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Audit Report

**Time Warner Cable Television
Franchise Fee Audit
Part I**

April 22, 2008

Office of the City Auditor
Austin, Texas

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City of Austin



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Date: April 22, 2008
To: Mayor and Council
From: Stephen L. Morgan, City Auditor
Subject: Time Warner Cable Television Franchise Fee Audit, Part I

I am pleased to present this audit report on Time Warner Cable Television's (TWC) collection and remittance of franchise fees and PEG access fees. The City agreed to a franchise with Time Warner Cable Television in August, 1996. Time Warner Cable Television is required to pay the City a franchise fee and a public, education, and government (PEG) access fee for use of the City's public rights-of-way. The franchise agreement with the City will end in August, 2011 at which time TWC will operate under a State franchise agreement. We chose to conduct this audit to ensure that TWC is remitting all revenue required by the terms of the municipal franchise agreement prior to the termination of that agreement.

We found that TWC owes the City \$1,072,148 in fees and associated interest as a result of the company not consistently updating its subscriber database to reflect annexations. A significant number of the customers identified are active and will continue to contribute revenue to the City. In addition, TWC mistakenly collected fees from customers in the extraterritorial jurisdiction (ETJ) areas of Austin.

We have two recommendations: 1) The Office of Telecommunications and Regulatory Affairs (TARA) should make arrangements with TWC for immediate payment of franchise fees, PEG access fees, other revenue, and interest owed to the City; and 2) TARA should review future quarterly filings from TWC to determine if customer jurisdiction information is coded correctly.

We appreciate the cooperation and assistance we received from Time Warner Cable Television, the City of Austin's Office of Telecommunications and Regulatory Affairs, the City Law Department, and the City Financial and Administrative Services Department during this audit.

Stephen L. Morgan, CIA, CGAP, CFE, CGFM
City Auditor

COUNCIL SUMMARY

The City of Austin granted Austin CableVision a cable television franchise in 1981. The Austin CableVision franchise expired and was renewed in July 1996 with Austin CableVision's successor, Time Warner Cable Television (TWC), operating under the franchise agreement. Under City Ordinance Number 960613-A, this cable franchise agreement runs for fifteen years and will expire in August 2011.

The franchise agreement between the City of Austin and TWC requires a payment of five percent of gross revenue derived within the franchise area. A 35 cent monthly fee per customer to fund the public, educational and governmental (PEG) access channels is also paid by TWC to the City. These payments from TWC are to compensate the City of Austin for the use of the public rights-of-way.

Legislative changes made in 2005 change the franchising authority from municipalities to the Public Utility Commission of Texas (PUCT) so TWC will be operating under a State franchise when the current franchise agreement between Austin and TWC expires. The City of Austin will still continue to receive the five percent franchise fee from TWC but the PEG fee will change from 35 cents per subscriber per month to one percent of gross revenues and these funds will no longer be allowed to fund access channel operating costs.

In reviewing TWC's subscriber data to determine if the franchise fee and PEG fee payments are correct, we discovered that TWC did not consistently update their subscriber database to reflect a series of annexations following the 1996 franchise agreement. Our geocode analysis identified 12,139 miscoded subscriber accounts within the full-purpose annexed area that were not charged fees and there were 5,677 subscriber accounts in the extraterritorial jurisdiction (ETJ) that were erroneously charged fees. We also found that the City had properly sent annexation notifications to TWC.

As a result, TWC owes the City \$1,072,148 in fees and interest. In addition, a significant number of the accounts identified are active accounts with TWC, and should continue to generate additional revenue for the City each month that they remain customers.



**ACTION SUMMARY
TIME WARNER CABLE TELEVISION
FRANCHISE FEE AUDIT
PART I**



Recommendation Text	Management Concurrence	Proposed Implementation Date
01. The Director of the Office of Telecommunications and Regulatory Affairs (TARA) should make arrangements with Time Warner Cable Television for immediate payment of franchise fees, PEG fees, other revenue, and interest owed to the City	Concur	April 2008
02. The Director of TARA should direct TARA staff to review TWC's future quarterly filings to determine if the customer jurisdiction information is coded correctly	Concur	January 2008

TABLE OF CONTENTS

BACKGROUND	2
OBJECTIVES, SCOPE, AND METHODOLOGY	3
AUDIT RESULTS	4
TWC’s liability to the City of Austin for underpaid franchise fees, PEG access fees and associated interest is \$1,072,148	4
A review of TWC’s subscriber database showed 12,139 subscriber accounts within the franchise area for which TWC did not collect franchise or PEG fees.	5
The City of Austin has a consistent process for public notice of annexations through public hearings and notifications.	5
The Office of Telecommunications and Regulatory Affairs (TARA) properly notified TWC of annexations as they occurred.	6
TARA did not consistently verify TWC supporting documentation to ensure proper customer coding	7
TWC incorrectly charged fees to subscribers in the ETJ	7
Issues for Further Study.....	8
Recommendations	8
Appendix A: Management Response	9
Exhibits	
Exhibit 1: Total Time Warner Cable Television Franchise Fees Paid	2
Exhibit 2: Summary of Miscoded Time Warner Customer Accounts	4
Exhibit 3: Miscoded Time Warner Accounts in Austin Full-Purpose Annexed Area	5
Exhibit 4: TARA Annexation Notification Process	6
Exhibit 5: Miscoded Time Warner Customer Accounts in the Austin ETJ	7

BACKGROUND

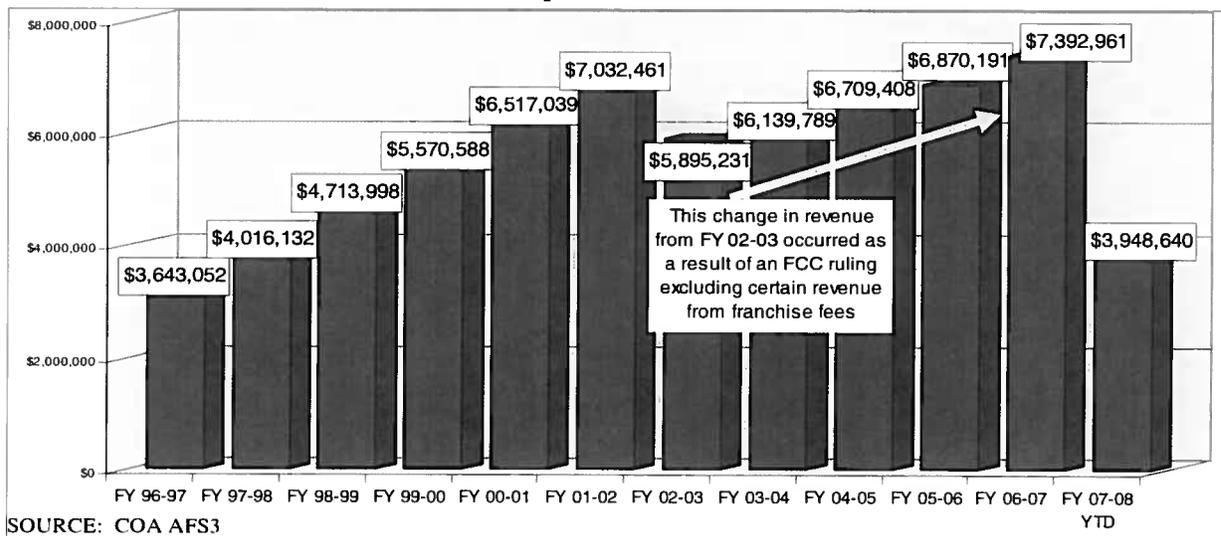
The City of Austin granted Austin CableVision a cable television franchise in 1981. The Austin CableVision franchise expired and was renewed in July 1996 with Austin CableVision's successor, Time Warner Cable Television (TWC), operating under the franchise agreement. Under City Ordinance Number 960613-A, this cable franchise agreement runs for fifteen years and will expire in August of 2011.

Cable television franchise agreements are governed by Federal law. Cable companies enter into franchise agreements with cities to access the public rights-of-way. The land and poles that cable television operators need to string their cables are owned by the public and managed by the City of Austin. These powers are found in Article I, Chapter 4 of the Austin City Charter. By Federal law, the City of Austin may grant a cable franchise and regulate the franchisee in any areas not preempted by the Federal Communications Commission (FCC).

Federal law allows the City to assess a maximum franchise fee up to five percent (5%) of TWC's gross annual cable television revenue. It is the responsibility of the franchisee to collect and remit the proper fees to the City. Per the agreement with TWC, there is a penalty of the greater of \$100 or ten percent interest (10%) for any unpaid fees. The City may use the franchise fees for any purpose. These funds go into the City's General Fund. In addition to the franchise fee, the City also receives a 35 cent (\$0.35) per subscriber per month public, educational, and governmental (PEG) access channels fee. The PEG fee funds the operations and equipment for the local public access television channels.

The franchise agreement has provided a significant stream of revenue since 1996. Exhibit 1 shows the history of Franchise Fees and PEG fees paid to City by TWC beginning in FY 1996-97. In FY 2001-2002, there was a change in Federal law that excluded internet and telephony revenue from gross revenues and that accounts primarily for the decrease in revenue shown in Exhibit 1.

EXHIBIT 1
TWC franchise fees paid total \$68.4 million since 1996



OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Determine whether franchise fee and PEG fee payments from the cable company are correct. More specifically, we focused on whether the cable franchise fee and PEG fee was remitted for all customers inside the Austin city limits.

Scope

The scope of work included cable franchise fee and PEG fee revenue collected by the City from 1996 to 2007.

Methodology

- Interviewed management and staff in the Office of Telecommunications and Regulatory Affairs (TARA), a division of Financial and Administrative Services Department (FASD), and Time Warner Cable Television to better understand their roles and responsibilities as it relates to cable franchise fee revenues.
- Reviewed applicable laws, regulations, or ordinances pertaining to cable franchise fee revenues.
- Identified and reviewed previous studies or audits related to cable franchise fee revenues.
- Flowcharted the TARA annexation notification process.
- Performed transaction testing on subscriber bills to ensure cable franchise fee revenues collected are accurate and complete.
- Used geocode analysis to map subscriber addresses and identify miscoding.
- Reviewed the City of Austin annexation/de-annexation records to determine whether Austin customers inside/outside the city limits were included/excluded in the TWC billing system.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS).

AUDIT RESULTS

Time Warner Cable Television (TWC) underpaid franchise fees and PEG fees to the City because the company did not consistently update its customer database as annexations occurred. In addition, TWC mistakenly charged fees to customers residing in Austin's extraterritorial jurisdiction.

TWC's liability to the City of Austin for underpaid franchise fees, PEG access fees and associated interest is \$1,072,148.

Time Warner Cable Television (TWC) did not collect the proper amount of franchise or PEG access fees from its customers because the company did not consistently update its customer database to reflect annexations. The resulting \$1.07 million owed the city is summarized in Exhibit 2 below. In addition, 6,614 of the 17,816 miscoded accounts identified are still customers of TWC, and represent additional monthly revenue going forward for the City. We also found that the City has a process for providing notice of annexations, and the City properly notified TWC of annexations as they occurred. However, the City did not verify the correctness of filings made by TWC.

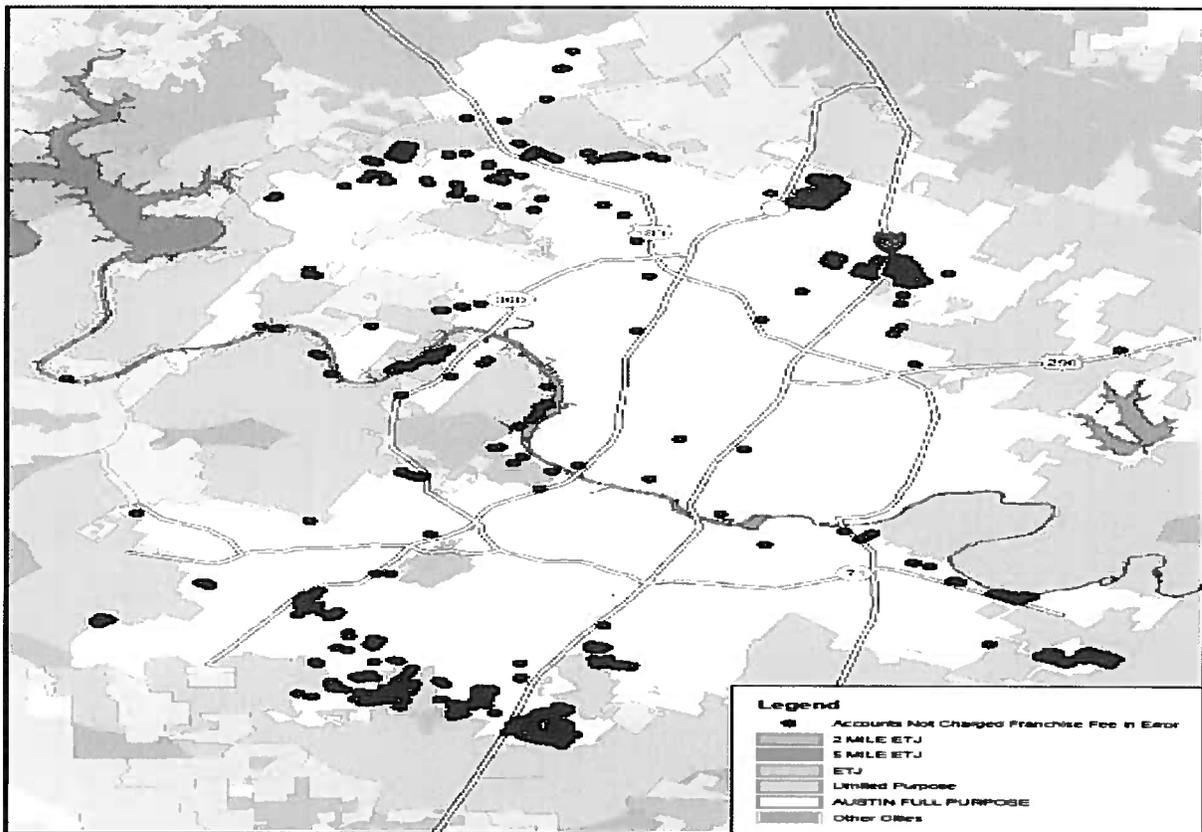
EXHIBIT 2
Summary of Miscoded Time Warner Customer Accounts

	Accounts Miscoded	Franchise Fee	PEG Fee	Total
Accounts Not Charged Fees In Error	12,139	\$1,235,978	\$141,705	\$1,377,683
Accounts Charged Fees In Error	(5,677)	(\$460,102)	(\$50,731)	(\$510,833)
Difference		\$775,876	\$90,974	\$866,850
10% Interest		\$188,369	\$16,929	\$205,298
Total Underpayment of Fees		\$964,245	\$107,903	\$1,072,148

SOURCE: Office of the City Auditor Analysis of TWC Subscriber Database, FY 1996-FY 2007

A review of TWC's subscriber database showed 12,139 subscriber accounts within the franchise area for which TWC did not collect franchise or PEG fees. The accounts were coded as outside the full-purpose annexed area of Austin and thus not subject to the fees. Exhibit 3 below shows the distribution of subscribers that were miscoded in the full-purpose annexed area:

EXHIBIT 3 Miscoded Time Warner Accounts in Austin Full-Purpose Annexed Area

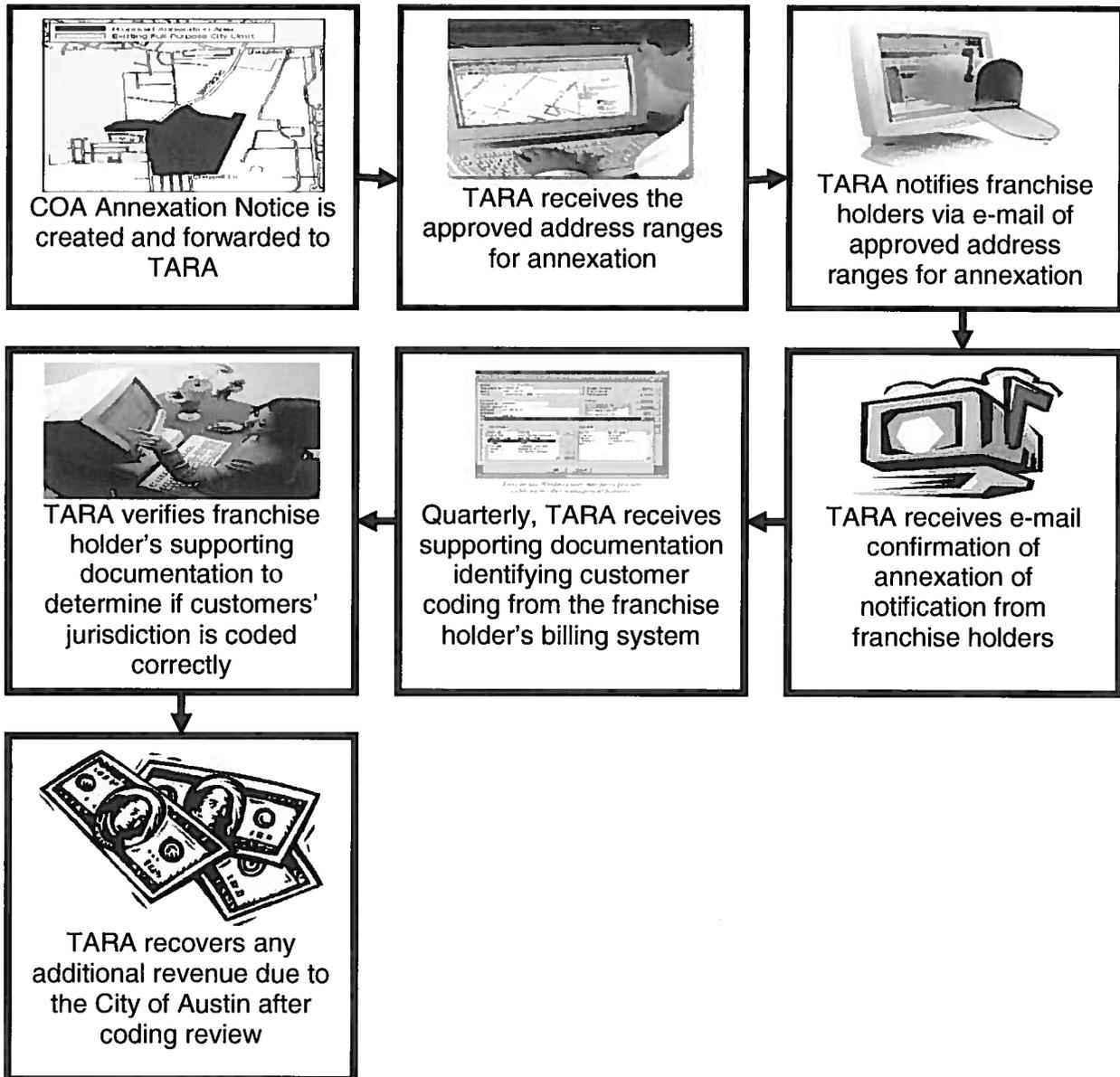


SOURCE: Office of the City Auditor analysis of Time Warner Cable Television Subscriber Database

The City of Austin has a consistent process for public notice of annexations through public hearings and notifications. The cable television franchise agreement does not specifically address the process through which the City notifies TWC about territorial annexations. However, Article I, Chapter 6 of the Austin City Code requires the City Council to hold a public hearing on annexations and that prior notice of such hearings shall be provided in the City and in the territory proposed to be annexed. The City also provides thorough annexation information for interested parties on the Austin City Connection website which can be accessed at the following web address: <http://www.ci.austin.tx.us/annexation/default.htm>.

The Office of Telecommunications and Regulatory Affairs (TARA) properly notified TWC of annexations as they occurred. TARA provided TWC with the information necessary to update its customer database as annexations occurred, including a full-purpose annexation notice with detailed maps, address ranges, and the effective date of the annexation ordinance. TARA also provides a receipt confirmation form to be returned by the franchise holder to acknowledge receiving the information. TARA's process is shown in Exhibit 4 below.

EXHIBIT 4
TARA Annexation Notification Process



SOURCE: City of Austin Office of Telecommunications and Regulatory Affairs

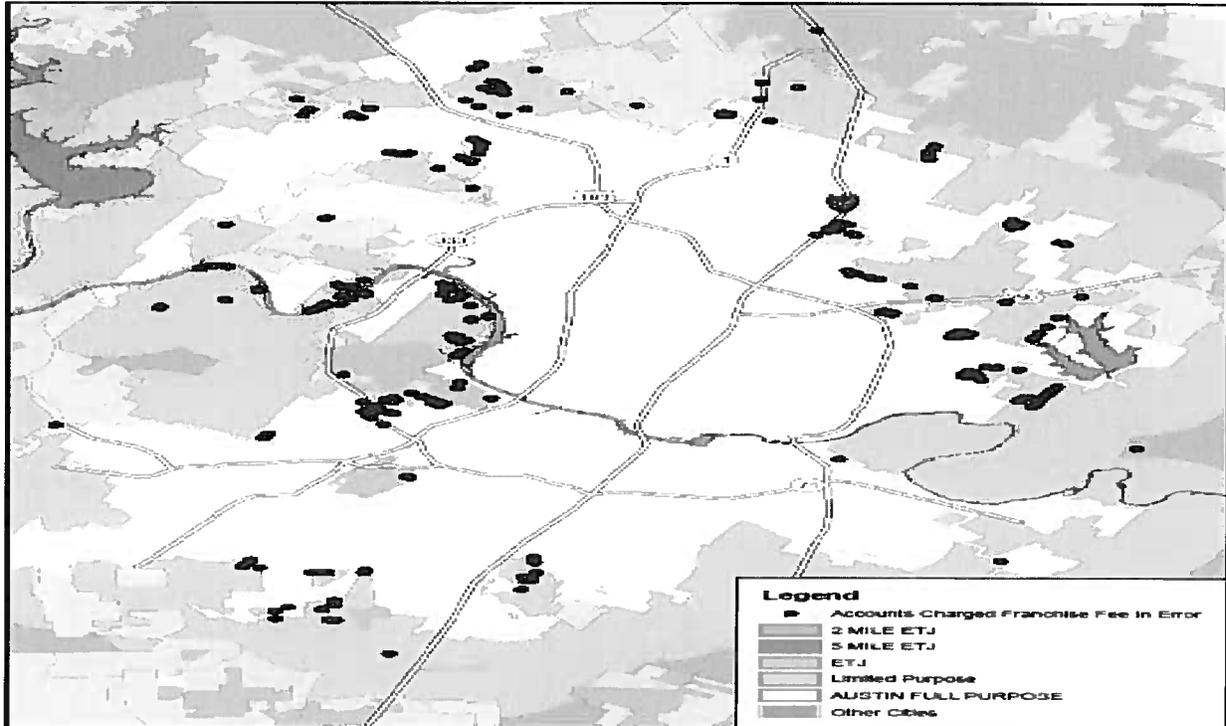
TARA did not consistently verify TWC supporting documentation to ensure proper customer coding. TARA’s duties include reviewing TWC’s customer database to confirm that the customer jurisdictions are coded properly. We found that TARA did not consistently verify the franchise holder’s quarterly filed supporting documentation to determine if the TWC subscribers were coded properly. We also found that TARA did not conduct a franchise-wide electronic verification of the subscriber data. Such a test would likely have identified the coding errors.

TWC incorrectly charged fees to subscribers in the extraterritorial jurisdiction (ETJ) areas.

The geocode analysis showed that TWC charged franchise fees and PEG fees to 5,677 customers in the ETJ area. However, subscribers in the ETJ are not subject to franchise fees or PEG fees. Yet TWC collected franchise fees totaling \$460,102 and PEG fees of \$50,731 from them. These numbers are summarized in Exhibit 2 (see above) as Accounts Charged Fees In Error.

Exhibit 5 below shows the distribution of TWC subscribers living in the ETJ charged franchise fees and PEG fees in error by TWC.

**EXHIBIT 5
Miscoded TWC Customer Accounts in the Extraterritorial Jurisdiction Area**



SOURCE: Office of the City Auditor Analysis of Time Warner Cable Television Subscriber Database

ISSUES FOR FURTHER STUDY

The Office of the City Auditor (OCA) is currently working with MuniServices LLC, a consulting firm that specializes in analyzing cable television franchises, to analyze other revenue sources such as advertising revenue and accounting adjustments for bad debt expense. The OCA will report the results of this work at a future time.

Texas Senate Bill 5, passed in 2005, changed the franchising authority for cable and video services from municipalities to the Public Utility Commission of Texas (PUCT) beginning when the current franchise agreement expires in 2011, at which time the City will no longer have the authority to grant a cable franchise. Future cable and video service franchises, commonly known as State franchises, will be granted exclusively by the PUCT. These changes to the law should not have any major negative impact upon the franchise fees which will remain at five percent of gross revenue. However, Texas Senate Bill 5 will affect PEG fees and the access channels operating funds in the future. PEG channels are not mandated by Federal law. Nine channels were assigned and are under the authority of the City for use related to governmental and educational purposes, or individual expression. Senate Bill 5 limits the PEG fees to one percent of gross revenues when a cable provider switches to a State franchise system. PEG fees will no longer be allowed to fund access channel operating costs and will be restricted to capital equipment costs only. The future impact of the changes to this funding source are not known at this time.

RECOMMENDATIONS

Recommendation

01. The Director of the Office of Telecommunications and Regulatory Affairs (TARA) should make arrangements with Time Warner Cable Television (TWC) for immediate payment of franchise fees, PEG fees and interest owed to the City.
02. The Director of TARA should direct TARA staff to review TWC's future quarterly filings to determine if the customer jurisdiction information is coded correctly

Management Response

01. *On April 22, 2008, TARA will send notice of payment due to Time Warner Cable, payable within 10 days after receipt of written notice.*
02. *Beginning with the first calendar quarter of 2008, TARA implemented the additional step in their annexation notification process of address verification to determine if TWC's customer billing system accurately reflects the City of Austin boundaries. In fact, we have implemented this additional step for all of our franchise holders.*

APPENDIX A
MANAGEMENT RESPONSE



April 21, 2008

To: Stephen L. Morgan, City Auditor

In response to the two recommendations resulting from the Time Warner Cable Franchise Fee Audit:

1. The Office of Telecommunications and Regulatory Affairs (TARA) should make arrangements with TWC for immediate payment of franchise fees, PEG access fees, other revenue, and interest owed to the City.

On April 22, TARA will send notice of payment due to Time Warner Cable, payable within 10 days after receipt of written notice, which is May 2, 2008.

2. TARA should review future quarterly filings from TWC to determine if customer jurisdiction information is coded correctly

Beginning with the first calendar quarter of 2008, TARA implemented the additional step in their annexation notification process of address verification to determine if TWC's customer billing system accurately reflects the City of Austin boundaries. In fact, we have implemented this additional step for all of our franchise holders.

Melissa Bedford-Guidry, our Regulatory Auditor Senior, is the responsible person for the verification process.

Sincerely,

Leslie Browder, Chief Financial Officer

cc: Rondella M. Hawkins