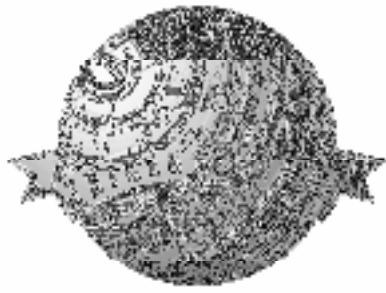


**MANAGEMENT AUDIT REPORT
OF
FRANCHISE FEES
LEGAL DEPARTMENT
REPORT NO. 07-105**



**City of Albuquerque
Office of Internal Audit and Investigations**



City of Albuquerque
Office of Internal Audit and Investigations
P.O. BOX 1293 ALBUQUERQUE, NEW MEXICO 87103

January 30, 2008

Accountability in Government Oversight Committee
City of Albuquerque
Albuquerque, New Mexico

Audit: Franchise Fees
Legal Department
07-105

FINAL

INTRODUCTION

The Office of Internal Audit and Investigations (OIAI) conducted a management audit of the administration of the City's franchise fee ordinances (ordinances). The audit was included in the fiscal year (FY) 2007 approved audit plan. Franchise operators pay the City a franchise fee in an amount equal to a percentage of gross revenues based on the following:

- Fiber Optics Telecommunications Provider (FOTP) A Franchise – 5%*
- FOTP B Franchise – 5%*
- FOTP C Franchise – 3%*
- Cable Television (CT) Franchise – 5%
- Albuquerque/Bernalillo County Water Utility Authority (ABCWUA) Franchise – 4%
- Natural Gas (NG) Franchise – 3%
- NM Water Utility Provider Franchise – 3%
- Electric Franchise - 2%
- Local Telephone Franchise – 2%*

* The Legal Department (Legal) is in the process of negotiating new franchise fee ordinances with the telecommunications franchise operators.

The Treasury Division (Treasury) of the Department of Finance and Administrative Services (DFAS) receives and processes franchise fee payments. One employee in Legal performs franchise work primarily involving negotiations with the four telecommunications companies. The City received approximately \$24 million of franchise fee revenue in FY06.

AUDIT OBJECTIVES

The objectives of the audit were to determine:

- Does Treasury monitor payments made by franchise operators for compliance with the franchise ordinances?
- Does Treasury inform Legal when payments have not been made by a franchise operator?
- Does Treasury have an adequate separation of duties for collecting, processing, posting and reconciling franchise fee revenues?
- Do the City departments responsible for monitoring compliance with the franchise ordinance ensure that the franchise operators and the City are complying with the franchise ordinance requirements?

SCOPE

Our audit did not include an examination of all functions and activities related to franchise fees. Our scope included the period from January 2005 through February 2007.

This report and its conclusions are based on information taken from a sample of transactions and do not intend to represent an examination of all related transactions and activities. The audit report is based on our examination of activities relating to franchise fees through the completion of fieldwork, December 19, 2007, and does not reflect events or accounting entries after that date.

The audit was conducted in accordance with Government Auditing Standards.

METHODOLOGY

OIAI interviewed Treasury and Legal staff who administer the ordinances. Documentation and processes reviewed included the following:

- Treasury procedures, controls and separation of duties relating to collecting, processing, posting and reconciling franchise fee revenues.
- Procedures and controls utilized by City departments to ensure that the franchise operators are complying with the payment terms and other requirements of the ordinances.
- Procedures and controls utilized by City departments to ensure that the City is complying with the requirements of the ordinances that are the responsibility of City departments.

FINDINGS

The following findings concern areas that we believe could be improved by the implementation of the related recommendations.

1. **DFAS SHOULD ENSURE ALL PAYMENTS RECEIVED FROM FRANCHISE OPERATORS ARE DEPOSITED AND POSTED TO THE GENERAL LEDGER.**

In November 2006, OIAI reviewed Treasury's franchise operators' documentation files and found a \$13,913 check, which was received by Treasury from FOTP C, but was never deposited. The check was dated July 24, 2003. Treasury immediately contacted the franchise operator to notify them about the stale dated check. The franchise operator cancelled the old check and issued a new check to the City.

The City's Cash Handling Policies and Procedures Manual requires all cash received by the City to be deposited with the City Treasurer or with the City's fiscal agent within 24 hours of receipt.

Treasury does not perform a periodic reconciliation to determine that all payments received from franchise operators are deposited and posted to the general ledger. Checks not deposited timely and kept in a secure location are at an increased risk of misappropriation.

RECOMMENDATION

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

RESPONSE FROM DFAS

"DFAS concurs with the recommendation.

“Treasury will review and revise its procedures to ensure all payments received are deposited and posted to the general ledger and will 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 will request and receive a deposit receipt from Treasury cashiers and verify the payment was recorded to the appropriate account and activity numbers.”

2. **DFAS SHOULD ENSURE PROPER SEPARATION OF DUTIES.**

One Treasury employee currently receives the franchise operators' checks in the mail and takes these checks to the cashiers for processing. This same employee maintains the records of the franchise operators' payments.

There is no log to document checks received by mail and no one ensures that the checks are deposited and posted. Misuse of City assets could result if logs are not utilized and duties are not separated.

According to the Government Finance Officers Association (GFOA), incompatible duties should be separated. Duties of recordkeeping and custody of assets should be assigned to different individuals. No one individual should be assigned more than one of these duties.

RECOMMENDATION

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 FROM DFAS

“DFAS concurs with the recommendation.

“Treasury will review and revise its procedures to ensure separation of duties and will implement new procedure by the end of FY 2009.

“Some revisions may include: Separating the custody and recordkeeping functions with respect to franchise payments received by designated 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 will continue to maintain the franchise log of expected and received franchise payments.

"Forwarding mailed franchise receipts un-opened to the lockbox provider currently presents a challenge because no subsidiary receivable exists to which a payments file produced by the lockbox provider can be applied. Treasury Division will continue to investigate this recommendation as an option as City billing technology evolves."

3. DFAS SHOULD VERIFY THE ACCURACY OF FRANCHISE FEES.

OIAI compared the August 2006 CRS-1 form to the revenue information reported by the franchise operators to the City. The CRS-1 form is used by entities doing business in New Mexico to report gross receipts to the state government. There was a difference of \$116,782 (37%) on FOTP C. FOTP C is in the process of settling the difference with the City.

Section 13-4-6-13D of the ordinance requires Treasury to annually verify the accuracy of the annual franchise fee within 30 days of submission of the statement.

The following ordinances also contain requirements for the Treasurer to verify the accuracy of the amounts reported by franchise operators:

- NM Water Utility Provider Franchise
- FOTP A Franchise
- FOTP B Franchise
- ABCWUA Franchise

Treasury does not verify the accuracy of the franchise fee reported by any of the above listed franchise operators. If the franchise fee is not verified, the City might be underpaid.

RECOMMENDATION

DFAS should verify the accuracy of the franchise fee.

Legal should recover the underpayment from FOTP C.

RESPONSE FROM DFAS

“DFAS concurs with this recommendation.

“Treasury will review and revise its procedures to ensure verification and accuracy of franchise fees and will implement new procedure 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 concurs with the recommendation.

“Upon receipt of a report from Treasury that there is a deficiency between the fees due and amounts paid or a discrepancy between the CRS-1 form and payments received, Legal will 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 will be sent to the provider seeking payment based on the additional revenue or justification for the difference. The Legal Department will assist DFAS/Treasury with standard letters of notice of delinquency and demand. Treasury will copy Legal on these letters and then notify Legal of the failure to pay. If the provider fails to pay the additional amount, it will be difficult to commence a judicial collection action without a more thorough audit of the provider’s books and records. Legal will work with Treasury to implement the new procedure by the end of FY 2009.”

4. **DFAS AND LEGAL SHOULD IMPLEMENT A MONITORING PROCESS TO ENSURE FRANCHISE OPERATORS ARE IN COMPLIANCE WITH ORDINANCE REPORTING REQUIREMENTS.**

OIAI reviewed all of Treasury's franchise operators' documentation files for reports required by the ordinances for the period January 2005 through November 2006. In those cases where the franchise operator had not filed the required reports, OIAI reviewed prior year records to determine how long the operator had not complied with ordinance reporting requirements.

Criteria	Condition	Cause	Effect
The FOTP ordinances require operators to submit to Treasury a statement* of the franchise fee due to the City by February 1 st of the following year.	FOTP A has not submitted the annual statement since 2001. FOTP B has never submitted an annual statement. FOTP C has not submitted the annual statement since 2004.	Neither Treasury nor Legal verifies that the franchise operators are complying with the ordinance requirements.	If compliance with ordinance requirements is not monitored, the City might receive less franchise fees than required by the ordinance.
The ABCWUA ordinance requires ABCWUA to submit to Treasury an annual statement* of franchise fee actually due to the City by February of the following year.	ABCWUA has not submitted the 2004, 2005 or 2006 statement to the City.		
The NG ordinance requires the franchise operator to submit an annual revenue report* which has been fully audited or certified by an officer.	The NG franchise operator has not submitted the 2004 or 2005 revenue reports.		
The CT franchise ordinance requires the franchise operator to provide the City an annual audited or certified statement.*	The most recent annual report submitted by the CT franchise operator was for 2003.		

Criteria	Condition	Cause	Effect
The CT franchise ordinance requires the following information be submitted to the City: <ul style="list-style-type: none">• Customer service standard report.• Performance bond of \$300,000 until the end of year five of the franchise and increases to \$400,000 thereafter.• Irrevocable letter of credit of \$25,000 until the end of year five and increases to \$50,000 thereafter.	OIAI determined: <ul style="list-style-type: none">• CT did not submit the 2004 or 2005 customer service standard reports.• The \$300,000 performance bond expired on October 16, 2006 and CT has not provided the City a new one.• The irrevocable letter of credit issued in July 2005 was only valid for 12 months and CT has not provided the City with any information indicating if the letter is still in effect.	Neither Treasury nor Legal verifies the franchise operators are complying with the ordinance requirements	If the performance bond and/or letter of credit are not in effect, the City could incur a financial loss.

*The financial reporting requirement is not uniform among the various franchise operator ordinances.

RECOMMENDATION

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 ordinances as they expire.

RESPONSE FROM DFAS

“DFAS concurs with this recommendation.

“Treasury and legal will develop a monitoring process to ensure franchise operators are in compliance with Ordinance reporting requirements and will 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 develop a tracking matrix of all franchise financial reporting requirements to the City. Treasury Division will 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 concurs with the recommendation.

“As ordinances expire and are renegotiated, Legal will strive to provide for a uniform reporting requirement in all franchises. Legal will 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.”

5. LEGAL SHOULD BE INVOLVED IN THE COLLECTION PROCESS IF FRANCHISE OPERATORS DO NOT MAKE THE REQUIRED PAYMENTS.

OIAI reviewed all franchise fee payments from January 2005 through February 2007. The franchise fee payments due from FOTPs A, B and C have not been paid for the following months:

Provider	Time Period Not Paid	Estimated Amount*
A	December 2006 through February 2007	\$47,000
B	April 2006 through February 2007	\$159,000
C	January 2007 through February 2007	\$38,000

*Estimated amount is based upon the average monthly payment to the City during 2006.

OIAI noted ABCWUA paid their July through October 2006 monthly franchise payments, which are approximately \$430,000 a month, in a lump sum in December 2006.

These ordinances require the franchise fee to be paid on the 25th day of each month for the preceding month. The ordinances do not address late fees on delinquent payments. Treasury sent delinquency notices to the FOTP franchise operators that had not paid, but copies were not sent to Legal. Since Legal was not aware of the non-payment, it was not able to get involved in the collection process in a timely manner. The City can not earn interest on the funds until the payments are made.

RECOMMENDATION

DFAS should notify Legal when franchise operators do not pay so it can be involved in the collection process.

Legal should take appropriate collection action 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 concurs with this recommendation.

"Treasury will develop a process to notify legal when franchise operators do not pay and will 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 Division management of delinquent amounts due. Treasury

Division management would then inform Legal of delinquencies to request assistance with collection efforts.”

RESPONSE FROM LEGAL

“Legal concurs with the recommendation.

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

6. DFAS SHOULD ENSURE THAT FRANCHISE OPERATORS PAY LATE FEES AS REQUIRED BY THE ORDINANCE.

OIAI reviewed the timeliness of all payments from January 2005 through September 2006 where the ordinance required the franchise operator to pay late fees if the payment was past due. The NG franchise operator did not pay late fees for the following payments:

Month	Date Franchise Fee was Due	Date Franchise Fee was Paid	Number of Days Late
August 2005	September 30, 2005	October 10, 2005	10
January 2006	February 28, 2006	March 9, 2006	9

The NG Franchise ordinance requires franchise fees to be paid no later than 30 days after the end of each calendar month. The ordinance also requires interest to be charged from the due date at a rate equal to the current prime rate published in the Wall Street Journal.

Treasury does not track late payments and does not follow-up on late fees on delinquent payments. If Treasury does not follow-up on late fees, the City will not receive this additional revenue.

RECOMMENDATION

DFAS should ensure that the NG Franchise operator pays late fees as required by the ordinance.

RESPONSE FROM DFAS

"DFAS concurs with this recommendation.

"Treasury will 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 will 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 will be incorporated to all franchisees by the end of FY 2009."

7. THE CAO SHOULD ENSURE ALL FRANCHISE OPERATORS ARE NOTIFIED ABOUT AREAS ANNEXED INTO THE CITY.

The ordinances for the FOTPs grant the right to operate a telecommunications system within the corporate limits of the City as existing at the time of the ordinance or as may be extended in the future. Franchise operators are not always notified when areas are annexed into the City. There is no City policy which addresses this issue. The following franchise operators are not notified by the City when areas are annexed into it:

- FOTP A Franchise
- FOTP B Franchise
- FOTP C Franchise
- ABCWUA Franchise

The Planning Department notifies some of the franchise operators when areas are annexed into the City. These franchise operators can then pay the City the franchise fees associated with franchise services provided in the newly annexed areas. Treasury and Legal are not communicating with the Planning Department. The CAO does not ensure that Planning notifies all of the franchise operators of newly annexed areas. As a result, the four franchise operators might not be paying the City the franchise fees for the newly annexed areas.

RECOMMENDATION

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

RESPONSE FROM CAO

“The CAO concurs with the recommendation.

“The City Planning Department will notify franchise operators of all areas annexed to the City. The City Legal Department will provide a current list of franchise operators, with the name of a contact person and address, to the Planning Department upon request.”

8. LEGAL SHOULD DEVELOP A PROCESS FOR THE TIMELY RESOLUTION OF DISPUTES WITH FRANCHISE OPERATORS.

On July 13, 2006, the City filed a lawsuit against the Local Telephone franchise operator. This lawsuit relates to an external audit that the City contracted for in 2000. The external audit concluded that the franchise operator had underpaid the City by approximately \$200,000. Legal informed OIAI that the City and the franchise operator had negotiated since 2000 about this dispute, but had not reached an agreement. The franchise operator has filed a motion to have the City's lawsuit dismissed due to statute of limitations. The statute of limitations relating to a written contract is six years.

The delay in filing the lawsuit was due to:

- Employee turnover in Legal;
- Unsuccessful settlement through negotiation.
- No process to ensure timely resolution of disputes.

The City is at risk having the lawsuit against the franchise operator dismissed because of the delay in filing. The City may not be able to collect the \$200,000 from the franchise operator that the external audit concluded was owed to the City.

RECOMMENDATION

Legal should develop a process for the timely resolution of disputes with franchise operators.

RESPONSE FROM LEGAL

“Legal concurs with the recommendation.

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

9. DFAS AND LEGAL SHOULD DEVELOP PERFORMANCE MEASURES FOR THE ADMINISTRATION OF FRANCHISE FEES.

Neither Treasury or Legal has implemented performance measures for the administration of franchise fees. Performance measures provide goals for City departments to follow and accomplish. The accomplishment of goals from the City's annual performance plan is reported by departments to the Administration and City Council. The information is also reported to the Indicators Progress Commission, a citizen group that reviews the City's progress toward defined goals.

The citizens of Albuquerque, the Administration and City Council will be unaware of the City's progress in administering the franchise fees if there are no performance measures. Management oversight should be increased through the development of performance measures for the administration of franchise fees.

RECOMMENDATION

Legal and DFAS should develop performance measures for the administration of the franchise fee ordinances.

RESPONSE FROM DFAS

“DFAS concurs with this recommendation.

“In participation with Legal, Treasury Division will 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 concurs with the recommendation.

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

CONCLUSION

OIAI believes the recommendations noted above will help Legal and DFAS better administer the franchise ordinances. DFAS and Legal should implement a monitoring process to ensure that the franchise operators comply with all ordinance requirements.

OIAI appreciates the cooperation of all City employees contacted during the audit.

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