



# **Verizon Franchise Fees Audit**

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## **Authorization**

We have conducted an audit of the Verizon Cable and Access Line Franchise Fees Audit. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

## **Scope and Methodology**

We conducted this performance audit 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. Our audit covered October 1, 2005 – March 20, 2009.

While we report to the Mayor and City Council and present the results of our work to the Audit Committee, we are located organizationally outside the staff or line management functions we are auditing. Therefore, this Audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to those charged with governance.

The objectives of our audit were to:

1. A. Determine that fees collected are properly calculated  
B. Ensure compliance with the State Franchise Agreement  
C. Review Customer Bills
2. Determine if all Franchise Fees have been reported from City of Garland customers by reviewing the accuracy of all customer addresses

To adequately address the audit objectives, we:

- Reviewed the State Issue Franchise Agreement (Obj. 1.B)
- Reviewed the franchise fee payments for video and cable sent to the City of Garland for accuracy (Obj. 1.A)
- Reviewed the franchise fee payments for access lines sent to the City of Garland for accuracy (Obj. 1.A)
- Reviewed financial reports (Obj. 1.A)
- Recalculated franchise fees (Obj. 1.A)
- Reviewed address listing for video and cable provided by Verizon and had GIS assist and determine if any City of Garland addresses were missing from Verizon's list and all customers were accounted (Obj. 2)
- Reviewed customers in border area zip codes for access lines to determine if all access lines are accounted to the City of Garland (Obj. 2)
- Reviewed video and cable customer bills (Obj. 1.C)

## **Overall Conclusion**

- We determined that franchise fee payments for video and cable and access line customers were calculated accurately. (Obj. 1.A)
- We determined that Verizon has not been in compliance with the State Franchise Agreement in regards to reporting Franchise Fees. (Obj. 1.B)
- We determined that Verizon is reporting and paying franchise fees on all their video and cable Garland customers (Obj. 1.A)
- We determined that franchise fees were calculated accurately on customer bills (Obj. 1.C)
- We are still waiting to receive data on access lines to determine the accuracy of all Garland customers and as soon as that information is received, it will be reported to management. (Obj. 2)

## **Background**

### **The History of Verizon Communications**

Verizon Communications Inc., based in New York City and incorporated in Delaware, was formed on June 30, 2000, with the merger of Bell Atlantic Corp. and GTE Corp. Verizon began trading on the New York Stock Exchange (NYSE) under the VZ symbol on Monday, July 3, 2000. Verizon's corporate headquarters is located at 140 West St. in Manhattan, NY, and it has a major operations hub, the Verizon Center, at the former headquarters location of AT&T in Basking Ridge, NJ.<sup>1</sup>

## **FRANCHISE FEES**

### **Communications Act of 1934**

Franchise Fees are governed by Utilities Code Chapter 66 (State-Issued Cable and Video Franchise) of the Local Government Code. Prior to September 2005, Franchise Fees were governed by a local franchise agreement. Now, providers have to obtain a State-Issued Certificate of Franchise Authority (SICFA) from the Public Utility Commission of Texas (PUC). The commission shall be designated as the franchising authority for a state-issued franchise for the provision of cable service or video service. Any entity or person seeking to provide cable service or video service shall file an application for a SICFA with the commission. Also, the holder of a SICFA shall pay each municipality in which it provides cable service or video service a franchise fee of five percent of gross revenues. The holder of a SICFA shall pay a municipality in which it is offering cable service or video service one percent of the provider's gross revenues, in lieu of in-kind compensation and grants.

<sup>1</sup> – [www.verizon.com](http://www.verizon.com)

## **ACCESS LINE FEES**

### **Texas Local Government Code, Chapter 283**

Chapter 283 (sometimes called HB 1777) was enacted by the 76th Legislature as a mechanism to increase competition in the telecommunications industry by establishing a uniform method for certified telecommunications providers (CTPs) to compensate municipalities for the use of public rights-of-way. The provisions of this statute went into effect on September 1, 1999. Chapter 26, Subchapter R, contains the Commission's Provisions Relating to Municipal Regulation and Rights-Of-Way Management.

A CTP has to apply for a certificate from the PUC. A CTP is any telecommunications provider that has been granted one of the following certificates by the PUC to provide telecommunications services in Texas:

- COA - Certificate of Operating Authority
- SPCOA - Service Provider Certificate of Authority
- CCN - Certificate of Convenience and Necessity

As of March 1, 2000, all telecommunications franchise fees in Texas are required to be based on a fee-per-access line method. The PUC, in October 1999, established three categories of access lines - residential, non-residential, and point-to point.

The three types of access lines are:

- Category 1 - Residential
- Category 2 - Non-Residential
- Category 3 - Point-to-Point

Category 1 shall include both analog and digital residential switched access lines and any other access line that provides residential voice service. It shall also include point-to-point private lines, whether residential or non-residential, only to the extent such lines provide burglar alarm or other similar security services.

Category 2 shall include all analog and digital non-residential switched access lines and any other access line that provides non-residential voice service.

Category 3 shall include all other point-to-point private lines, whether residential or non-residential, not otherwise included within category 1.

CTPs must submit a quarterly access line update with increases or decreases and must compensate the municipality accordingly.

## BREAKDOWN OF A CUSTOMER'S BILL

Customers sometimes have difficulty interpreting a cable bill and do not understand what all the charges mean. Following is a brief summary of all the charges on a Verizon's customer's bill, some of the charges are a flat rate while others are based on a percentage:

**Interstate Subscriber Line Charge** - A monthly fee paid by a telephone subscriber to the local exchange carrier for part of the cost of installation and maintenance of the telephone wire, poles, and other facilities that link a residence to the telephone network.

**911 Equalization Surcharge** - A universal telephone number that gives the public direct access to the Public Safety Answering Point for emergency calls. Basic 911 service collects 9-1-1 calls from one or more local exchange switches that serve a geographic area, and sends each call to the appropriate designated authority.

**Texas Universal Service** - Longstanding public policy that all Americans should have access to phone service at a reasonable cost. Also, the financial mechanism that compensates companies for providing telecommunications services, especially in rural, insular and high-cost areas.

**Texas Universal Service Fee** - The surcharge(s) on services to support universal service. The fees on customer bills fund subsidies to high-cost area telephone companies, and programs for schools and libraries, rural health care, and low-income consumers.

**Municipal Right-of-Way** - A fee assessed for the privilege of using the municipal public rights-of-way. This fee provides the municipality the funds needed to recover the cost of administering the access to the right-of-way. Typical costs included are for inspection, permit processing, engineering, traffic, and other such expenditures that the municipality incurs to manage the health and safety of its citizens, as utility companies work in the right-of-way. The fee is generally either an amount per telephone access line or a percentage of revenue.

**Emergency Service Charge** - The 911 Emergency Service Fee is a fee to cover the costs of local jurisdictions providing 911 emergency response services to its citizens. The fee is generally either an amount per telephone access line or a percentage of revenue. State law mandates the fee.

**Federal Universal Service Fee** - A monthly, per-line surcharge paid by the customer to recover local companies' contribution to the Federal Universal Service Fund. This fund supports telecommunications and information services in schools, public libraries, and rural health-care facilities. The fund also subsidizes local service to high-cost areas and low-income customers. The FCC regulates this charge.

The Federal Universal Service Fund (FUSF) rate is reviewed quarterly. This fee helps to keep local telephone rates affordable for all customers and gives a discount to schools, libraries and low-income families.

**Video Franchise Fee** - Fee imposed to customers for a holder of a state-issued certificate of franchise authority to pay a municipality in which it provides cable service or video service.

**PEG Grant Fee** - Fee imposed to customers for a holder of a state-issued certificate of franchise authority to pay a municipality to allow public, educational, and governmental (PEG) access channels for noncommercial programming.<sup>2</sup>

<sup>2</sup> SOURCE: Breakdown of a Customer's Bill, [www.verizon.com](http://www.verizon.com)

## **Management Accomplishments**

Financial Services has tracking procedures in place to ensure that each franchisee remit fees when they become due. Financial Services maintains a franchisee contact list and communicates with each franchise on a periodic basis.

## Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding #	Condition (The way it is)	Criteria (The way it should be)	Cause (Difference between condition & criteria)	Effect (So what?)	Recommendation	Management Response
1 (Obj. 1.B)	Verizon is not complying with Utilities Code Chapter 66 when reporting “gross revenues.” Their reporting method is on the accrual basis and not the cash basis.	Utilities Code Chapter 66. State-Issued Franchise Sec. 66.002 (B) states: For purposes of this section, “gross revenues” does not include: (i) any revenue not actually received, even if billed, such as bad debt.	Verizon reports on the Accrual Basis rather than the Cash Basis.	<ul style="list-style-type: none"> <li>• Reporting on the cash basis would be easier to audit since cash received is easier to verify than net income and bad debt expense.</li> <li>• There would be less chance for manipulating gross revenues incorrectly and estimating bad debts since Verizon would only report on what was received.</li> <li>• There is also non-compliance of Chapter 66 when reporting on the accrual basis.</li> </ul>	Management should ensure that Verizon reports their “gross revenues” on what was actually received as it is stipulated on Utilities Code Chapter 66 Sec. 66.002 (B) (i).	Financial Services will discuss with the City Attorney current reporting practices for gross revenues. Financial Services will then determine appropriate actions in seeking Verizon’s compliance with Utilities Code Chapter 66 Sec.66.002 (B) (i). Financial Services will have Verizon’s response by September 30, 2010.