City of Albuquerque

Office of Internal Audit

FOLLOW-UP OF FRANCHISE FEES AUDIT
LEGAL DEPARTMENT
AUDIT #07-105
DECEMBER 8, 2011

INTRODUCTION

The Office of Internal Audit performed a follow-up of Audit No. 07-105, Franchise Fees–Legal Department (Legal). The audit included recommendations to Legal, the Department of Finance and Administrative Services (DFAS) and the CAO. This follow-up is to report on the progress made by these departments in addressing our findings and recommendations. Our follow-up procedures rely on the department providing the status of the recommendation.

Our follow-up is substantially less in scope than an audit. Our objective is to report on the status of corrective action in regards to our findings and recommendations. We limited our scope to actions taken to address our audit recommendations from the date of our final report, January 30, 2008 through November 30, 2011.

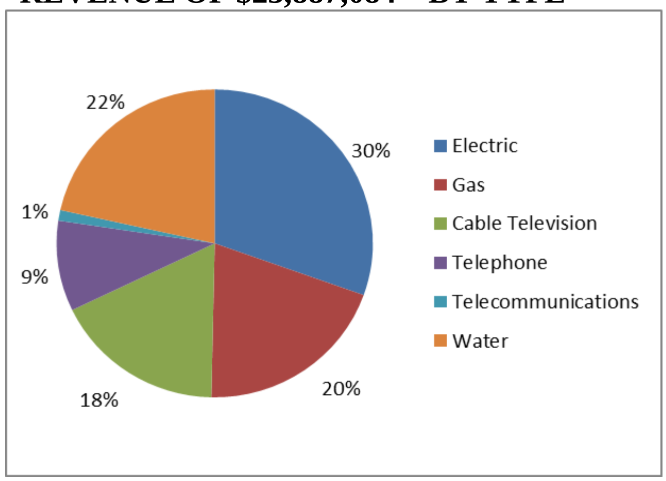
BACKGROUND INFORMATION

The City has statutory authority to negotiate franchise fees for use of City right-of-way by utilities. Franchise fees are imposed on utilities providing electricity, natural gas, communications (telephone and cable TV), and water. The tax base is the gross revenue of the utility. Current fees are:

- Electric – 2%
- Natural Gas – 3%
- Cable TV – 5%
- Telecommunication – 3%
- Water – 4%

The City collected a total of $23,887,084 in franchise fees in Fiscal Year (FY) 2010. This includes $5,141,465 paid by the Albuquerque Bernalillo County Water Utility Authority (ABCWUA) to the City. The chart below illustrates the percentage of total revenue that came from each franchise type.

FY 2010 TOTAL FRANCHISE FEE REVENUE OF $23,887,084 – BY TYPE



In FY11, the City collected approximately $23.3 million (unaudited) in franchise fee revenue, which includes ABCWUA.

SUMMARY

Three of the recommendations in the audit have been fully implemented, five have been partially implemented and one was resolved.

The status of the recommendations is identified by the symbols in the following legend:

Fully Implemented Partially Implemented Not implemented Resolved

Recommendation #1 DFAS should ensure all payments received from franchise operators are deposited and posted to the general ledger.

Response: DFAS concurred with the recommendation. Treasury would review and revise its procedures to ensure all payments received are deposited and posted to the general ledger and would implement new procedures by the end of FY 2009.

Some revisions may include designating a staff member to log all franchise payments received by Treasury and ensure these payments are deposited timely. This employee would request and receive a deposit receipt from Treasury cashiers and verify the payment was recorded to the appropriate account and activity numbers.

Fully Implemented

Status Reported by DFAS: Treasury has implemented the following: (1) a log for all incoming franchise check payments to include name of franchise, check #, amount, check date, date posted. (2) a log to include check #, amount, transmittal date and deposit date. Treasury provided both of these logs to OIA. Treasury also provided draft franchise fee procedures that addressed deposit preparation and recordkeeping.

Recommendation #2 DFAS should ensure proper separation of duties for collecting and posting franchise fee revenue. Treasury should consider eliminating the mailing of payments directly to Treasury and require facilities to use the lockbox provider.

Response: DFAS concurred with the recommendation. Treasury would review and revise its procedures to ensure separation of duties and would implement new procedures by the end of FY 2009.

Some revisions may include: Separating the custody and recordkeeping functions with respect to franchise payments received by designating one employee to serve in the custody function, to include opening mail containing payments, logging these payments into a check log, presenting the checks to Treasury cashiers for deposit, and delivering the payment receipt and franchise remittance paperwork to the recordkeeping staff member.

The separate recordkeeping staff member would continue to maintain the franchise log of expected and received franchise payments.

Forwarding mailed franchise receipts un-opened to the lockbox provider presented a challenge because no subsidiary receivable ledger exists to which a payment file produced by the lockbox provider could be applied. Treasury Division would continue to investigate this recommendation as an option as City billing technology evolves.

Fully Implemented

Status Reported by DFAS: Treasury has implemented separation of duties for collecting and posting revenue. Currently, the process is as follows:

1. Finance Technician #1 – opens mail with Franchise payments and logs checks received into check log sheet
2. Finance Technician #2– creates transmittal for deposit of franchise fee checks and transfers to cashier for processing in the Point of Sale system.
3. Finance Technician #3 – logs revenue into 2nd log spreadsheet for recording due date, transmittal date and deposit date of checks and files all information for record keeping.

Forwarding mailed franchise receipts un-opened to the lockbox provider currently still presents a challenge because no subsidiary receivable ledger exists to which a payment file produced by the lockbox provider can be applied. Treasury Division, together with Information Technology Services Division and Accounting, are exploring and working together to implement an online payment capability for business registrations, liquor licenses and health permits. If this initiative is implemented there would be capabilities to add franchise fee payments, as well as other City service's payments not mentioned.

Recommendation #3: DFAS should verify the accuracy of the franchise fee. Legal should recover the underpayment from Fiber Optics Telecommunications Provider (FOTP) C.

Response from DFAS: DFAS concurred with the recommendation**.** Treasury would review and revise its procedures to ensure verification and accuracy of franchise fees and would implement new procedures by the end of FY 2009.

Treasury may consider on a quarterly basis, requesting from the four noted franchises copies of their monthly CRS-1 reports filed with the New Mexico Taxation & Revenue Department. Treasury Division could independently compute the franchise fees due and compare the result with the amounts paid and any deficiencies could be reported to the City Legal Department for assistance with recovery.

Response from Legal: Legal concurred with the recommendation.

Upon receipt of a report from Treasury that there was a deficiency between the fees due and amounts paid or a discrepancy between the CRS-1 form and payments received, Legal would first determine whether there is a reason for the difference, such as the reporting to the State of revenue that is not part of the revenues upon which franchise fees are paid. A letter would be sent to the provider seeking payment based on the additional revenue or justification for the difference. The Legal Department would assist DFAS/Treasury with standard letters of notice of delinquency and demand. Treasury would copy Legal on these letters and then notify Legal of the failure to pay. If the provider failed to pay the additional amount, it would be difficult to commence a judicial collection action without a more thorough audit of the provider's books and records. Legal would work with Treasury to implement the new procedure by the end of FY 2009.

Partially Implemented

Status Reported by DFAS: When this audit was completed Treasury had contemplated requesting copies of CRS-1 Reports from the NM Taxation and Revenue Department. However, after careful thought and discussion, both Treasury and Legal concluded that the only way to obtain a correct determination of franchise fees would be to hire an outside CPA firm with expertise in franchise accounting. This would require an appropriation in the budget.

Status Reported by Legal: The City began a preliminary review of franchise fees payments made by FOTP C in 2006. Another company acquired the FOTP in November 2006. When Legal found a discrepancy in the amount of fees paid, negotiations were commenced to settle the claim. Because the new company could not obtain all records prior to its acquisition of FOTP C, and because the City did not have the funds for a thorough audit, it was difficult to determine with precision the underpayment of fees. The result was a settlement agreement in which the new company agreed to a payment of $40,000. The agreement was signed by the CAO at that time, after recommendation by Legal and the City Economist. Without funding in the budget for regular audits, we cannot verify the accuracy of franchise fees.

OIA Note: Legal provided a copy of the settlement agreement and a copy of the check the City received. Neither DFAS nor Legal is verifying the accuracy of franchise fees.

Recommendation #4 DFAS and Legal should implement a monitoring process to ensure that the franchise operators are in compliance with the ordinance requirements. Legal should consider developing a uniform financial reporting requirement and updating the ordnances as they expire.

Response from DFAS: DFAS concurred with this recommendation.

Treasury and Legal would develop a monitoring process to ensure franchise operators are in compliance with Ordinance reporting requirements and would implement the new process by the end of FY 2009.

Some ideas for the monitoring process may include: Treasury Division and Legal reviewing all franchise ordinances and developing a tracking matrix of all franchise financial reporting requirements to the City. Treasury Division would monitor compliance with this matrix and inform the respective franchise and Legal when any of these requirements are not met by the specified date.

Response from Legal: Legal concurred with the recommendation.

As ordinances expired and were renegotiated, Legal would strive to provide for a uniform reporting requirement in all franchises. Legal would strive to establish a process for monitoring the reporting requirements of the various franchises and compliance therewith and have a table of the various franchise reporting requirements completed by the end of FY 2009.

Partially Implemented

Status Reported by DFAS: Legal has provided Treasury with a calendar of franchise requirements. The document includes what reports are required and also specifies the payment due dates. Also, Legal provided Treasury with a delinquent payment and reporting letter to send out when payments and reports are not submitted.

Treasury has been monitoring some compliance reporting on franchise operators. We believe most franchise operators are in compliance with reporting. However, there is still more work needed in the compliance effort. Because of limited staffing, our main concentration is collection of timely franchise payments.

Status Reported by Legal: A calendar of requirements has been established as well as an outline of the requirements for each franchise. A memo to Treasury concerning the process was also provided. A memo was also sent to the Planning Department recommending that as boundaries change due to annexations, a notice be sent to the franchisees informing them of the change in boundaries. Because of fluctuations in the state of case law concerning telecommunications franchise agreements, Legal has not negotiated new telecommunications franchise agreements. Legal is waiting for the outcome of the federal case of Qwest/Century Link v. City of Santa Fe before it addresses changes to the master telecommunications ordinance. They will then be uniform. Legal has provided Treasury a calendar of the various franchise requirements with a form demand letter for their use.

OIA Note: Legal provided the memo sent to the Planning Department regarding boundary changes, the calendar of franchise requirements for Treasury and a form demand letter. However, DFAS-Treasury stated that they are focusing on ensuring franchise payments are collected timely and are not monitoring the franchises for reporting compliance. Legal and DFAS-Treasury should work together to determine who is responsible for monitoring reporting compliance.

OIA compared a listing of current franchises provided by Legal to payment spreadsheets maintained by DFAS-Treasury. OIA noted a telecommunications franchise agreement that was signed in May 2008. To date, DFAS-Treasury does not show any payments have been made by the franchise. OIA also noted that the City is accepting payments from a telecommunications franchise without an agreement in place. Without a monitoring function, the City may not be receiving all funds it is due.

Recommendation #5: DFAS should notify Legal when franchise operators do not pay so it can be involved in the collection process. Legal should take appropriate collection actions for the delinquent payments from the three FOTPs. Legal should consider having all ordinances address late fees on delinquent franchise payments as the ordinances are re-negotiated.

Response from DFAS: DFAS concurred with this recommendation.

Treasury would develop a process to notify Legal when franchise operators do not pay and would implement the new process by the end of FY 2009.

The new process may include: Treasury Division reviewing the franchise receivables database to ensure it is optimally developed to track expected and received payments. A Treasury Division staff member would be designated to maintain the franchise receivables database and inform Treasury management of delinquent amounts due. Treasury management would then inform Legal of delinquencies to request assistance with collection efforts.

Response from Legal: Legal concurred with the recommendation.

Legal would obtain the information from Treasury in this regard including copies of the demand letters and seek collection as appropriate. From the audit report it was difficult to determine which providers owed what amount. Legal was working on drafting and negotiating a new telecommunications franchise ordinance. When it is in place Legal would attempt to collect back payments. Legal would use the information from Treasury concerning the nonpayment to pursue collection of this amount. Legal would include a provision for late fees on future franchise ordinances.

Partially Implemented

Status Reported by DFAS: Currently, Treasury does not have an A/R system to track payments. Payments are tracked through a spreadsheet. Treasury's process for late payments is as follows: Treasury will allow a grace period up to the end of the month for payments. If payments are late after the end of each calendar month then a demand letter for payment & penalties (if required by ordinance) will be sent out to the franchise operator. Legal is then notified of delinquencies to assist with the collection efforts.

There was one franchise operator that was late several months but is now caught up with all payments. A demand letter was not sent out due to an oversight on Treasury's part. Treasury would like to recommend an audit be performed on this franchise due to its delinquencies in payments.

Status Reported by Legal: Legal has provided Treasury a form demand letter. When there is a demand made by Treasury for nonpayment, a copy is sent to Legal and collection is initiated. Late fees are being added to all franchise ordinances as they are drafted.

OIA Note: The City received a settlement on one of the three delinquent FOTPs. The other two FOTPs were purchased by another franchise.

Recommendation #6: DFAS should ensure that the Natural Gas (NG) Franchise operator pays late fees as required by the ordinance.

Response from DFAS: DFAS concurred with this recommendation.

Treasury would review the NG ordinance for specific terms on late payments and establish a late fee computation algorithm to compute late fees for the NG Franchise. Once the amount owed has been computed Treasury would work with Legal on drafting a letter to be sent to the NG Franchise requesting late fee payment by the end of June 2008.

The late fee computation and notification would be incorporated into all franchisees by the end of FY 2009.

★ Resolved

Status Reported by DFAS: Treasury's process for late payments is as follows: Treasury will allow a grace period up to the end of the month for payments. If payments are late after the end of each calendar month then a demand letter for payment & penalties (if required by ordinance) will be sent out to the franchise operator. Legal is then notified of delinquencies to assist with the collection efforts.

For those franchisees that do not have a late fee computation provision in the ordinance, Legal will have to incorporate the computation when they re-negotiate the contracts.

OIA Note: DFAS-Treasury determined the two payments made by the NG franchise in the original audit had been made timely, so late fees were not assessed.

Recommendation #7 The CAO should ensure all franchise operators are notified about areas annexed into the City.

Response from CAO: The CAO concurred with the recommendation. The City Planning Department would notify franchise operators of all areas annexed to the City. The City Legal Department would provide a current list of franchise operators, with the name of a contact person and address, to the Planning Department upon request.

Partially Implemented

OIA Note: On July 1, 2008, Legal sent the Planning Department (Planning) a memo recommending that as boundaries change due to annexations, a notice be sent to the franchisees informing them of the change in boundaries. The letter contained a list of the franchise operators at that time, with contact information. Planning stated that they do notify franchisees when new areas are annexed into the City, although annexations do not happen frequently. Planning was not sure if the contact information it has is current. Legal should send regular updates of franchise operators and contact information to Planning.

Recommendation #8: Legal should develop a process for the timely resolution of disputes with franchise operators.

Response: Legal concurred with the recommendation.

A procedure would be established by Legal by the end of FY 2009 that routinely commenced actions to resolve disputes within a reasonable period of time without further approvals or considerations being necessary. The procedure would set forth a form notice/demand letter and standard form complaint. As with the issues related to Finding 3, if it was a dispute in the payment amount, a more complete audit would be necessary following a discrepancy in the CRS-1 form.

Fully Implemented

Status Reported by Legal: See response to #5. Funds in the budget for audits by experts in franchise fees would be necessary for an adequate determination of underpayment.

OIA Note: Legal provided Treasury of demand letter templates. Based on discussions with Legal, there is a process in place to move forward with legal action, if necessary.

Recommendation #9: Legal and DFAS should develop performance measures for the administration of franchise fees.

Response from DFAS: DFAS concurred with this recommendation.

In participation with Legal, Treasury Division would develop new performance measures addressing franchise fees administration as a component of its FY 2010 budget submission. These measures will include collection and compliance benchmarks.

Response from Legal: Legal concurred with the recommendation.

Legal and Treasury would work together to develop new performance measures addressing franchise fees administration while being cautious not to make commitments beyond staffing and budgetary limitations.

Partially Implemented

Status Reported by DFAS: Treasury has considered several performance measures going forward:

% of Franchisees compliant in reporting requirements – calculation to be determined annually, by performing an annual check on reporting requirements for each franchisee. This measure has not been calculated, due to limited staffing, but will be calculated going forward.

Delinquency rate % - calculation to be determined annually.

Fiscal Year	Franchise Fees Revenue	Delinquency rate
FY10	18,745,619	0.59%
FY11 (unaudited)	18,186,384	0.61%

Status Reported by Legal: See Treasury's response concerning performance measures.

OIA Note: Performance measures have been considered. In the first measure proposed above, DFAS-Treasury reports that the measure has not been calculated due to limited staffing, but would be calculated going forward. However, in Recommendation #3, DFAS-Treasury stated that they are focusing on ensuring franchise payments are collected timely and are not monitoring the franchises for reporting compliance. DFAS-Treasury and Legal should work together to determine who is responsible for monitoring reporting compliance and tracking the performance measure.