Franchise Fees Audit
October 2010

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Franchise Fees Audit

Office of the City Auditor
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Project #09-08 **October 15, 2010**

Executive Summary

Franchise fee revenues have remained stable or increased over the past several years

Adequate controls over franchise fees have not been established

Approximately $82,000 in underpaid telephone and taxicab franchise fee revenue

Outside consultant identified gas franchise fee underpayments of $185,190

Opportunities for Improvement

- ***Periodic review of all franchise fee payments***
- ***Centralized receipt of telephone fee payments***
- ***Standardized remittance form for telephone companies***
- ***Increased controls over taxicab franchise fees***

As part of the Fiscal Year 2009 Annual Audit Plan, the City Auditor's Office conducted an audit of Franchise Fees. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The objectives of the audit were to determine whether:

- Franchise fees were received from all applicable operators;
- Franchise fees were calculated accurately and paid in a timely manner; and,
- Controls are in place to adequately protect the collecting, processing, posting and reconciling of franchise revenue.

During this audit, the City Auditor's Office noted that franchise fees were not received from all applicable operators, specifically taxicabs and telephone companies. Some taxicab companies did not pay the required street use fee, which is a violation of city code and resulted in an estimated revenue loss of approximately $6,700. The review of telephone franchise fees indicated that 23 operators had not paid their quarterly fee which was estimated at $44,355.

Most franchise fees appeared to have been calculated accurately and paid in a timely manner. However, a re-calculation of franchise fees paid by telephone companies indicated possible underpayments of approximately $30,522.

In January 2010, the City Attorney's Office contracted with an outside consultant to conduct a review of gas franchise fees. The consultant's review identified underpayments of approximately $185,000 and approximately $9,500 in interest. More detail regarding the consultant's review is included in this report.

The City Auditor's Office concluded that an adequate separation of duties exists within the Financial and Management Resources Department (FMR) to properly account for franchise fees collected. However, it appears that centralization could make the

collection process more efficient. The City Auditor's Office also noted that controls over taxicab window decals should be strengthened.

These findings and recommendations are discussed in the Detailed Audit Findings section of the report.

Audit Scope and Methodology

The audit was conducted in accordance with generally accepted government auditing standards. The following methodology was used in completing the audit.

- Discussed franchise fee procedures with various employees within the City Attorney's Office, FMR, Water Utilities Department and Handitran
- Reviewed City Code of Ordinances (City Utility Code), Local Government Code, Council Resolutions, and franchise agreements
- Reviewed the Public Utility Commission of Texas (PUC) website
- Reviewed franchise fee payment records for FY2008 through the second quarter of FY2010
- Performed a recalculation of franchise fees paid
- Reviewed franchise operators' payment remittance forms

Electric

The City Auditor's Office obtained quarterly kilowatt-hour (kWh) totals from Oncor Electric. Due to proprietary reasons, Oncor representatives did not provide us with customer information to support their reported totals. We therefore could not perform any tests to validate Oncor's reported kWh sold nor could we verify that Oncor reports included all of their Arlington customers.

There are several other electric companies operating within Arlington (e.g., Cirro Energy, Direct Energy, First Choice Power, Reliant Energy, etc.). However, since Oncor is the transmission/distribution company that sells electricity to these companies, Oncor is responsible for paying electric franchise fees. Electricity that Oncor provides to other electricity companies should be included in Oncor's quarterly reporting.

During the audit, management indicated that an outside consultant may be asked to perform a compliance audit at some time in the future.

Gas

The City Auditor's Office reviewed Atmos Energy's quarterly payment history to determine whether payments were being made in a timely manner. Due to a recent audit of Atmos Energy by an outside consultant, we did not perform any additional test procedures.

The City contracted with J. Stowe & Company in January 2010 to conduct a review of franchise fees paid to the City of Arlington by Atmos Energy Mid-Tex. Information publicized by J. Stowe & Company indicated that the consultant had vast experience in the review of franchise fee payments and appeared to be qualified to perform the work. In April 2010, the consultant concluded that Atmos was largely in compliance with the agreement concerning franchise fees paid to the City of Arlington from 2007 to 2009. However, the consultant indicated that in 2009, Atmos made a unilateral decision to exclude certain revenue that had been included in payments prior to that period. The consultant also indicated that Atmos excluded from gross revenue, monies donated in support of others that could not pay their bills, as well as pipeline gas purchase disallowance refunds. Additionally, Atmos remitted its April 2009 payment based on the incorrect franchise fee rate. Based on the consultant's preliminary findings, estimated franchise fee underpayments,

including interest, was approximately $195,000. Management indicated that there have already been discussions to resolve the audit discrepancies with Atmos.

Cable

Due to time constraints, we did not perform a review of AT&T Mobility (digital cable) financial records. At the time of our request for information, AT&T representatives stated that there were approximately 700 previous requests for audit information and that it would be several months before they would be able to process our request.

Time Warner Cable (TWC) allowed an on-site review of their financial records, including a customer list. TWC informed the City Auditor's Office that TWC overpaid franchise fees over several months due to "bundled" services. An example of bundled services is when a customer's phone, cable and internet services are included in one package. Per TWC, the Director of Government Relations – North Texas Division is working with City of Arlington personnel to resolve this issue. By the end of the audit field work, no information had been provided regarding a resolution.

Telephone

The City's financial records and information posted on the PUC website were reviewed to obtain reasonable assurance that telephone franchise fee payments were accurate. The City Auditor's Office chose not to perform a detailed review of active telephone access line records since franchise fees are based on information provided to the PUC and the process necessary to review telephone company records is very time consuming, as outlined below.

1) The City must notify the Certificated Telecommunications Provider (CTP) by certified mail and tell them why a review of their records is necessary.
2) Within 21 days of receipt of the request, the CTP must provide the City with a written list of business records necessary to conduct the review.
3) The City must then request the specific records that they want to review and provide written notice to the CTP.
4) Within 30 days of the request, the CTP must provide the business records.

Once this process is complete, the City can only review the business' records: 1) on each CTP's premises, 2) at each CTP's principle Texas office, and 3) records may not be removed or reproduced without permission of the CTP.

Utilities

The Water Utilities Department provided detailed information as to how the utility franchise fee was calculated. The information provided was sufficient to allow the City Auditor's Office to reasonably verify the fee calculation.

Sanitation

Republic Waste Services provided adequate financial information to determine, with reasonable assurance, that they are calculating their franchise fee accurately. Republic also provided a customer listing so their customer base could be validated.

Taxicab

Handitran personnel are responsible for collecting revenues related to the taxicab franchise fee. The City Auditor's Office was provided detailed information relating to the various taxicab companies operating within Arlington, along with revenue received from those companies.

Background

Franchise fees are established and amended through the approval process of the City Council. Any time there is a rate change or verbiage change in any of the franchise documents, an ordinance must be approved by the City Council.

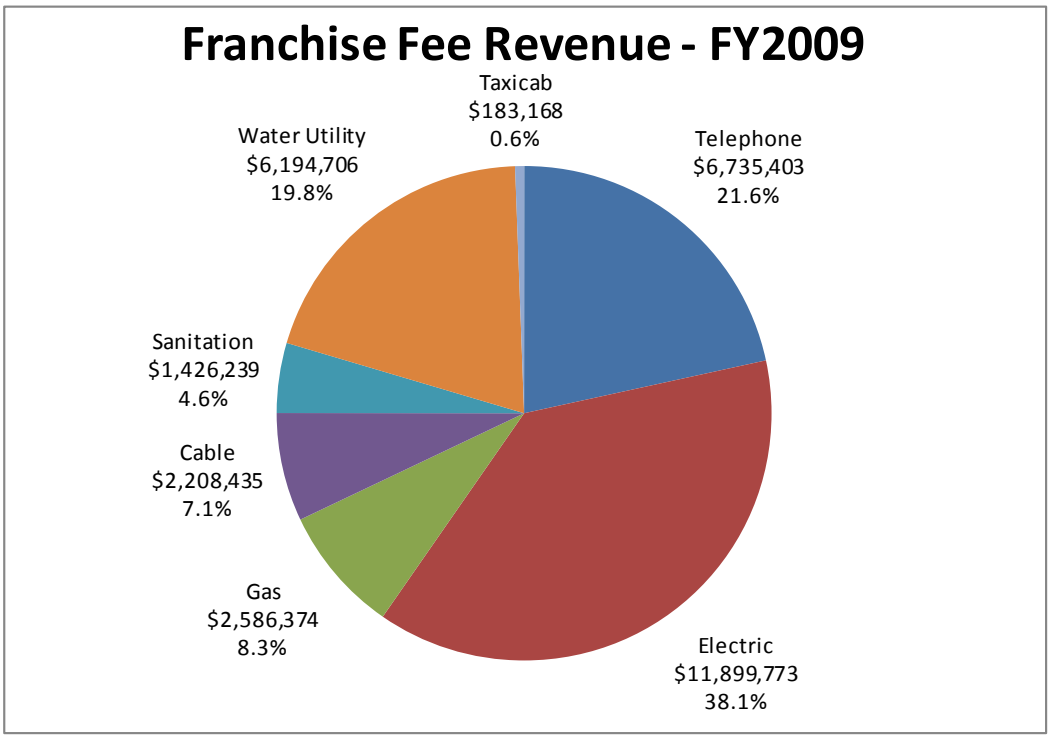
Franchise fees are paid by vendors for the use of city streets, alleys, grounds, and public right-of-ways. The City of Arlington currently receives franchise fee payments from vendors engaged in the business of providing electric, gas, telephone, water and sewer, sanitation, cable and taxicab service to the citizens of Arlington. Even though the franchise operator is required to pay the franchise fee, the operator is allowed to recoup those fees. The estimated amount of the franchise fee is passed along to the individual customer on monthly billings, which is in turn included in the operator's gross revenue. As noted in the following chart, the basis for most franchise fees is gross revenue, with the exception of electric, telephone and taxicabs.

City Franchise Operators

Category	Vendor Name	Frequency	Current Fee Basis	Payment Method
Electric	Oncor (TXU) Electric	Quarterly Annually	Per kWh Delivered 4% of Discretionary Chgs	Wire Transfer
Gas	Atmos Energy	Quarterly	5% of Gross Revenue	Wire Transfer
Telephone	AT&T Various others	Quarterly Quarterly	Per Access Line @ Rate Established by PUC	Wire Transfer Check
Water	City of Arlington	Monthly	5.8% of Gross Revenue (less Water/Sewer Impact Fee and Interest Income)	Interfund Transfer
Sanitation	Republic Waste Services (Duncan Disposal)	Monthly	5% of Gross Commercial Revenue	Check
Cable	Time Warner Cable AT&T U-Verse	Monthly Quarterly	5% of Gross Revenue 5% of Gross Revenue	Wire Transfer Check
Taxicab	Various	Monthly	$270/vehicle/year	Check

Source: City Ordinances, Local Government Code and Franchise Agreements

The following pie chart shows FY2009 franchise fee revenue ($31,234,098), by revenue source, as reflected within Lawson.



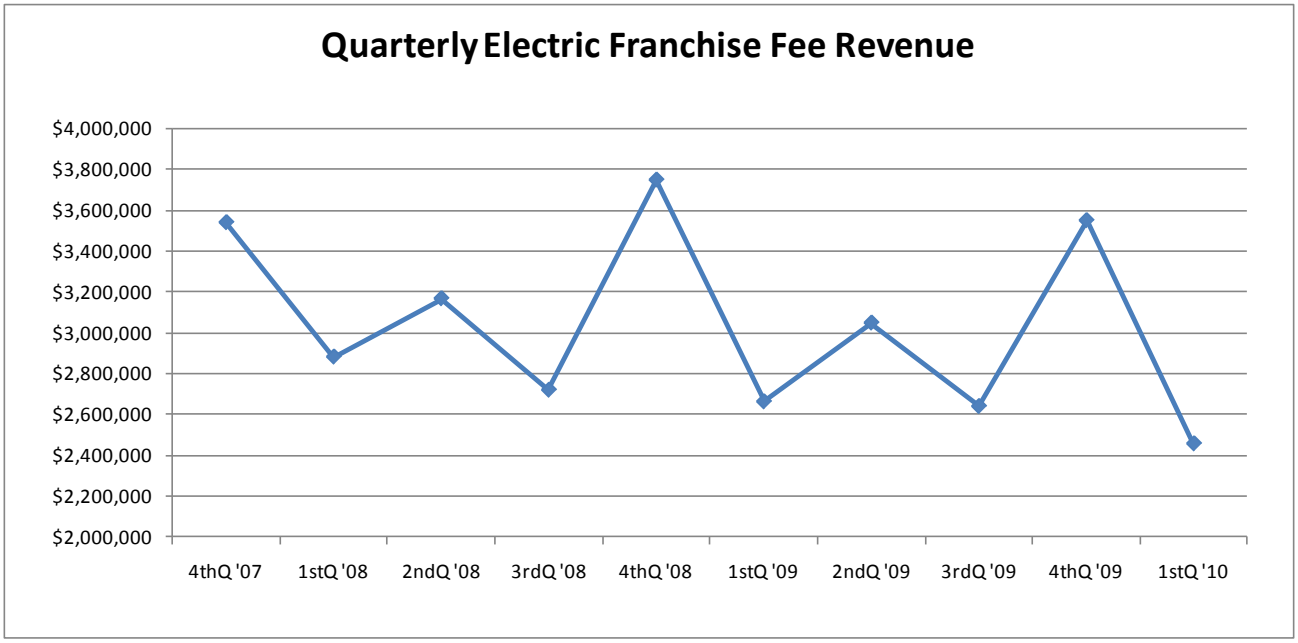
Source: Lawson Financial System

Charts showing the history of revenues received, by calendar quarter, for each franchise source during FY2008 through the 2nd Quarter of 2010 are shown on the following pages. Fees are paid by the operators in the month subsequent to the actual revenue (i.e. for 3rd Quarter gross revenue totals, the franchise fee is paid during the 4th Quarter). The basis for each franchise, method of payment, etc. is noted above each chart.

Electric

The electric franchise fee is governed by Article 4 of the City Utility Code and Title 2, Subtitle B, Chapter 33 of the Texas Local Government Code. Oncor Electric is the City of Arlington's electricity provider. Oncor sends a remittance letter prior to sending franchise fee payments to the City via wire transfer. The remittance letter shows the basis period, the total kWh delivered, the rate factor and the payment amount.

Electric franchise revenue is highly dependent on weather fluctuations. The following chart shows that the revenue appears to follow the trend that would logically be expected for annual usage. During hotter months, higher electric usage is necessary to cool homes; therefore, revenue peaks during the 4th quarter of each year (July, August and September sales). During the fall, winter and spring months, when the temperatures are colder or more moderate, homes use less electricity.

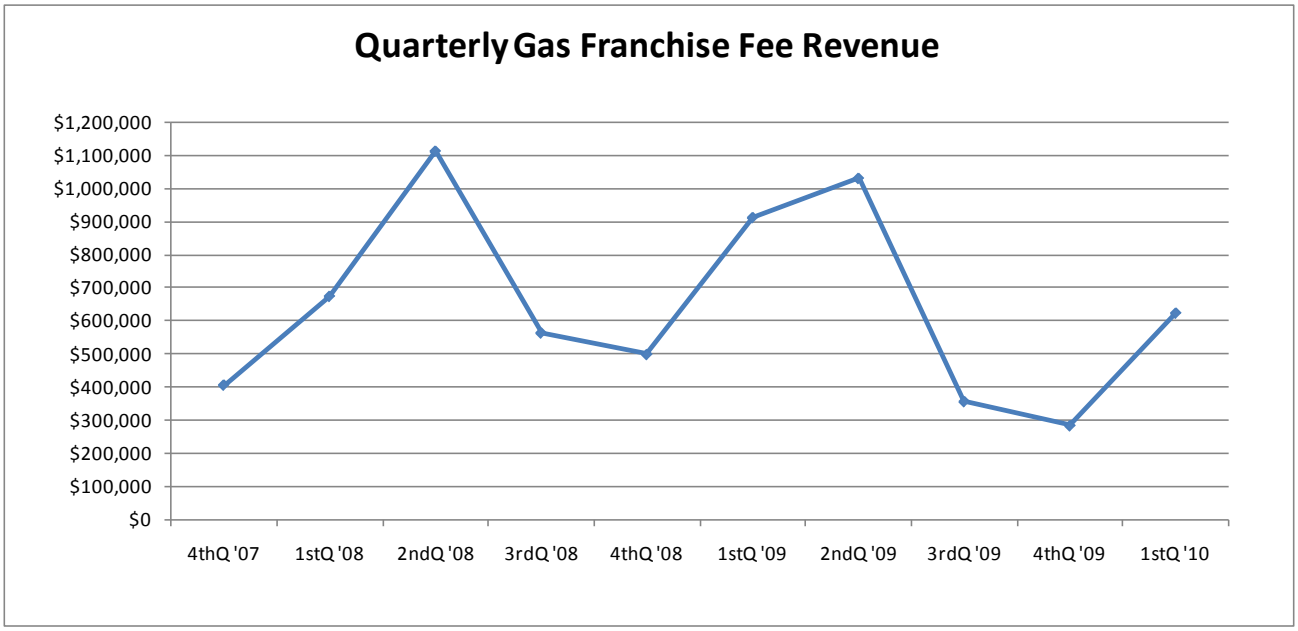


Source: Auditor-prepared, based on franchise fees received

Gas

The gas franchise fee is governed by Article 3 of the City Utility Code and Title 3, Subtitle A, Chapter 103 of the Texas Local Government Code. Atmos Energy is the City of Arlington's gas provider. Atmos Energy sends a remittance letter prior to sending franchise fee payments via wire transfer. The remittance letter includes the gross revenue totals for the various categories, the franchise fee rate and the payment amount.

As with electric revenue, gas revenue is highly dependent on weather fluctuations. The following chart shows that gas revenue appears to follow the trend that would logically be expected for annual usage. During the hotter months of July through September (4th quarter payments), gas usage is minimal. Therefore, gross revenue to the operator is lower. During quarters when temperatures cool off or warm up, revenues rise or fall accordingly. However, during the months of January through March (2nd Qtr payments), when temperatures are normally the coldest, gas revenue increases significantly.

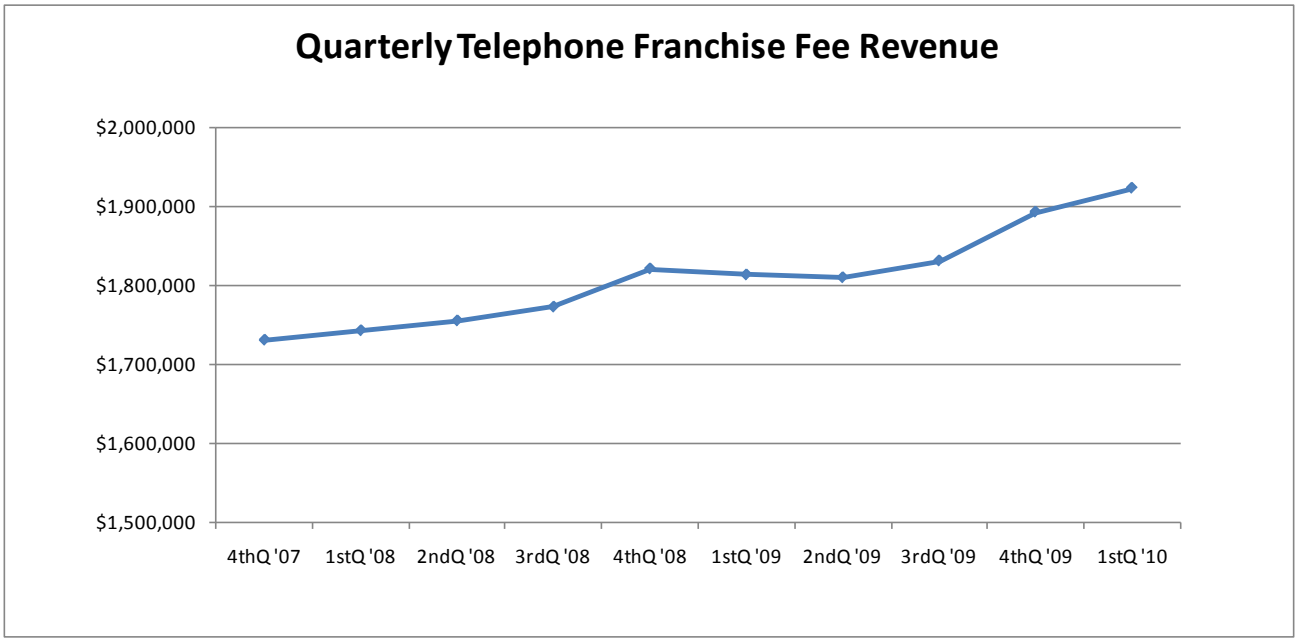


Source: Auditor-prepared, based on franchise fees received

Telephone

The telephone franchise fee is governed by Title 9, Subtitle A, Chapter 283 of the Texas Local Government Code. In 1999, the Texas Legislature passed legislation that eliminated municipal telephone franchise agreements. To provide telephone service to Texas cities, a telephone company is required only to be certified by the PUC as a CTP. The franchise fee is based on the number of access lines the company is operating within the city multiplied by a specific rate (by category) which is set by the PUC. There are approximately 60 companies that provide telephone service to the citizens of Arlington. During this review, it was noted that many of the telephone companies (42 of 60) sent a remittance letter with their franchise fee payment. The remittance letters contained the number and category of access lines, the PUC rate and the payment amount. The remaining telephone companies (18 of 60) only sent a check.

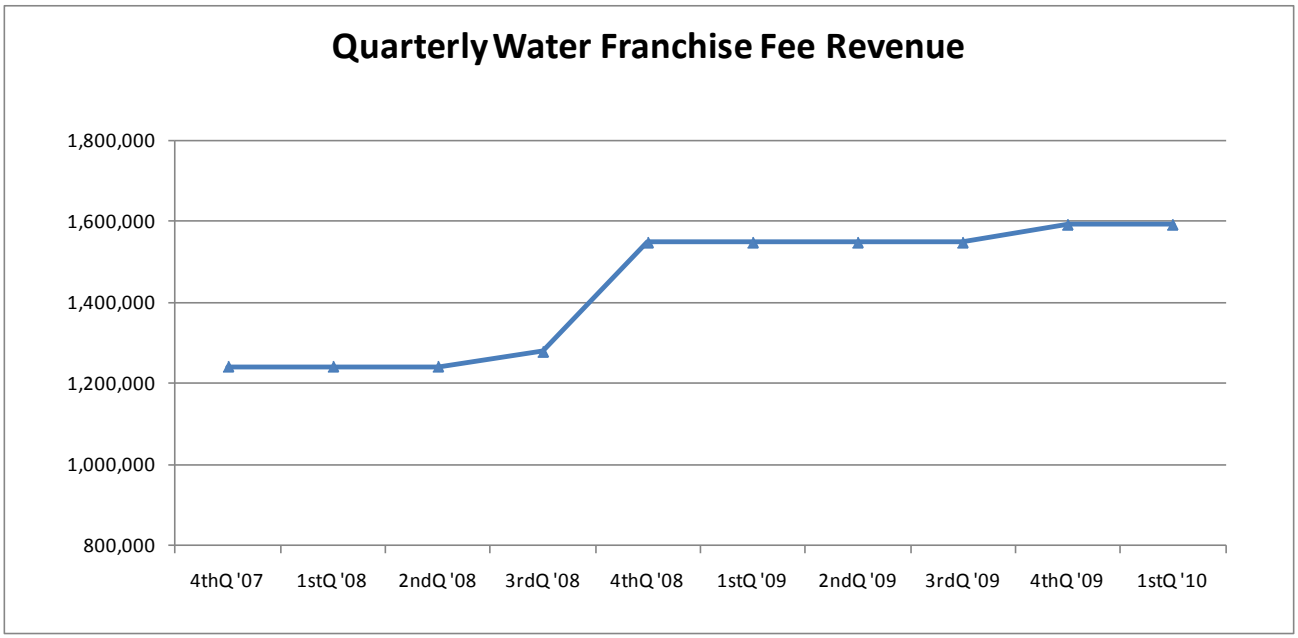
As noted in the following graph, the telephone franchise fee revenue has steadily increased over the years. The City Auditor's Office noted that for AT&T, telephone fee revenue has decreased over time (from $1,363,689 in the 4th Qtr 2007 to $1,139,888 in the 1st Qtr 2010), possibly due to the widespread use of cellular phones and customers disconnecting land lines. However, video service (cable) has increased significantly during that same time period (from $16,854 in the 4th Qtr 2007 to $335,572 in the 1st Qtr 2010) due to the introduction of AT&T U-Verse. Most other telephone company fee revenue has remained fairly constant, with some slight increases or decreases.



Source: Auditor-prepared, based on franchise fees received

Water

The water utility franchise fee is established through the City's annual budget process. This franchise fee is based on the total estimated utility revenue less water and sewer impact fees and interest income. For several years, the franchise fee was calculated at 5% of the estimated utility revenue. In FY2009, the 5% rate was used to calculate the annual fee. However, in order to help balance the budget, the Water Utilities Department was required to pay an additional $800,000, which created an effective rate of 5.8%. For the 2010 budget, the 5.8% rate was used to calculate the utility franchise fee. Once the annual amount of the franchise fee is calculated by the Water Utilities Department, a recurring entry of 12 equal installments is entered into the Lawson accounting system. At the end of the year, if the total revenue is greater or smaller than the original estimate, a "true-up" calculation is performed and an entry is made to adjust appropriately.

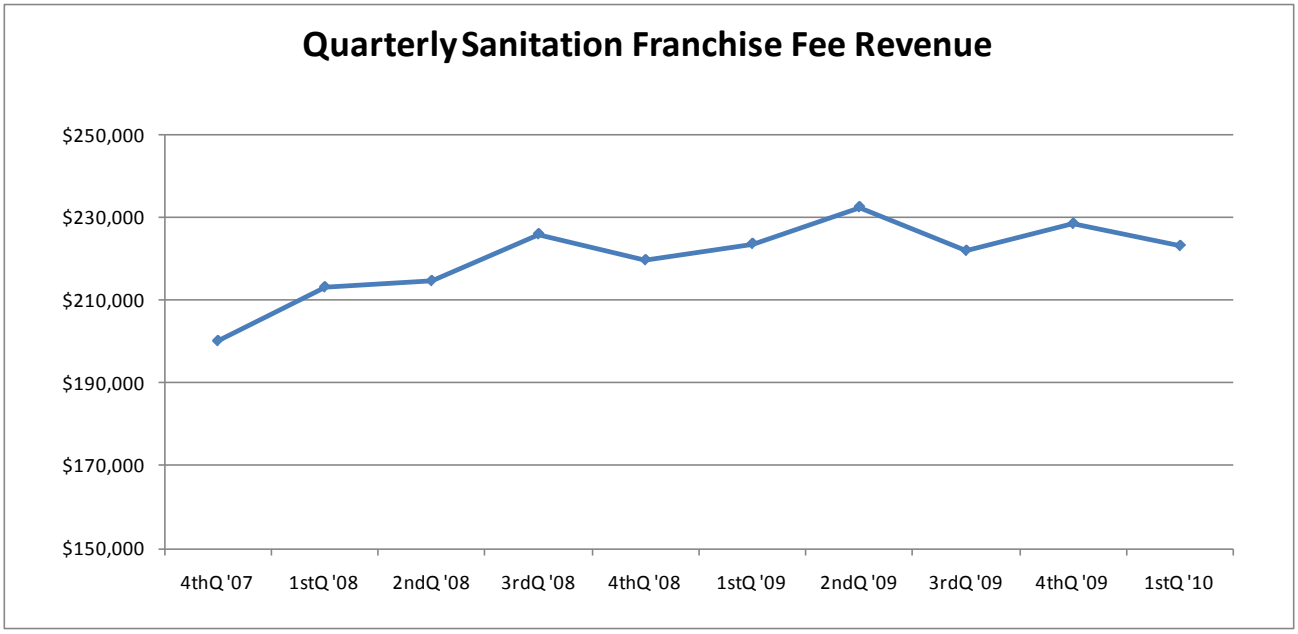


Source: Lawson Financial System

Sanitation

The sanitation franchise fee is governed by a contract between Republic Waste Services of Texas, Ltd. and the City of Arlington. The contract allows the operator to use the public streets, alleys and thoroughfares within the city limits to collect and deliver disposal waste. The franchise fee is related to the gross revenue obtained from the commercial and industrial business sector. Republic's revenue is determined by the size of the disposal container and the number of dumps during the month for each customer being serviced.

During this review, it was noted that Republic Waste Services sends a remittance letter with their franchise fee payment. The letter contains the monthly gross billings for commercial/industrial customers, the fee rate and the payment amount. The following graph shows that the sanitation franchise fee revenue has slightly trended upward over the past years.

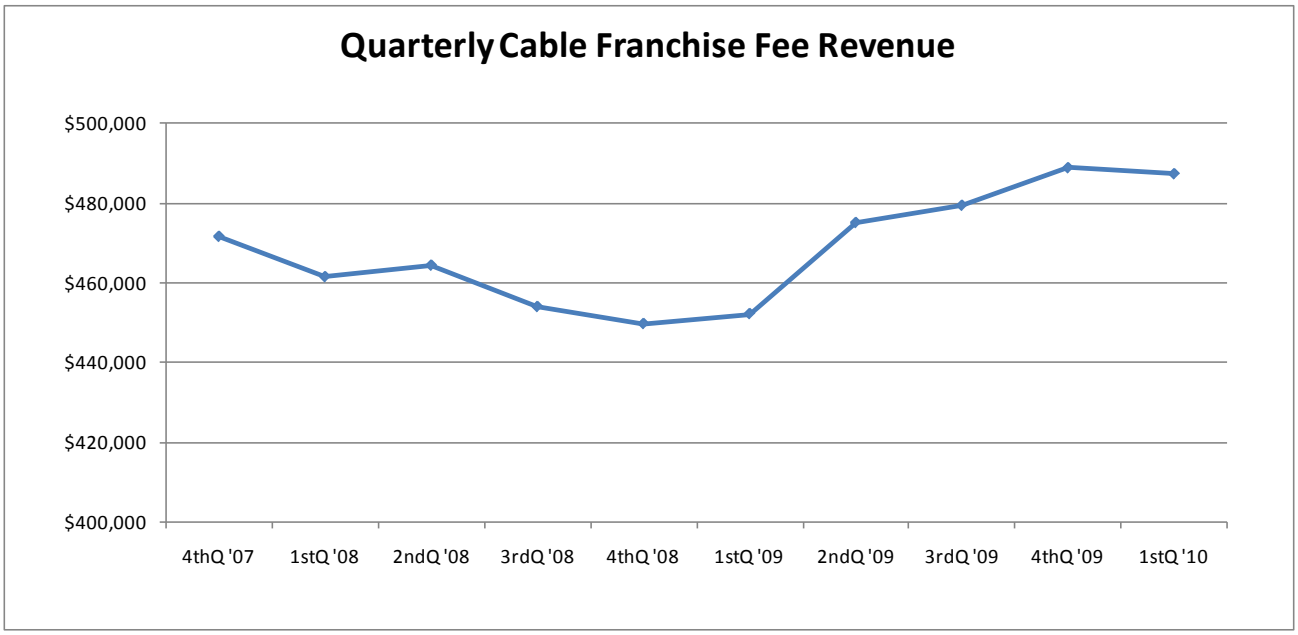


Source: Auditor-prepared, based on franchise fees received

Cable

The AT&T U-Verse franchise fee is governed by Texas Local Government Code Title 2, Subtitle C, Chapter 66 and is regulated by the PUC. Time Warner Cable, until recently, was governed by a franchise agreement between the City of Arlington and Time Warner Cable Company. However, on August 12, 2010, this cable franchise agreement expired and has now changed to a state franchise that is governed by the same Local Government Code mentioned above.

During this audit, it was noted that both AT&T and Time Warner Cable send a remittance letter with their franchise fee payments. The AT&T remittance letter contains the gross revenue for the period, the fee rate and the payment amount. Time Warner Cable's remittance letter includes the payment amount, along with a summary of gross revenue for the period.

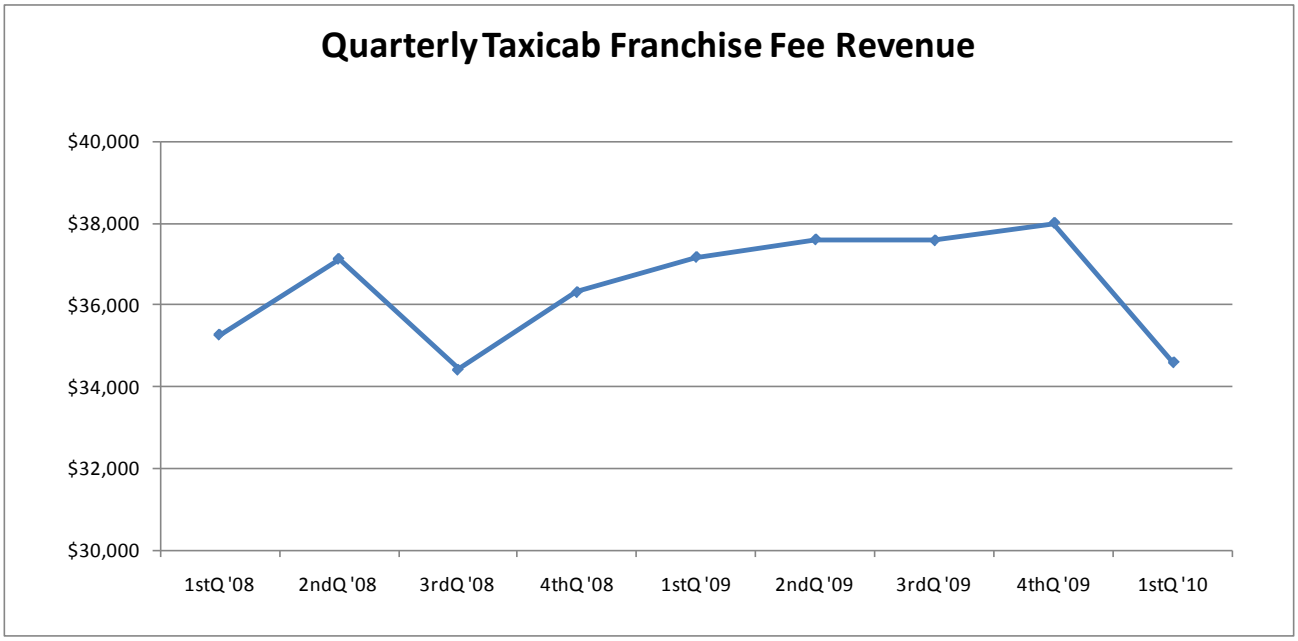


Source: Auditor-prepared, based on franchise fees received

Taxicab

The taxicab franchise fee is governed by the Transportation Chapter of the City of Arlington Code of Ordinances. Employees within Handitran are responsible for collecting these fees. The street use fee is $270 per vehicle, per year. There are also several other fees which are detailed in Finding #1 of this report.

Based on the authorized number of taxicabs operating in Arlington, taxicab franchise fee revenue is expected to be consistent. However, some delinquent payments in the 1st, 3rd and 4th quarters of 2008 caused revenue to be reduced. Also, during the 1st Qtr of 2010, one of the operators decreased their authorized vehicles from 100 to 30, which caused a drop in revenue.



Source: Auditor-prepared, based on franchise fees received

Detailed Audit Findings

1. Adequate controls do not exist to ensure that franchise fees are accurate and collected as required by City ordinance.

In order to ensure that franchise operators are paying the appropriate fees, tests should be performed on a routine basis to ensure compliance with established franchise ordinances. Discussions with various city personnel indicated that no one reviews payments and/or related documentation to ensure accuracy. Nor is anyone making sure that the City has received payments from all operators.

Franchise fees (other than taxicab) that are paid by check are sent to FMR. FMR lists the check payments on a schedule, prepares the deposit, and records the franchise fees within the appropriate general ledger account. FMR retains the deposit records, and on a monthly basis, prepares a list of all franchise fees received. At the end of each fiscal year, this list is given to the external auditor for review during the annual audit. The list provided to the external auditor is simply obtained from the Lawson accounting system. Although FMR appears to have established an adequate segregation of duties, the lack of a review process could lead to missed revenue. As noted below, our audit results indicated missed revenue totaling approximately $82,000 for the period October 1, 2007 through March 31, 2010.

FMR management indicated that a proposal was being prepared to obtain the assistance of an outside consultant to periodically review franchise fees. The proposal was planned to be presented to the City Council on September 28, 2010. At the end of the audit fieldwork, no additional information had been provided regarding the proposal. On October 12, 2010, the City Council authorized MuniServices to conduct franchise fee compliance reviews of Time Warner, Atmos Energy, AT&T and TXU Energy, on behalf of the City of Arlington.

<u>Telephones</u>
Within 45 days of the end of each quarter, telephone companies are required to report their number of access lines, by category and by city, to the PUC. The telephone companies are then required to submit franchise fee payments to the City based on the number of access lines and the rate established by the PUC. This information, which is published on the PUC website, is available to validate telephone franchise fees submitted to the City of Arlington.

The PUC reported that during the period being audited (FY2008 through March 2010), there were approximately 55 to 60 telephone companies operating access lines within the Arlington city limits. Most companies were operating during the entire audit period; however, others were only in existence for a portion of the time. After comparing information on the PUC website to FMR's deposit records, the City Auditor's Office concluded that 23 companies had not paid quarterly franchise fees, even though they had reported access lines to the PUC. The unpaid fees were estimated at $44,355, as shown in the following table.

Telephone Access Lines Reported to PUC
Non-Payment to City

Company Name	2007	2008				2009				2010	
	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	Totals
Category 1 :											
ACN Communications Services	-	-	-	-	-	130	114	-	-	-	244
Amerimex Comm.	-	-	33	-	-	-	-	-	-	-	33
Broadlink Telecom	131	137	110	95	92	81	69	69	33	33	850
CallNet Communications	-	-	-	-	24	28	5	-	-	-	57
Connect I.T.	-	-	-	-	123	175	-	-	42	44	384
Excel Telecommunications	258	237	151	140	112	115	108	88	77	58	1,344
Global Connection of America	-	-	-	-	-	-	5	22	18	20	65
Navigator Telecommunications	-	10	-	-	-	-	-	-	-	-	10
New Talk, Inc. dba Get A Phone	423	423	625	691	-	-	-	-	-	-	2,162
Powernet Global Communicatio	47	-	153	-	-	-	-	-	-	-	200
Quality Telephone	-	-	70	56	12	30	39	27	46	21	301
Tim Ron Enterprises	-	-	-	-	-	-	6	-	-	-	6
Total Telephone Service Co.	11	16	11	9	8	6	30	-	-	-	91
Westel, Inc.	-	5	3	3	-	-	-	-	-	-	11
Total Lines Reported	870	828	1,156	994	371	565	376	206	216	176	5,758
Effective PUC rate	$2.62	$2.62	$2.62	$2.66	$2.66	$2.66	$2.66	$2.72	$2.72	$2.72	
Franchise Fees Owed (Cat. 1)	$2,279.40	$2,169.36	$3,028.72	$2,644.04	$986.86	$1,502.90	$1,000.16	$560.32	$587.52	$478.72	$15,238.00
Category 2:											
Broadview Networks	-	-	-	-	51	48	48	48	50	51	296
CallNet Communications	-	-	-	-	9	6	-	-	-	-	15
Cypress Communications	-	-	-	-	6	6	6	6	-	-	24
Formost Telecommunications	-	-	15	-	-	-	-	-	-	-	15
Global Crossing Telemanageme	-	-	-	-	-	-	-	-	6	-	6
Metropolitan Tele aka MetTel	-	62	100	-	-	-	-	-	-	-	162
Navigator Telecommunications	-	600	-	-	-	-	571	-	543	-	1,714
NOS Communications	-	-	-	-	24	-	-	-	-	-	24
Powernet Global Communicatio	-	-	99	-	-	-	-	-	-	-	99
Tel West Network	-	-	-	-	-	-	-	1,272	-	-	1,272
Total Telephone Service Co.	11	19	11	10	18	22	16	-	-	-	107
USCom Telephone	75	75	50	-	-	-	-	-	-	-	200
Westel, Inc.	-	71	53	40	37	29	23	21	22	21	317
Total Lines Reported	86	827	328	50	145	111	664	1,347	621	72	4,251
Effective PUC rate	$6.61	$6.61	$6.61	$6.71	$6.71	$6.71	$6.71	$6.85	$6.85	$6.85	
Franchise Fees Owed (Cat. 2)	$568.46	$5,466.47	$2,168.08	$335.50	$972.95	$744.81	$4,455.44	$9,226.95	$4,253.85	$493.20	$28,685.71
Category 3:											
Excel Telecommunications	-	-	44	-	-	-	-	-	-	-	44
Looking Glass Networks	-	-	-	-	3	-	-	-	-	-	3
Tel West Network	-	-	-	-	-	-	-	8	-	-	8
Total Lines Reported	0	0	44	0	3	0	0	8	0	0	55
Effective PUC rate	$7.80	$7.80	$7.80	$7.92	$7.92	$7.92	$7.92	$8.09	$8.09	$8.09	
Franchise Fees Owed (Cat. 3)	$0.00	$0.00	$343.20	$0.00	$23.76	$0.00	$0.00	$64.72	$0.00	$0.00	$431.68
Total Franchise Fees Due to City	$2,847.86	$7,635.83	$5,540.00	$2,979.54	$1,983.57	$2,247.71	$5,455.60	$9,851.99	$4,841.37	$971.92	$44,355.39

Note 1: This schedule shows payments that should have been submitted during the calendar quarter. Associated access line counts were reported to the PUC during the previous quarter.

Note 2: Broadlink Telecom's 3rd quarter 2009 and New Talk's 1st quarter 2008 access lines were estimated based on the previous quarter's report. No access lines were reported to the PUC for those periods.

Note 3: Excel Telecommunications did not report May 2008 access lines to the PUC. The number of lines reported in April was also used as the May count when estimating the 3rd quarter 2008 total.

In addition, it appeared that other telephone companies paid the wrong amount. Fees received from 54 telephone companies during the 1st and 3rd quarters of 2009 and 1st Qtr 2010 were recalculated using the PUC rate schedule. A total of 134 payments were recalculated. Of the 134 payments, 114 (85%) were recalculated with no exception. However, there appears to have been a net underpayment of approximately $30,522 for the aforementioned quarters. A schedule of the net underpayments is shown in the following table.

Telephone Franchise Fees
Questioned Underpayments

	1st Qtr 2009			3rd Qtr 2009			1st Qtr 2010			Total Net Over/
Company	Amt. Paid	Calculated	Variance	Amt. Paid	Calculated	Variance	Amt. Paid	Calculated	Variance	(Under)Pymt
AireSpring, Inc.	$925.98	$925.98	$0.00	$513.75	$509.96	$3.79	$513.75	$513.75	$0.00	$3.79
AT&T Texas - ILEC	1,246,360.62	1,258,229.17	(11,868.55)	1,181,229.48	1,193,911.56	(12,682.08)	1,139,888.11	1,150,870.43	(10,982.32)	(35,532.95)
Birch Telecom of Texas *	37,911.33	37,911.33	0.00	33,017.32	33,198.49	(181.17)	28,827.97	29,012.78	(184.81)	(365.98)
Broadwing Communications	2,985.95	2,985.95	0.00	2,966.05	2,965.82	0.23	2,671.50	2,671.50	0.00	0.23
BullsEye Telecom	2,489.41	2,402.18	87.23	2,461.78	2,522.96	(61.18)	0.00	0.00	0.00	26.05
CBeyond Communications of Texas **	13,273.92	11,360.03	1,913.89	13,340.41	0.00	0.00	13,955.25	12,035.45	1,919.80	3,833.69
Cleartel Telecommunications	319.18	319.18	0.00	268.46	262.96	5.50	0.00	0.00	0.00	5.50
Global Crossing Telemanagement	20.13	20.13	0.00	34.25	33.55	0.70	41.10	41.10	0.00	0.70
Inter-Tel Netsolutions (Mitel Netsolutions)	3,895.98	3,895.98	0.00	4,367.76	4,278.45	89.31	3,984.16	3,984.16	0.00	89.31
Level 3 Communications	332.64	332.64	0.00	419.76	419.76	0.00	372.14	347.87	24.27	24.27
McLeod USA Telecommunications **	17,898.78	0.00	0.00	21,450.98	21,448.61	2.37	21,998.98	21,998.98	0.00	2.37
Metropolitan Tele aka MetTel	766.36	764.94	1.42	988.30	986.37	1.93	0.00	0.00	0.00	3.35
nii Communications	1,871.85	1,871.85	0.00	634.13	611.76	22.37	0.00	0.00	0.00	22.37
NTS Communications	631.17	631.17	0.00	452.78	452.78	0.00	259.70	348.75	(89.05)	(89.05)
Talk America Communications / Cavalier	147.10	142.18	4.92	135.47	135.47	0.00	95.21	97.21	(2.00)	2.92
Tel West Network Services	7,407.84	7,407.84	0.00	0.00	0.00	0.00	9,772.50	9,672.79	99.71	99.71
Time Warner Cable Info (Digital)	68,339.90	68,339.90	0.00	73,986.41	72,360.63	1,625.78	74,696.27	74,696.27	0.00	1,625.78
Trans National Comm (TNCI, Inc.) **	579.48	885.72	(306.24)	1,394.27	0.00	0.00	1,024.37	986.40	37.97	(268.27)
United Communications dba Call One	635.58	635.58	0.00	345.84	345.84	0.00	258.61	264.02	(5.41)	(5.41)
TOTALS	$1,406,793.20	$1,399,061.75	($10,167.33)	$1,338,007.20	$1,334,444.97	($11,172.45)	$1,298,359.62	$1,307,541.46	($9,181.84)	($30,521.62)

* includes payments to Ionex Communications South

** Variance not calculated. Payment considered reasonable when compared to previous or subsequent quarters; however, nothing was reported on PUC website.

Total underpayments listed in the aforementioned charts were based on information published on the PUC website. The City Auditor's Office did not verify the PUC information. However, cities rely on PUC's publication when determining the amount of franchise fees due.

As noted in the Background section of this report, some telephone companies do not submit a remittance form when paying their quarterly franchise fees. A remittance form would help management identify discrepancies between the number of lines published by the PUC and the number of lines on which the franchise fee payment is based.

Taxis

The City of Arlington requires operating certificates, street use fees and driver permits from taxicab companies operating within the city of Arlington. Handitran employees are currently responsible for collecting fees prescribed by the Transportation Code as they relate to taxicabs operating within the city. The Transportation Code relates only to taxicab companies picking-up passengers within Arlington. Companies that pick up passengers outside Arlington may drop them off in Arlington without requiring certification.

Article II, Section 2.01 of the City's Transportation Code states that "No person shall operate any taxicab service or special service transportation vehicle service (which vehicles and services are not within the exclusive jurisdiction of the Interstate Commerce Commission) within the jurisdiction of the City without first having obtained a certificate.…"

Article III, Section 3.08 (A) states that "The certificate holder shall pay to the Administrator a street use fee as set by resolution for total number of vehicles authorized under the terms of the certificate pro-rated per month."

Article IV, Section 4.01 states "Every person desiring to drive a taxicab, jitney or special service transportation vehicle in the City shall apply for and obtain a permit from the Administrator. It shall be unlawful for a certificate holder to permit any person to drive a taxicab, jitney or special service transportation vehicle under authority of such certificate unless such driver shall have a permit in good standing duly issued by the Administrator."

A review of the accounting records retained by Handitran indicates that appropriate franchise fees are being received from 12 taxi companies operating in Arlington. According to Handitran personnel, several other taxi companies have been observed operating within the city limits. Taxicabs licensed by another governmental entity and transporting a passenger from a point outside the City to a destination inside the City are exempt from Arlington's street use fee if the taxicab leaves Arlington without receiving a passenger inside Arlington. City staff would, therefore, have to determine whether other taxis observed are actually receiving a passenger inside Arlington. Such verification would appear to be a difficult task. However, if taxi companies are receiving passengers in Arlington without paying the street use fee, total missed revenue could be significant since taxi companies consist of numerous vehicles. The current fee schedule is as follows.

Taxicab Fees	
Application fee Certificate to Operate Taxicab Service or Special Transportation Service:	$750.00
Annual Street Use Fee (per vehicle):	$270.00
Driver Permit Fee:	$25.00
Driver Permit Replacement Fee:	$10.00
Taxicabs, Special Service Transportation Vehicles and Jitneys Vehicle Inspection Fee (uninspected):	$25.00
Taxicabs, Special Service Transportation Vehicles and Jitneys Vehicle Re-Inspection Fee (uninspected):	$10.00

Source: Council Resolution 07-770, as amended

Handitran relies on taxicab companies to pay their fees each month. Normally, companies pay street use fees in person at the Handitran office at which time they receive decals for their vehicles. However, on occasion, companies may not pay their monthly fee, violating city code. During the audited period, non-payments were estimated at $6,682.50. These non-payments represent months in which taxicab payments were skipped. Handitran personnel stated that it is very difficult to obtain payment once the month has passed. The City Auditor's Office was informed that Handitran recently implemented a process whereby Handitran staff makes courtesy calls to taxicabs with unpaid street-use fees.

Recommendation:

The Chief Financial Officer (CFO) should require that staff compare telephone franchise payments received to the PUC website, on a quarterly basis, to confirm that franchise fees were received from all companies that reported access lines to the PUC.

Management's Response:

Partially Concur. As an alternative to this recommendation, the Mayor and City Council have authorized hiring a third party to review and monitor franchise fees.

Target Date: January 1, 2011

Responsibility: Mike Finley, Assistant Director of Financial and Management Resources

Audit Comment:

Since the third party contract relates to only two of the 60 telephone franchisees (AT&T and Time Warner), management may still want to consider at least an occasional review of compliance by telephone franchisees other than AT&T and Time Warner. Comparative analysis would have required minimal effort to identify the 23 companies that provided access lines to Arlington citizens, but did not forward fee payments to the City as required.

Recommendation:

For telephone companies that did not submit payment, based on the comparison mentioned above, the CFO should seek payment.

Management's Response:

Concur. Following completion of this audit, these findings will be sent to the respective franchisees as official documentation of under or over payment. Financial and Management Resources will send a letter seeking payment or providing a rebate for the telephone companies that did not submit accurate payment based on the audit findings.

Target Date: December 1, 2010

Responsibility: April Nixon, Director of Financial and Management Resources

Recommendation:

The CFO should recalculate, on at least a sample basis, telephone franchise payments received. Based on sample results, management should pursue companies that have underpaid, if deemed cost effective.

Management's Response:

Partially Concur. Based on results of third party franchise fee monitoring, FMR will attempt to recover underpayments from all the City's major utility franchisees.

Target Date: January 1, 2011

Responsibility: Mike Finley, Assistant Director of Financial and Management Resources

Recommendation:

The CFO should consider billing telephone companies for unpaid franchise fees totaling approximately $75,000.

Management's Response:

Concur. Following completion of this audit, these findings will be sent to the respective telephone franchisees as official documentation of under or over payment. Financial and Management Resources will send a letter seeking payment or providing a rebate for the telephone companies that did not submit accurate payment based on the audit findings.

Target Date: December 1, 2010

Responsibility: April Nixon, Director of Financial and Management Resources

Recommendation:

The CFO should ensure that a standardized form is created and made available to those required to pay telephone franchise fees. The form should include the basis on which the

amount paid was calculated and an attestation regarding the correctness of information provided. A copy of the form should be e-mailed, faxed or mailed to franchisees that submit payment without the form.

Management's Response:

Do Not Concur. As the Internal Auditors have pointed out in the first three recommendations, much of the information that would be captured on a standardized form is available on the PUC website, and these companies are required by law to provide the correct amount of franchise fees to be paid. The third party vendor will monitor new and current utilities on the PUC website.

Target Date: January 1, 2011

Responsibility: Mike Finley, Assistant Director of Financial and Management Resources

Recommendation:

The CFO should consider billing taxicab companies for the approximate $6,700 in missed revenue.

Management's Response:

Concur. Handitran staff will analyze the make-up of the unpaid and underpaid taxicab revenue and then determine the cost effectiveness of pursuing any amounts owed to the City.

Target Date: January 1, 2011

Responsibility: Bob Johnson, Handitran Manager

Recommendation:

The CFO should assign an individual(s) the responsibility of establishing appropriate controls to ensure that all franchise revenue is received in accordance with City requirements.

Management's Response:

Concur. FMR staff will work with a third party to monitor franchise fee revenue and establish appropriate controls to ensure franchise fee revenue is received in accordance with City requirements.

Target Date: January 1, 2011

Responsibility: Mike Finley, Assistant Director of Financial and Management Resources

2. The collection of telephone franchise fees is not assigned to one specific person, division or department.

As noted in Finding #1 of this report, tests should be performed on a routine basis to ensure compliance with established franchise ordinances. Currently, telephone franchise fees are

collected via mail within FMR and the City Attorney's Office. However, multiple persons are not granted access to the PUC website that reports telephone access line counts.

During a 1998 lawsuit styled *Southwestern Bell Telephone Company v. City of Arlington*, the City Attorney's Office was listed as the main contact. Many companies, therefore, still mail their check directly to the City Attorney's Office. Upon receipt of franchise payments, City Attorney's Office staff makes a record of checks received. The checks are then forwarded to FMR for deposit and posting within Lawson.

The City Attorney's Office indicated that there is nothing in the litigation that requires the City Attorney to be the contact person. However, the PUC does require an actual named person to be the contact. This contact person will receive the annual CPI adjustment notifications and will be the person who the PUC assigns the password to access the confidential information relative to those access line counts reported to and listed on the PUC's website.

Recommendation:

The CFO should ensure that franchise fee checks, other than for taxicabs, be mailed directly to FMR for processing. Those companies that mail checks to the City Attorney's Office should be contacted to change the mailing address for their payments.

Management's Response:

Concur.

Target Date: January 1, 2011

Responsibility: David Barber, Assistant City Attorney

3. The current process does not adequately account for vehicle decals printed for taxicab street use franchise fees.

Accounting for the numerical sequence of vehicle decals is necessary to ensure proper recording and accountability of taxicab franchise fee revenue. Once a year, 1,000 decals for each month are printed and numbered. The City's Print Shop is responsible for printing the decals, as requested by Handitran staff. Upon receipt of the printed decals, the pre-numbered decals are issued to taxicabs authorized to operate within the city. Handitran staff is available to distribute decals to taxi companies for a two-hour period, two days a week.

As taxicab companies pay their monthly street use fee, they are issued the requested number of decals. Handitran management emphasized that taxi companies may not request street use fees for all of their vehicles (e.g., the company does not plan to operate all of their vehicles within the corporate limits of Arlington). Companies that allow taxicabs to operate within the City of Arlington without paying the street use fee are in violation of City code. Handitran management indicated that they rely on the Code Compliance Division and the Police Department for enforcement. However, the Code Compliance Division focuses on compliance during major events while the Police Department focuses on compliance with traffic law.

There are currently 493 vehicles authorized to operate within the city. Since 1,000 decals are printed, 507 decals are not used. Handitran indicated that some decals are unusable due to misalignment of the printing machine, while others are simply not used because they are not needed. Per Handitran, misprinted or unused decals are shredded.

Handitran personnel keep records of all decals that are issued to taxicab companies. However, there is no record of which decal numbers were not used, why they were not used, or the disposition. In order to properly account for decals, Handitran should document the disposition of all printed decals.

Recommendation:

The Transit Manager should ensure that adequate records are retained concerning all printed decals.

Management's Response:

Concur.

Target Date: January 1, 2011

Responsibility: Bob Johnson, Handitran Manager

Recommendation:

The Transit Manager should limit the printing of decals to a reasonable number, thereby decreasing monthly printing costs.

Management's Response:

Concur.

Target Date: January 1, 2011

Responsibility: Bob Johnson, Handitran Manager

In response to audit recommendations made by the City Auditor's Office, management provided the following background information.

Background

Audits of utility franchise fee payments over the last decade (like the audit of Atmos Energy payments recently conducted by the City Attorney's Office) have been paid for by City departments, and have been conducted intermittently. Franchise fee auditing has not been centralized in any single department. Over the years, the City Attorney's Office, the Public Information Office, and others have conducted these audits. The City has primarily depended on the utilities to properly report their information to the PUC and then remit the appropriate franchise payments to the City. When reviews are conducted, the amounts of underpayment and overpayment vary. According to this audit, the recent Atmos review identified a significant underpayment; but as you see with the

sampling of telephone franchise fees, the findings indicate an underpayment each year of less than one half of one percent of the total telephone franchise fees collected.

According to the audit, of the 19 phone companies that were reviewed, 14 overpaid and five underpaid. ATT, our largest phone company, represented 98 percent of the under payments. The other four companies underpaid by an average of $192 over the two year period.

The City recognizes that all revenues are important and due diligence should be exercised to ensure all dollars owed are collected; however, hiring staff members to do this review and monitoring may not be the most cost effective approach. On October 12, 2010, the Mayor and Council approved a contract with Muni Services, Inc., a third party auditing firm, that will perform this review for us. We will be paying $20,000 a year for them to audit our largest gas, phone, electric, and cable providers. They bring a team of people to the project with connections and specialized knowledge for accessing information about the City's franchise utilities. The audits will include reviewing utilities' documentation, testing procedures, analyzing billing, and mapping residents within our borders to ensure the City is getting the franchise fees it is owed. These services are actually more comprehensive than those recommended in the audit.

Many of the responses to this audit involve the use of this third-party service provider.

Audit Comment:

As noted in management's background discussion, the City has primarily depended on the utilities to properly report their information to the PUC and then remit the appropriate franchise payments to the City. Our preliminary fieldwork indicated that management had not assigned anyone to monitor and/or verify that utilities properly remitted their franchise payments. As mentioned in the Audit Scope and Methodology section of this report, the City Auditor's Office chose not to conduct field visits of the CTPs due to the amount of time required to access the information. However, a comparative analysis was deemed necessary due to the level of assessed risk. For example, not assigning a person the responsibility to account for and/or verify franchise fee payments was considered a high risk.

Management's responsibility is to perform periodic risk assessments, identify necessary controls, capture and communicate pertinent information and monitor the quality of the control systems over time. Consistent monitoring and communication with franchisees will increase compliance over time. The City Auditor's Office did not intend for any of the audit recommendations to result in the hiring of additional staff. Based on our audit results, the amount of effort required to conduct quarterly analysis does not warrant an additional position. PUC quarterly access line count reports can be copied and pasted from the PUC website to an Excel file for ease of analysis.

The City Attorney's Office contracted with a consultant to review Atmos' accounting policies related to gross receipts, review accounting procedures that were applied to customer and non-customer revenue, obtain an understanding of the annexation procedures for transfer of customers to the City service area, and obtain an understanding of franchise fee receipts from customers, NSF charges, etc. In contrast, the review conducted by the City Auditor's Office was based solely on comparative data (e.g., PUC website versus total payment to the City). The compliance review

initiated with MuniServices (by FMR in October 2010) includes a review of franchise agreements, relevant state law, and analysis of general ledgers, financial statements, provider revenue, etc. A review of this extent is comparable to the Atmos review and should help identify revenues that have been excluded from the franchise fee calculation. While the use of an outside consultant can be a significant part of an internal control system, it should not be the stand-alone control that ensures compliance with franchise fee requirements.