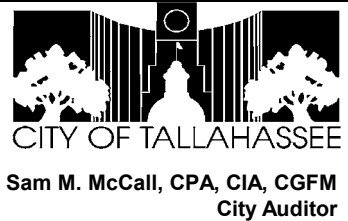


Audit Report

of the



“Franchise Agreement with Comcast Cable Communications, Inc., of Tallahassee”

Report #0217

May 17, 2002

Summary

In January 2002, the Office of the City Auditor was informed of the results of a Leon County review of franchise fees paid by Comcast Cable Communications, Inc. (Comcast). The review claimed that Comcast had paid the City franchise fees that were owed to the County for the period October 1, 1998, to September 30, 2001, due to jurisdiction coding errors in the Comcast billing system. Based on the County’s review, Comcast initially withheld \$195,807 in franchise fees due to the City for the third quarter, 2001, until the County’s claim was or was not substantiated.

After correspondence with the City Auditor and the City Attorney, Comcast remitted the \$195,807 to the City, and the Office of the City Auditor embarked on an audit of the franchise agreement between the City and Comcast for the three-year period ending September 30, 2001. One of the audit objectives was to determine the accuracy of the jurisdiction coding in the Comcast billing system and verify the County’s results.

During our audit, we noted the following:

- We concurred that the miscoded addresses identified by the County as “City” should have been “County.” In addition, we identified more miscoding errors in the County’s favor. Our analysis of the accuracy of jurisdiction coding in the Comcast billing system indicated that there were over 5,800 errors among the 82,788 addresses (7%). We identified 2,688 addresses that were miscoded as county and should have been city; and 3,173 addresses that were miscoded as city and should have been county.
- Comcast has not fully complied with the City Cable Ordinance in that they have not provided the City with the required annual,

audited, and certified financial statements of revenue for each of the last three fiscal years. When we brought this issue to the attention of Comcast, they agreed to engage their independent auditors to prepare the required reports.

- Subsequent to fieldwork, Comcast provided an audited schedule of gross revenues for the years ending December 31, 1999 and 2000, and the nine months ending September 30, 2001, and we were able to verify the accuracy of the franchise fee payments made by Comcast for that same period. We noted no exceptions.
- Generally, there appeared to be adequate controls in place to ensure that the received payments from Comcast were properly received and deposited.
- Revisions to the State’s Telecommunications Act, effective October 1, 2001, change the responsibility in collecting and auditing franchise fees from telecommunication companies from the local jurisdictions to the Department of Revenue.

We have met with Comcast and Leon County to share the results of our analysis of the accuracy of the jurisdiction coding in the Comcast billing system. We also communicated that the City should not be responsible for any franchise fees or related interest due to the County based on the miscoding of jurisdictions in the Comcast billing system by Comcast employees.

Scope, Objectives, and Methodology

The scope of this audit included a review of the franchise fees due the City and collected from Comcast for the period of October 1, 1998, to September 30, 2001.

Our objectives for this report are to determine:

1. the accuracy of customer’s jurisdiction coding (City or County) in the Comcast billing system;
2. compliance with the City Cable Ordinance and Franchise Agreement requirement; and
3. the accuracy and timeliness of the payment and deposit of franchise fees by Comcast to the City for the period October 1, 1998, to September 30, 2001.

To achieve our objectives, we: reviewed the contractual documentation; reviewed payments made to the city for timeliness and accuracy; recalculated expected franchise fees based on audited schedule of gross revenues; and determined when the received monies were deposited into the City’s accounts. In addition, we conducted tests to determine if Comcast had obtained the appropriate insurance bonds and provided the required reports to the City. Finally, we worked with the Information Systems Services Geographic Information System (GIS) Coordinator to utilize the GIS to determine the accuracy of the jurisdiction coding in the Comcast billing system.

These audit procedures were conducted in accordance with Generally Accepted Government Auditing Standards and Standards for the Professional Practice of Internal Auditing, as appropriate.

Background

Leon County’s Review of Franchise Fees and Jurisdiction Verification

In January 2002, our office was informed that Leon County had engaged a consultant to conduct a review of Comcast franchise fees due and paid to the County during the period October 1, 1998, through September 30, 2001. Included in the review was an examination of the jurisdiction coding of the addresses in the Comcast billing system. The County’s review was designed to identify only addresses that were miscoded as City and should be County. The results of their review identified 1,661 miscoded jurisdictions out of 82,788 addresses. The County’s review did not, however, consider that there could be addresses that were miscoded as County and should be City.

The County presented their review results to Comcast and requested payment for the franchise fees that were due to the County for the revenues

that would have been paid by the customers at the miscoded addresses. Based on the County’s claim of underpayment of franchise fees due to the miscoding of records, Comcast deducted the underpayment amount (\$195,807 including interest and penalties) from the City’s franchise fee payment stating that the City had been overpaid that same amount. Subsequently, after correspondence with the City Auditor and City Attorney, Comcast remitted the entire \$195,807 to the City.

Therefore, to respond to Comcast’s and the County’s claim that the City had been overpaid and to ensure that the City had been paid the appropriate franchise fees, one of our audit objectives is to determine the accuracy of the customer’s jurisdiction coding in the Comcast billing system.

Cable Ordinance and Franchise Agreement

The City is authorized to grant franchises for the construction and maintenance of a cable communications system that is to be made available to the residents and institutions of the City through Chapter 13, Article V of the City of Tallahassee Code of Ordinances. In 1992, the City and Comcast entered into a three-year franchise agreement. The franchise agreement contained an option to renew for an additional seven-years (exercised in 1995). The current franchise agreement will expire on September 1, 2002.

The terms of the agreement include, but are not limited to, the following provisions:

- Comcast is granted the right, privilege, and authority to construct, operate, maintain, and reconstruct a cable communications system within the streets, alleys, and public ways of the City.
- Comcast shall provide citywide cable communications to the residents and institutions of the City.
- Comcast and the City shall adhere to the provisions of the Cable Ordinance; however, if there is conflict between the agreement and the ordinance, the express terms of the agreement shall prevail.
- Comcast shall provide some cable access to City buildings, education buildings, and other public buildings.

- Comcast shall provide video coverage of City Commission meetings.
- Comcast shall construct (but does not maintain) a defined path of fiber optic network at no charge.
- Subscribers shall have rights, including non-discrimination of service, subscriber contracts, notification regarding accessing private property, privacy of subscriber information, billing practices, resolution of complaints and complaint tracking, and outages.
- Comcast shall file all rates and charges with the City.
- Comcast is to obtain adequate performance bond to guarantee its financial obligations.
- Comcast shall pay to the City a franchise fee of 5% of gross revenues received from City residents, or the maximum permitted by law during the period of operations pursuant to the provisions of the Cable Ordinance.

Residency, also referred to as jurisdiction, indicates where an address is located, i.e., City of Tallahassee or Leon County. The total amount of gross revenues collected from City residents determines the amount of franchise fees due to the City by Comcast.

Comcast utilizes a billing system to track customer

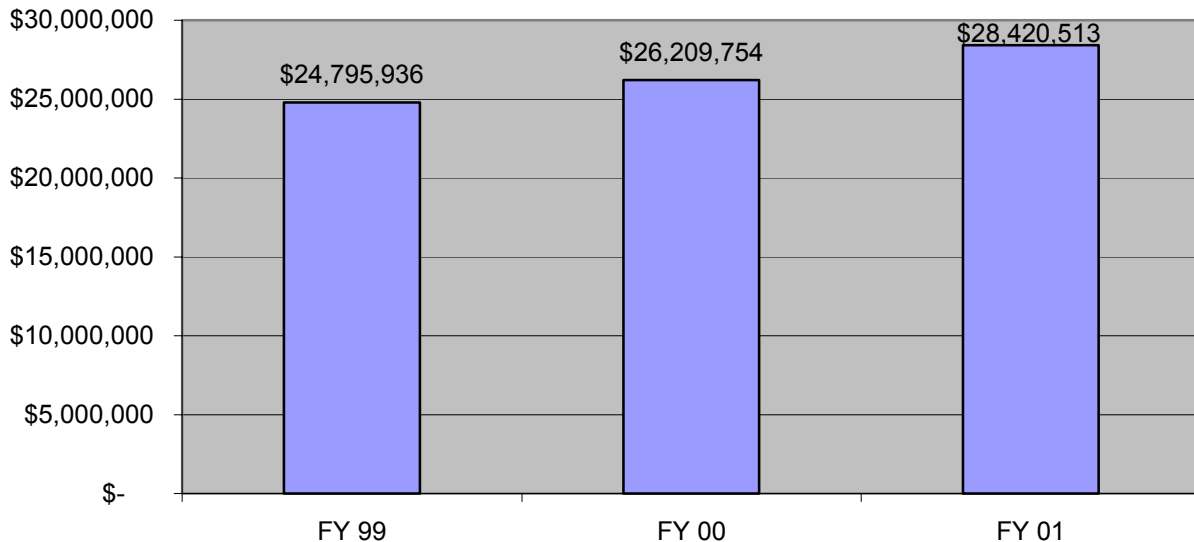
accounts, including identifying the services provided, issuing bills, and recording payments. The billing system has a database of all addresses to which cable service could be provided. A franchise code indicates the jurisdiction in which the address is located. Comcast employees responsible for the installation of cable at the residences and institutions determine the franchise code. Comcast has not verified their addresses and franchise codes with either the City or the County.

The Cable Ordinance defines gross revenues as “all revenue derived directly or indirectly by the Grantee, its affiliates, subsidiaries, and any person in which the Grantee has a financial interest from the operation of the Grantee’s cable system pursuant to a franchise granted by the City.” In 1999, the gross revenue definition was revised in a settlement agreement to mean net of bad debt expense. Therefore, Comcast deducts the non-collected accounts receivable from the gross revenues and then calculates the franchise fee on that amount.

Comcast prepares quarterly “statement of gross revenues” showing a summary of revenue sources and amounts, number of customers served, and fees due the City. The revenue is recorded on the accrual basis and the revenue statements and fees are reported to the City. Figure 1 shows the gross revenues reported by Comcast for each fiscal year (FY) in the audit period.

Figure 1

Comcast Gross Revenues by Fiscal Year

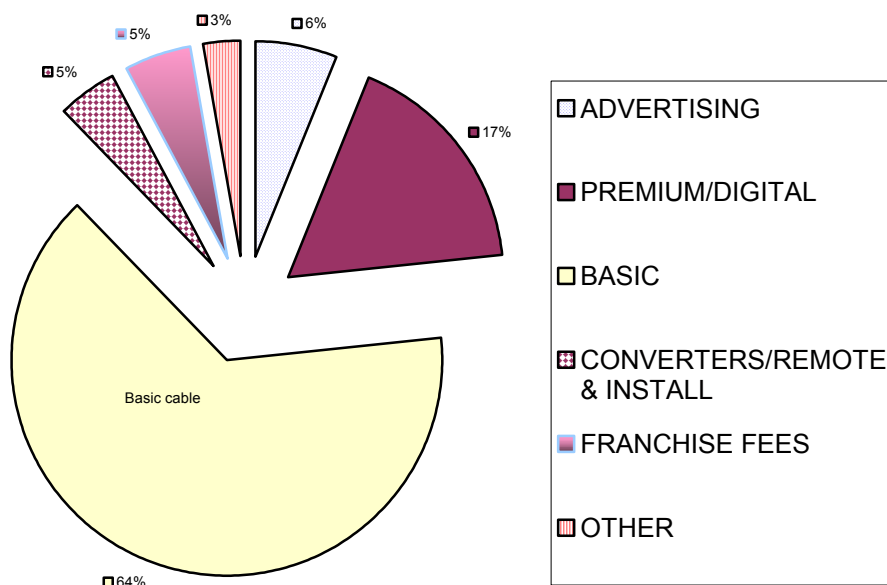


The gross revenues are generated from the various services provided by Comcast. In FY 2001, the majority (\$18.3 million) of the total

gross revenues (\$28.4 million) were generated from basic cable services. Figure 2 shows a breakdown of the revenue sources reported by Comcast for FY 2001.

Figure 2

FY 2001 Source of Comcast Gross Revenues

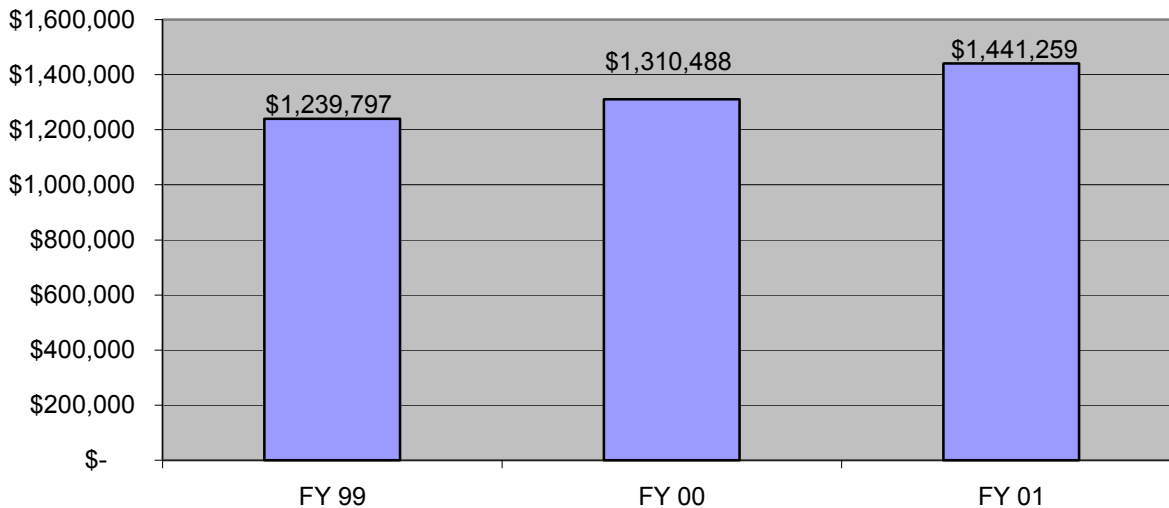


The City deposited \$3,991,543 for franchise fees earned during the three-year audit period. Comcast reported total gross revenues of \$79,426,203 over

the same period. Figure 3 shows the franchise fees collected for each of the same three fiscal years.

Figure 3

Total Franchise Fees Paid to the City by Year



Issues Identified in Prior Audits

There have been two prior audits conducted related to the Comcast Franchise Agreement:

- “Report on an Audit of the Franchise Agreement Between the City of Tallahassee and Comcast Cablevision of Tallahassee, Inc.” issued in February 1995 (#J9310). The two main issues addressed in this audit included the types of revenues that were and were not included in the calculation of “gross revenues” and the miscoding of city Comcast accounts as county. Auditors tested a sample of addresses from the Comcast billing system to determine if the addresses were coded to be in the correct jurisdiction. Specifically, they identified some county addresses that were incorrectly coded as county and should have been city. As a result of that audit, Comcast corrected the coding errors.
- “Comcast Franchise Revenue Audit” (#9806), resulted in a settlement agreement between the City and Comcast that revised the definition of “gross revenues” in the Cable Ordinance to: 1) exclude bad debt write-offs; and 2) make a payment for back franchise fees due to the City of \$225,000 (June 1999).

The specific errors identified in each of the two prior audits have been resolved, but the cause of the jurisdiction miscoding is still an issue, as shown below.

Assurances

As stated above, our objectives for this audit report are to provide assurances by determining: 1) the accuracy of the address jurisdiction code in the Comcast billing system; 2) compliance with the City Cable Ordinance and Franchise Agreement requirements; and 3) the accuracy and timeliness of the payment and deposit of the franchise fees by Comcast to the City for the period October 1, 1998, through September 30, 2001. Each objective is addressed below.

1. Our analysis of the accuracy of jurisdiction coding in the Comcast billing system indicated that there were over 5,800 “franchise codes” among 82,788 addresses that were incorrect, resulting in an error rate of 7 percent.

As mentioned earlier, Leon County contracted with a consultant to review Comcast’s compliance with the County Franchise Ordinance 92-14, Section 11, Paragraph C. Part of the review included an analysis to verify the accuracy of the jurisdiction coding of addresses in the Comcast billing system. Comcast provided a data set of addresses from their billing system as of March 2001 for the consultant to conduct their analysis. Their analysis of the 82,788 records identified 1,661 miscoded accounts (identified as city when it should have been county) over a 42-month period resulting in an underpayment of \$195,807 (including interest for late payment).

To verify the County’s review results, we obtained the same data set of 82,788 records from Comcast and conducted a similar analysis. We worked with the City’s Information Systems Services Geographic Information System (GIS) Coordinator and compared the addresses and franchise code from the Comcast billing system to the addresses and jurisdiction label (city or county) in the Leon/Tallahassee Inter-local GIS.

We also reviewed the methodology used by the consultant to determine the amount owed to the County. We disagreed with two of their assumptions.

- a. The review period covered 36 months (3 years), but the calculation was based on 42 months (3 ½ years);
- b. The calculation was based on an assumption that each address subscribed to cable service for 100% of the 42-month period. In Tallahassee, there can be a lot of turnover at an address resulting in periods where cable service may not be activated.

A comparison of the data analyses results conducted by the County and the City is provided in Table 1 below.

2. We noted examples of non-compliance and compliance with the City Cable Ordinance and Franchise Agreement.

Comcast did not comply in that they did not provide the required annual, audited, and certified financial statements of revenue for each of the three years in our review period.

To verify that the gross revenues reported by Comcast are accurate, we requested Comcast to provide us with an examination level attestation report consistent with the City Cable Ordinance that requires "annual, audited and certified financial statements of revenue received during the previous calendar year, prepared in accordance with generally accepted accounting principles." Comcast had not provided the City the required financial statements for any of the three years in the audit period. Instead, they provided a statement of gross revenues for the related period, prepared by Comcast employees, detailing the types of revenues collected, the associated bad debt write-offs, and the franchise fees paid. However, the information was not "audited and certified," and therefore we were not satisfied nor could we confirm from an independent source that the financial information presented is accurate.

Subsequent to our fieldwork, Comcast provided an audited schedule of gross revenues for the years ended December 31, 1999 and 2000, and for the nine months ended September 30, 2001. The audit stated that the schedule "presents fairly, in all material respects, the gross revenues," as defined in the Ordinance [Cable Communications Ordinance No. 92-0026AA, as amended by the Franchise Agreement dated August 26, 1992].

Comcast did comply with the Franchise Agreement in that they obtained the required performance bond of \$150,000.

However, the amount had not been revised to cover the associated increased liability, which has grown to approximately \$300,000 during the audit period. The performance bond should have been increased to cover the amount of the franchise fees that would be due. This is no longer an issue for franchise fees, since the Communications Services Tax Simplification Law now requires the businesses (including Comcast) to pay the franchise fees to the Department of Revenue (DOR) rather than the individual jurisdiction. Exclusive of franchise fees, the City should re-evaluate the bond requirement to ensure that it is adequate for any obligations due to the City.

3. Based on audited schedule of gross revenues for the years ending December 31, 1999 and 2000, and the nine months ending September 30, 2001, we were able to verify the accuracy of the franchise fee payments by Comcast for that same period.

We recalculated the expected franchise fees due based on the audited schedule of gross revenues and compared that calculated amount to the actual franchise fee payments received from Comcast. We noted no exceptions.

Overall, Comcast submitted franchise payments to the City in a timely manner.

The Cable Ordinance requires payment to the City within 45 days after the end of each quarter. Of the 13 quarterly payments made to the City during the audit period, Comcast was late on one payment (the final payment) of \$386,868. Comcast submitted partial payment of \$191,061 fifty-six days late, and the remaining balance due of \$195,807 sixty-five days late, causing the City to lose \$3,163 in unearned interest. This occurred when Comcast withheld franchise fees based on the miscoding of addresses reported by the County.

We noted that there appeared to be adequate controls in place to ensure that the payments received from Comcast were properly received and deposited, specifically:

- there was adequate separation of duties between receiving and depositing the franchise fees;
- the franchise fees were deposited into the City's bank account in a timely manner for 12 of the 13 quarterly payments examined during the audit period. However, there was one payment (\$325,263 made in November 2000) that was not deposited timely. There were 89 days from the day the payment was received before it was deposited, resulting in lost interest of approximately \$5,239. In this instance, we could not conclusively determine from City records which department (employee) was responsible for the untimely deposit of this payment. As of October 1, 2001, all franchise fee payments are received in and deposited by the Revenue Office.

Table 1
Results of Comcast Jurisdiction Coding Analyses

Description	Number of Records	
	ATCS ⁽¹⁾	City Auditor
Complete database provided by Comcast for analysis	82,788	82,788
Comcast coded to be in the County	28,570	28,569
Comcast coded not City or County (i.e., Wakulla, Taylor)	n/p	54
Comcast coded to be in the City (ATCS included all records that were not coded as County)	54,220	54,165
Unknown addresses	474 ⁽²⁾	1,127
Miscoded as City, should be County	1,661	3,173
Miscoded as Other, should be County	n/p	18
Miscoded as County, should be City	n/p	2,688
Miscoded as Other, should be City	n/p	4
Average franchise fee per quarter	\$6.92 ⁽³⁾	\$6.92
Number of quarters to base calculation for franchise fees due	14 (42 months)	12 (36 months)
Legend: n/p - not provided ⁽¹⁾ The County contracted with ATCS to conduct the review. ⁽²⁾ ATCS states that County verified that all 474 were county, and that none were miscoded. All unknown addresses were assumed to be coded accurately. ⁽³⁾ ATCS provided an average quarterly franchise fee for each year in the analysis (\$6.91, \$6.94, and \$7.20 respectively).		

To summarize the results of our analysis, we:

- concurred that the 1,661 addresses identified by the County’s review were miscoded and should be county. We identified 1,512 additional addresses that were also miscoded resulting in a total of 3,173 addresses that were miscoded as city and should be county;
- noted that there were 2,688 off-setting addresses that were miscoded as county and should be city; and
- did not determine whether there were coding errors for 1,127 unknown addresses. The majority (91%) of these addresses were rural routes coded to be in the county. To further verify the jurisdiction coding of these addresses, it would require physically visiting each location with a Comcast representative.
- estimated that Comcast has underpaid the County for franchise fees for approximately 503 miscoded addresses, consisting of 18 miscoded as other and 485 (the difference of 3,173 less 2,688) miscoded as city. Rather than \$195,807 claimed due based on 1,661 miscoded addresses, we estimated that the maximum

amount owed (if all addresses were active 100% of the time), without interest and penalty, would be:

503 x 12 quarters x \$6.92 avg. fee= **\$41,769**

Changes Regarding the Payment of Franchise Fees

As of October 1, 2001, the Telecommunications Act (Chapter 202, Communications Services Tax Simplification Law) was revised to “provide a fair, efficient, and uniform method for taxing communications services sold in this state.” The following revisions in the law impact the City.

- Franchise rates previously were negotiated with municipalities; now the Florida Statutes sets the rates for fees and taxes for communication services sold in the state.
- Taxes are collected from the customers and submitted to the Department of Revenue by the dealer of communications services (previously paid directly to the municipality).
- The Department of Revenue (DOR) is to distribute the appropriate amount to each

- municipality and county monthly along with a report providing: each dealer providing service in their jurisdiction; the gross taxable sales reported by each dealer; the amount of the dealer's collection allowance; any adjustments specified on the return and the net amount transferred to the jurisdiction; and the administrative fee deducted by the department.
- The DOR is responsible for dealing with delinquent taxes and performing the audits.
 - If Comcast uses the DOR's certified addresses database for Leon County, then Comcast will be held harmless should there be any errors in the jurisdiction coding. The Tallahassee/Leon County Geographic Information System (GIS) staff worked with County and City staff to assist the DOR in updating their address database. Comcast management has expressed their intention of using the DOR database to update the addresses in their billing system in order to eliminate the liability regarding the accuracy of the jurisdiction coding.

Conclusion

As a result of our audit procedures and analyses, we have:

- met with Comcast and Leon County and re-emphasized to Comcast that neither the City nor the County had responsibility in the determination of an address' franchise code; rather this was determined by Comcast employees;
- communicated with Comcast and Leon County the results of our analysis and our conclusion that the City should not be responsible for the \$195,807 or any monies that may have been received by the City as a result of coding errors in the Comcast billing system;
- communicated with Comcast and Leon County that we disagreed with the consultant's methodology for calculating amounts owed, specifically that each address was assumed to have cable service 100% of the time during the 42-month period;

- made available to City management, Leon County, and Comcast the methodology and results of our analysis for their review and verification;
- recalculated the expected franchise fees based on an audited schedule of gross revenues for the years ended December 31, 1999 and 2000, and the nine months ended September 30, 2001, and were able to verify the accuracy of the franchise fee payments by Comcast for that same period;
- recommended that when negotiating for the new cable franchise agreement, the requirement for "annual, audited, and certified financial statements of revenue received prepared in accordance with generally accepted accounting principles" continue to be included. This would provide the City with verified annual gross revenues to use to calculate the expected franchise fees and compare to the actual franchise fee payments received. The City could then notify DOR if any discrepancies were suspected; and
- recommended that the City re-evaluate the bond requirements to ensure that the required coverage is adequate to protect the City from any related liabilities resulting from the Cable Franchise Provider.

We would like to thank City staff for their assistance in this audit, including Information Systems Services GIS Coordinator, Treasurer-Clerk Revenue Director, Utility Business and Customer Services Director, Cable Communications Administrator, and the City Attorney. We would also like to thank Comcast and Leon County for their assistance in providing needed information, open communication, and professionalism toward an equitable resolution.

Appointed Officials' Response

City Manager and City Treasurer-Clerk:

We concur with the Auditor's recommendations and will negotiate towards that end with Comcast.

Copies of this audit report #0217 (project #0208) may be obtained at the City Auditor's web site (<http://talgov.com/citytlh/auditing/index.html>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (dooleym@talgov.com).

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