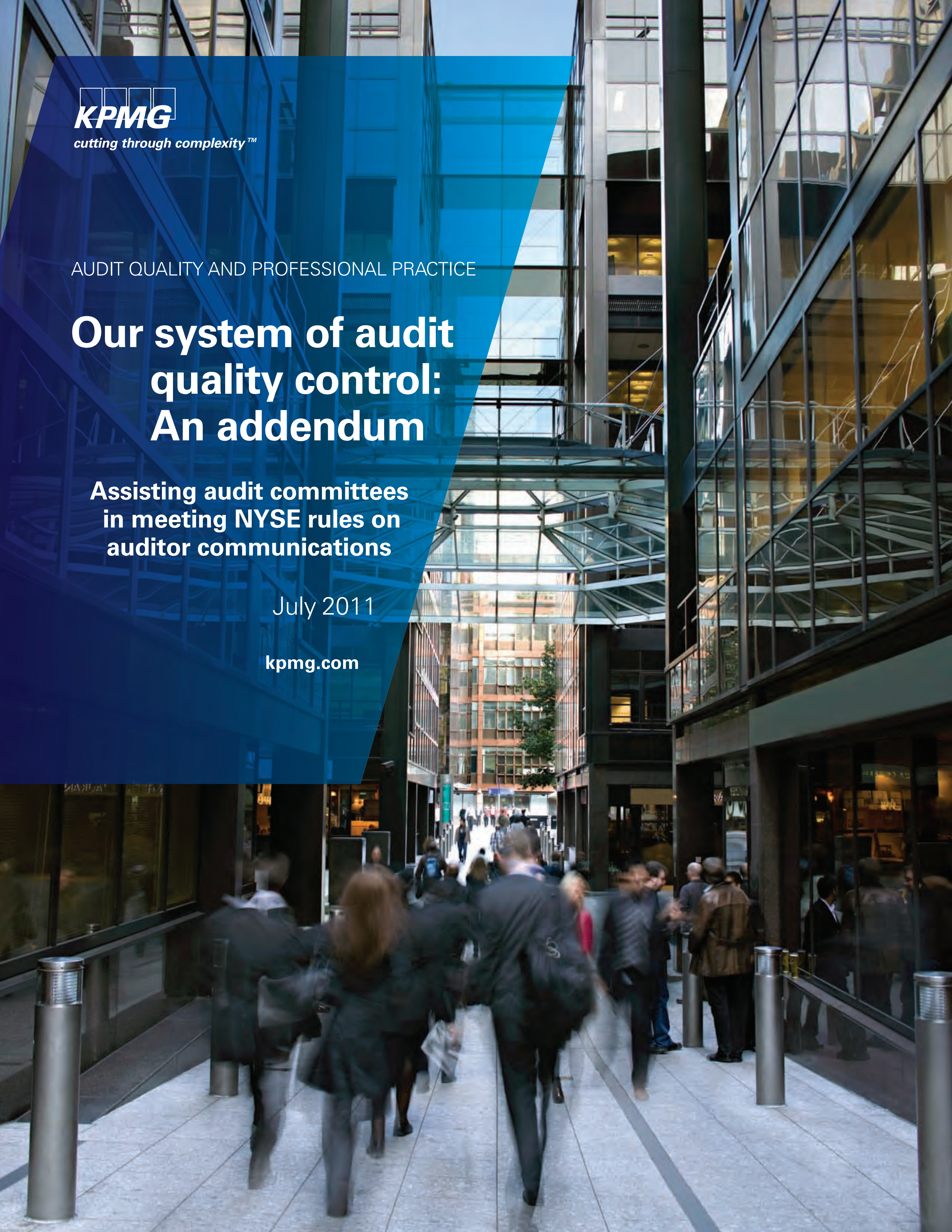
Conclusion

We are confident that our firm's tone at the top, structure, policies, and procedures support our professionals and enable them to provide a high level of audit quality in an independent, objective, and ethical manner, maintaining public and stakeholder confidence.

As businesses and markets evolve, we pledge to keep pace by continuing our substantial investment in the research and development needed to maintain audit quality and by staying abreast of changing public and regulatory expectations in the audit environment.

KPMG intends to continue to provide our professionals with training, technology-based tools, and audit methodologies that contribute to high-quality audits.

We encourage you to contact KPMG with any comments or questions you may have.



KPMG

cutting through complexity™

AUDIT QUALITY AND PROFESSIONAL PRACTICE

Our system of audit quality control: An addendum

Assisting audit committees in meeting NYSE rules on auditor communications

July 2011

kpmg.com

Our system of audit quality control:
An addendum

Quality control
KPMG LLP (KPMG) maintains a system of audit quality control that is designed to meet or exceed the requirements of applicable professional standards issued by the Public Company Accounting Oversight Board (PCAOB) and the American Institute of Certified Public Accountants (AICPA). The accompanying document, *Our system of audit quality control: Serving the public interest through independence, integrity, ethics, objectivity, and quality performance,* describes that system and encompasses:

- Leadership responsibilities for quality within KPMG (the "tone at the top")
- Engagement performance
- Relevant ethical requirements
- Human resources
- Acceptance and continuance of client relationships and specific engagements
- Monitoring

KPMG continuously reviews its policies and practices to respond to changes in regulatory and professional requirements.

External regulatory reviews
The PCAOB was established by the Sarbanes-Oxley Act of 2002 (Act) to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. To assist it in fulfilling its mission, the PCAOB conducts periodic inspections of registered public accounting firms.

KPMG has been subject to eight periodic PCAOB inspections, including a limited inspection in 2003. The status of the four most recent PCAOB inspections follows:

For its 2010 inspection, the PCAOB selected various public company audit engagements of KPMG for review. In addition, the PCAOB completed certain procedures relating to the activities and responsibilities of KPMG's executive and national office. KPMG has not yet received the PCAOB's 2010 inspection report.

On October 5, 2010, the PCAOB released KPMG's 2009 inspection report. The public portions of the report are available on the PCAOB's website, http://pcaobus.org/Inspections/Reports/Documents/2010_KPMG_LLP.pdf. KPMG expects to submit to the PCAOB its response to the nonpublic portion of this report by September 2011.

The PCAOB released KPMG's 2008 inspection report in June 2009. The public portions of the report are available on the PCAOB's website, http://pcaobus.org/Inspections/Reports/Documents/2009_KPMG_LLP.pdf. KPMG submitted to the PCAOB its response to the nonpublic portion of this report in June 2010.

The public portions of the PCAOB's reports do not include information that, under the Act, is considered nonpublic, including any criticisms of a firm's system of quality control. Although KPMG does not publicize nonpublic portions of PCAOB inspection reports, the firm would be pleased to discuss with our clients significant information contained in the reports.

In October 2010, the PCAOB determined that KPMG had addressed the quality control criticisms in the nonpublic portion of the 2007 inspection report to the PCAOB's satisfaction for purposes of Section 104(g)(2) of the Act. As a result, under the Act, the PCAOB did not make public any of its comments on KPMG's system of audit quality control included in the nonpublic portion of the 2007 inspection report.

Internal quality reviews
KPMG conducts an annual internal review of its accounting and auditing practice through its Quality Performance and Compliance Program (QPCP). The QPCP is designed to meet the quality control element of monitoring required by applicable professional standards promulgated by the PCAOB and the AICPA. For the five-year period ended December 31, 2010, our QPCP did not identify any issues considered to have a material effect on the conduct of KPMG's accounting and auditing practice. Like most companies with quality review programs, we identify areas for continuous improvement and address our findings through enhancement of policies and guidance, where appropriate; other written communications to our professionals; internal training; and periodic partner, manager, and staff meetings. These areas also are emphasized in subsequent years of the QPCP to assist our audit quality function in assessing our continuous improvement goals.

External peer reviews
KPMG's system of audit quality control for its nonpublic company accounting and auditing practice is subject to external peer review triennially.

PricewaterhouseCoopers LLP issued a report on its most recent external peer review in December 2008. In that report, KPMG received a peer review rating of *pass* for the year ended March 31, 2008. Under the AICPA's Peer Review Standards, firms may receive a rating of *pass, pass with deficiency(ies)*, or *fail*.

KPMG's most recent peer review report and the AICPA's acceptance letter of our peer review are public documents and are accessible through the AICPA's peer review public file website, http://peerreview.aicpa.org/publicfile/DocDefault.aspx.

PricewaterhouseCoopers LLP is in the process of conducting its external peer review for the year ended March 31, 2011.

Review action plans

As part of our continuous improvement and quality control efforts, KPMG has a dedicated audit quality function that participates in the development of remedial action plans and monitors the timely implementation, execution, and effectiveness of those plans.

Other inquiries or investigations of audits carried out by the firm

Currently, we are not aware of any inquiry or investigation by governmental or regulatory authorities against KPMG or any of its partners that might have a material adverse effect on KPMG's operations or our ability to fulfill our obligations as independent auditor to our clients.

In the last five years, we believe that inquiries or investigations by governmental or regulatory authorities related to KPMG's Audit practice have not resulted in material revisions to its audit-related quality control or other procedures.