

October 31, 2016

To the Honorable Mayor and Members of the City Council  
City of Scottsdale, Arizona

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Scottsdale, Arizona (City) for the year ended June 30, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter provided to you during the planning phase of the audit. Professional standards also require that we communicate to you the following matters related to our audit.

**Qualitative Aspects of Accounting Practices**

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by City of Scottsdale, Arizona are described in Note I. to the financial statements. No matters have come to our attention that would require us, under professional standards, to inform you about the methods used to account for significant unusual transactions and the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

As described in Note I.E. of the financial statements, the City implemented the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, for the year ended June 30, 2016. GASB Statement No. 72 requires governments to use certain valuation techniques to measure fair value and establishes a hierarchy of the inputs to valuation techniques used to measure fair value. In addition, certain disclosures are required about the fair value measurements, the level of fair value hierarchy, and the valuation techniques.

As described in Note I.F. of the financial statements, a prior period adjustment was reported which increased the net position of governmental activities by \$666.6 million. This adjustment was necessary to properly account for the underlying land of streets received as capital contributions from developers and dedicated to the City prior to June 30, 2006. The City had previously recorded the entire capital contribution to the streets category, which is a depreciable category. This correction moves the portion attributable to land from the streets category to the land category, a non-depreciable category.

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 significantly from management's current judgments.

The most sensitive estimates affecting the financial statements are:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time management estimates those assets will provide some economic benefit in the future.
- Management's estimate of the accrued compensated absences is based on leave rates and City policies regarding payment of unused vested leave.
- Management's estimate of the allowance for uncollectible receivable balances is based on past experience and future expectation for collection of various account balances.
- Management's estimate of the insurance claims incurred but not reported is based on information provided by the entity's third party administrators and subsequent claims activity.
- The assumptions used in the actuarial valuations of the pension and other postemployment benefits plans are based on historical trends and industry standards.
- Management's estimate of the pollution remediation liability is based on projected cash flows of future remediation expenses.

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

#### **Difficulties Encountered in Performing the Audit**

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

#### **Audit Adjustments**

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements as a whole and each applicable opinion unit.

#### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### **Management Representations**

We have requested certain written representations from management, which are included in the management representation letter provided to us at the conclusion of the audit.

#### **Management Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City of Scottsdale, Arizona's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants regarding auditing and accounting matters.

### **Discussions with Management**

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

### **Compliance with Ethics Requirements Regarding Independence**

The engagement team, others in our firm, and as appropriate, our firm, have complied with all relevant ethical requirements regarding independence. Heinfeld, Meech & Co., P.C. continually assesses client relationships to comply with relevant ethical requirements, including independence, integrity, and objectivity, and policies and procedures related to the acceptance and continuance of client relationships and specific engagements. Our firm follows the "Independence Rule" of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. It is the policy of the firm that all employees be familiar with and adhere to the independence, integrity, and objectivity rules, regulations, interpretations, and rulings of the AICPA, U.S. Government Accountability Office (GAO), and applicable state boards of accountancy.

### **Responsibility for Fraud**

It is important for both management and the members of the governing body to recognize their role in preventing, deterring, and detecting fraud. One common misconception is that the auditors are responsible for detecting fraud. Auditors are required to plan and perform an audit to obtain reasonable assurance that the financial statements do not include material misstatements caused by fraud. Unfortunately most frauds which occur in an organization do not meet this threshold.

The attached document prepared by the Association of Certified Fraud Examiners (ACFE) is provided as a courtesy to test the effectiveness of the fraud prevention measures of your organization. Some of these steps may already be in place, others may not. Not even the most well-designed internal controls or procedures can prevent and detect all forms of fraud. However, an awareness of fraud related factors, as well as the active involvement by management and the members of the governing body in setting the proper "tone at the top", increases the likelihood that fraud will be prevented, deterred and detected.

### **Restriction on Use**

This information is intended solely for the use of the members of the City Council and management of City of Scottsdale, Arizona and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

*Heinfeld, Meech & Co., P.C.*

Heinfeld, Meech & Co., P.C.  
Phoenix, Arizona

# Fraud Prevention Checklist

The most cost-effective way to limit fraud losses is to prevent fraud from occurring. This checklist is designed to help organizations test the effectiveness of their fraud prevention measures.

## **1. Is ongoing anti-fraud training provided to all employees of the organization?**

- Do employees understand what constitutes fraud?
- Have the costs of fraud to the company and everyone in it — including lost profits, adverse publicity, job loss and decreased morale and productivity — been made clear to employees?
- Do employees know where to seek advice when faced with uncertain ethical decisions, and do they believe that they can speak freely?
- Has a policy of zero-tolerance for fraud been communicated to employees through words and actions?

## **2. Is an effective fraud reporting mechanism in place?**

- Have employees been taught how to communicate concerns about known or potential wrongdoing?
- Is there an anonymous reporting channel available to employees, such as a third-party hotline?
- Do employees trust that they can report suspicious activity anonymously and/or confidentially and without fear of reprisal?
- Has it been made clear to employees that reports of suspicious activity will be promptly and thoroughly evaluated?
- Do reporting policies and mechanisms extend to vendors, customers and other outside parties?

## **3. To increase employees' perception of detection, are the following proactive measures taken and publicized to employees?**

- Is possible fraudulent conduct aggressively sought out, rather than dealt with passively?
- Does the organization send the message that it actively seeks out fraudulent conduct through fraud assessment questioning by auditors?
- Are surprise fraud audits performed in addition to regularly scheduled audits?
- Is continuous auditing software used to detect fraud and, if so, has the use of such software been made known throughout the organization?

- 4. Is the management climate/tone at the top one of honesty and integrity?**
  - Are employees surveyed to determine the extent to which they believe management acts with honesty and integrity?
  - Are performance goals realistic?
  - Have fraud prevention goals been incorporated into the performance measures against which managers are evaluated and which are used to determine performance-related compensation?
  - Has the organization established, implemented and tested a process for oversight of fraud risks by the board of directors or others charged with governance (e.g., the audit committee)?
- 5. Are fraud risk assessments performed to proactively identify and mitigate the company's vulnerabilities to internal and external fraud?**
- 6. Are strong anti-fraud controls in place and operating effectively, including the following?**
  - Proper separation of duties
  - Use of authorizations
  - Physical safeguards
  - Job rotations
  - Mandatory vacations
- 7. Does the internal audit department, if one exists, have adequate resources and authority to operate effectively and without undue influence from senior management?**
- 8. Does the hiring policy include the following (where permitted by law)?**
  - Past employment verification
  - Criminal and civil background checks
  - Credit checks
  - Drug screening
  - Education verification
  - References check
- 9. Are employee support programs in place to assist employees struggling with addictions, mental/ emotional health, family or financial problems?**
- 10. Is an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?**
- 11. Are anonymous surveys conducted to assess employee morale?**