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Office of the City Auditor

Audit Report

**AUDIT OF
COMCAST CABLE FRANCHISE FEES
2002 THROUGH 2005
(Report No. A07-010)**

April 27, 2007

City Auditor

Craig D. Kinton

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Executive Summary

This report presents the results of our audit¹ of Comcast Cable Franchise Fees for the calendar years 2002 through 2005. The franchise is administered by the Office of Financial Services. We conclude that Comcast Cable (Comcast) owes the City, a total of \$118,944.55 that includes \$92,151.20 underpaid franchise fees and \$26,793.35 interest through April 2007.

During this period Comcast paid the City a total of \$19,742,982 in franchise fees payments. The recomputed franchise fees due the City during the audit period are \$19,835,133. The difference of \$92,151 represents less than half of one percent of the total franchise fees paid during the four year audit period.

There are opportunities for OFS to improve their administrative and financial oversight processes. Specifically, the revenues for the monthly franchise fees are not accompanied by adequate supporting data and all late penalty calculations are not performed.

Recommendations Summary

We recommend the Director of the Office of Financial Services:

Recommendation 1:

With the assistance of the City Attorney, collect the \$118,944.55, which represents \$92,151.20 in underpaid franchise fees and interest of \$26,793.35 through April 2007. (See Appendix IV for applicable computed interest)

Recommendation 2:

Implement monitoring procedures which include requesting Comcast to provide supporting documentation on the methodologies for each revenue source.

Recommendation 3:

Ensure that when late payments are received by OFS, staff determine the amount of interest and compare to the late fee to ensure the appropriate payment penalty is used.

¹ Audit conducted under authority of Dallas City Charter, Chapter IX, Section 3.

Management's Response Summary

The Director of OFS agrees with the three recommendations and is taking corrective actions to timely address the issues identified in this report. Comcast takes no exception to the report's findings. The complete responses are included as Appendix V to this report.

Audit Results

1. Comcast owes the City \$118,944.55 for underpaid franchise fees and interest for the audit period 2002 through 2005.

Comcast understated the amount of franchise fees that was due to the City for the period from January 2002 through December 2005 by \$92,151.20. This was determined when our office could not, and Comcast could not support, the franchise fees to their underlying financial statements. We then required Comcast to recompile their financial data for the period and then recomputed their monthly franchise fees for calendar years 2002 through 2005. Comcast's recomputed monthly franchise fees shows an underpayment totaling \$92,151.20 to the City, for calendar years 2002 through 2005. We reviewed their calculations and agree with this amount.

This underpayment represents less than one half of one percent of the total franchise fees paid during the four year audit period. Franchise fees were under paid for 35 months and over paid for 13 months. The underpayment was primarily attributed to adjustments to Subscribers' Bad Debts written off and to Advertising Sales revenues. (See Appendix III, Table 2 for details for each year).

Due to this underpayment, Comcast also is liable for interest during this period. Section 9.e. of franchise Ordinance No. 24361 requires interest for underpayments at the rate of 8% per annum, "...compounded monthly, calculated from the date each portion of the underpayment was originally due until the date the Company remits the underpayment to the City, shall be paid within forty-five (45) days of the City's submitting an invoice for such sum to the Company, with reasonable detail supporting the amount claimed."

When we applied the interest rate to the underpaid franchise fees through April 2007, the total interest due is \$26,793.35, making the total due to the City to be \$118,944.55.

Recommendation 1:

We recommend the Director of the Office of Financial Services (OFS) with the assistance of the City Attorney collect the \$118,944.55, which represents \$92,151.20 in underpaid franchise fees and interest of \$26,793.35 through April 2007. (See Appendix IV for applicable computed interest).

Management's Response

Agree. OFS will make all reasonable efforts to collect the aforementioned sum and will if necessary obtain assistance from the City Attorney. OFS will pursue all remedies available under the franchise to ensure that amounts owed are paid.

2. The Office of Financial Services needs to improve the monitoring of cable franchise fees.

Comcast did not provide documentation on the methodologies associated with each revenue source. No additional supporting documents had been submitted by Comcast. When OFS received the remittances, the remittances are not consistently dated to signify the actual receipt date. Without the notation of the receipt date we could not readily determine whether payments were received within the required time frame or whether late fees or interest were applicable.

An effective internal control system requires on-going monitoring of activities. Although OFS performs some monitoring by monthly comparing budgeted franchise fees amounts to actual franchise fees received, understanding the methodology that Comcast uses to derive revenues would provide additional assurance to the accuracy and reliability of the reported franchise fees. When Comcast modifies their methodology, such as adding and deleting revenue service codes, this should be identified to OFS.

Section 15.d. of franchise Ordinance No. 24361 gives the City the right to require "the Company report to the City such reasonably requested information relating to the Company and/or the Affiliates necessary for the administration of this Ordinance. Within reason, the City shall have the right to establish forms for all reports, determine the time for reports and the frequency with which any reports are to be made, and require that any reports be made under oath."

Comcast paid their franchise fees late several times during the audit period. When the payment was made, Comcast included a late fee, \$200 per day.

The franchise agreement states that "In the event any monthly payment or partial payment is made after 3:00 P.M. on the due date, the company shall pay a late payment penalty of the greater of (i) \$200 per day or portion thereof, or (ii) interest at ten percent (10%) annual percentage of the total amount past due."

We saw no documentation to show that OFS calculated the interest to ensure the appropriate late fee was assessed. When we calculated the late events, the \$200 per day fee was used and was correct.

Recommendation 2:

We recommend the Director of OFS to implement monitoring procedures which include requesting the cable franchisee to provide supporting documentation on the methodologies for each revenue source.

Management's Response

Agree. OFS will request the current franchisee Comcast Cable of Dallas L.P. DBA Time Warner Cable, to provide narrative description of the methodologies used to determine each category of revenues. Further, OFS will request a mapping of services offered to those categories of revenues. OFS shall review the remittance advice of the company at least quarterly to determine if there has been any change in revenue codes and, if there are such changes, request explanations from the company.

Recommendation 3:

We recommend the Director of OFS to ensure that when late payments are received by OFS, staff determine the amount of interest and compare to the late fee to ensure the appropriate payment penalty is used.

Management's Response

Agree. This process is already in place and is being followed by OFS.

Appendix I

Background, Objectives, Scope and Methodology

Background

Ordinance No. 24361 defines the terms and conditions under which the cable franchisee operates within the City of Dallas. Part of this ordinance, Section 9, defines the fees, payments, and compensation that the cable operator agrees to pay the City. The principal fees and payments of this agreement include:

- 1) A franchise fee of 5% of cable gross revenues;
- 2) Late fee payments of \$200 per day or partial day or interest at 10% annual percentage rate of the total amount past due; and
- 3) Interest of 8% for any net undisputed amount due to the City, compounded monthly.

The effective date of the franchise was January 1, 2001. The current franchise agreement is effective through December 31, 2015, plus any extensions mutually agreed to by the parties. On December 5, 2005, Ordinance No. 26167 approved the transfer of the control of the cable television franchise to Time Warner Cable, Inc.

Comcast's monthly revenues are generated from three primary sources:

- 1. Customer subscriptions to television and music services.** These services include basic, expanded basic, premium channels, pay per view, etc. Revenues originate from monthly customer billings that are recorded to the Cable Service Group (CSG), a third party service provider billing system. CSG provides to Comcast monthly reports of these revenues.
- 2. Advertising sales and production services.** Billings for advertising sales and production services are processed and handled at the local Dallas office. Accounting functions for advertising are handled primarily in the Denver, Colorado office.
- 3. Commissions for Home Shopping Network for airing network programming and other miscellaneous revenues.** These transactions are recorded on manually prepared journal entries which are posted by the Philadelphia office to the General Ledger.

The Office of Financial Services provides management oversight of the franchise.

Objectives, Scope and Methodology

The objectives of the audit were to determine whether:

- Comcast's franchise fee payments to the City were accurate and comply with the provisions of the ordinance.
- OFS oversight and monitoring of the franchise agreement is adequate.

The audit was conducted in accordance with generally accepted government auditing standards and covered franchise fee payments for calendar years 2002 through 2005. However, we also reviewed certain matters, procedures, and transactions occurring outside that period.

To develop an understanding of relevant internal controls, policies and procedures, we:

- Reviewed the franchise ordinances.
- Held several meetings and conference calls with Comcast's and City personnel concerning relevant internal controls, access to documentation, accounting methodologies, processes, and other matters.
- Judgmentally selected 12 months for initial test of subscriber revenue.
- Judgmentally selected 14 months and performed various tests including reconciliations of subscriber and non-subscriber revenues, bad debt allocations, and verified the amounts recomputed for franchise fee.
- Compiled revenues and franchise fee amounts submitted with Comcast's monthly remittances.
- Reviewed Comcast's independent external audit reports.
- Compared the independent external audit reports of annual gross revenues with the annual gross revenue amounts compiled from the monthly remittances.
- Reviewed SAS 70 reports for Comcast's third party service provider.
- Reviewed invoices for advertising services and the associated advertising contracts.
- Consulted with Assistant City Attorneys.
- Provided to the City Council periodic status reports.
- Reviewed other municipalities audit reports on franchise fees.

Comcast revenue used for computing monthly franchise fees is comprised of more than 88 per cent from subscribers, more than 10 per cent from Advertising Sales, and less than 1 percent from other revenue sources, such as Home

Shopping Network and other miscellaneous sources. (See Appendix III, Table 1 for Sources of Revenues)

Comcast paid its monthly franchise fees by checks. Attached to each check is a list of the major revenue categories and amounts (remittance advice) used to compute the franchise fee. Comcast did not provide additional documentation to support the revenues used to compute the monthly franchise fee paid to the City.

To verify the reliability and accuracy of the remittances to the City, we judgmentally selected a sample of 12 months during the 48 month audit period, January 2002 through December 2005, and requested Comcast to provide the documentation to support the Subscribers revenues reported on the remittance advices for the selected months.

Based on our tests of 9 sample months, we were unable to reconcile Subscribers revenues to the amounts shown on the remittance advices. We then requested Comcast to reconstruct the revenue reported on the monthly remittance advices for the calendar years 2002 through 2005. Comcast retrieved the data for the period and recalculated the revenue and the associated franchise fees payable.

To verify the reliability and accuracy of the recomputed monthly franchise fees, we judgmentally selected a sample of 14 months and performed various tests including subscriber revenue reconciliation, verification of advertisement sales, and reasonableness of bad-debt allocation etc. for the franchise fees revenues. Through discussions, review of documentation, and test of transactions, we gained an understanding of Comcast's accounting methodologies and industry practices. As a result of our tests, we did not identify any additional franchise fees that were due to the City.

Appendix II

Major Contributors to this Report

Paul Garner, Assistant City Auditor
Theresa Hampden, Audit Manager
Jing Xiao, Project Manager
Cristian Aquino, Auditor
Thandee Kywe, Auditor

Appendix III

**Table 1 - Summary of Comcast Franchise Fee Revenues
Calendar Years 2002 – 2005**

Dallas Franchise Revenue Summary (Comcast January 2007 Submission)					
Revenue Type	2005	2004	2003	2002	Total
Subscriber Revenue	\$87,419,755	\$83,197,740	\$82,557,287	\$81,072,957	\$334,247,739
Non-Subscriber:					
-Advertising	\$11,287,823	\$10,064,868	\$ 9,847,982	\$ 9,330,886	\$40,531,559
-Home Shopping & Others	544,581	511,580	723,990	421,351	2,201,502
Total Non-Subscriber Revenues	\$11,832,404	\$10,576,448	\$10,571,972	\$ 9,752,237	\$42,733,061
Total Gross Revenues	\$99,252,159	\$93,774,188	\$93,129,259	\$90,825,194	\$376,980,800
Percent of Gross Revenues					
Subscriber	88.078%	88.721%	88.648%	89.263%	88.664%
Advertising	11.373%	10.733%	10.575%	10.273%	10.752%
Home Shopping & Others	0.549%	0.546%	0.777%	0.464%	0.584%

**Table 2 - Summary of Underpaid Franchise Fee Revenues
Calendar Years 2002 – 2005**

Summary of Comcast Recomputed Franchise Fee (Comcast January 2007 Submission)					
	2005	2004	2003	2002	Total
Total Franchise Fee Paid	\$5,197,521	\$4,922,835	\$4,833,816	\$4,788,810	\$19,742,982
Franchise Fee Due Per January 2007 Submission	\$5,217,838	\$4,935,483	\$4,901,539	\$4,780,273	\$19,835,133
Calculated Over (Under) Payment	(\$20,317)	(\$12,648)	(\$67,723)	\$8,537	(\$92,151)

**An Audit Report on –
Comcast Cable Franchise Fees
2002 through 2005**

Appendix IV

**Computed Interest
Audit Period 01/01/2002 through 12/31/2005**

	Month	Franchise Fee Over/(Under) Payment	Accumulated Over/Under	Interest Imposed in the month (8% annual)	Accumulated Over/Under with Compounded Interest
1	Jan-02	(\$1,934.12)	(\$1,934.12)	\$12.89	(\$1,947.01)
2	Feb-02	16,927.18	14,980.17	-	14,980.17
3	Mar-02	(2,960.73)	12,019.44	-	12,019.44
4	Apr-02	(3,452.09)	8,567.35	-	8,567.35
5	May-02	(1,207.48)	7,359.87	-	7,359.87
6	Jun-02	(3,100.74)	4,259.13	-	4,259.13
7	Jul-02	(801.39)	3,457.74	-	3,457.74
8	Aug-02	(2,356.78)	1,100.96	-	1,100.96
9	Sep-02	(1,856.11)	(755.15)	5.03	(760.18)
10	Oct-02	971.31	211.13	-	211.13
11	Nov-02	9,519.60	9,730.73	-	9,730.73
12	Dec-02	(1,211.89)	8,518.84	-	8,518.84
13	Jan-03	3,281.69	11,800.53	-	11,800.53
14	Feb-03	4,154.06	15,954.59	-	15,954.59
15	Mar-03	5,901.56	21,856.15	-	21,856.15
16	Apr-03	5,436.84	27,292.99	-	27,292.99
17	May-03	8,973.20	36,266.19	-	36,266.19
18	Jun-03	(52,434.08)	(16,167.89)	107.79	(16,275.69)
19	Jul-03	9,584.10	(6,691.59)	44.61	(6,736.20)
20	Aug-03	5,660.86	(1,075.34)	7.17	(1,082.51)
21	Sep-03	(40,793.91)	(41,876.42)	279.19	(42,155.61)
22	Oct-03	(5,797.83)	(47,953.44)	319.71	(48,273.14)
23	Nov-03	(8,051.63)	(56,324.77)	375.52	(56,700.29)
24	Dec-03	(3,637.90)	(60,338.19)	402.27	(60,740.47)
25	Jan-04	(4,478.56)	(65,219.03)	434.82	(65,653.84)
26	Feb-04	2,276.33	(63,377.51)	422.54	(63,800.05)
27	Mar-04	(11,009.12)	(74,809.17)	498.75	(75,307.92)
28	Apr-04	2,304.01	(73,003.91)	486.72	(73,490.63)
29	May-04	(203.69)	(73,694.32)	491.32	(74,185.64)
30	Jun-04	(947.93)	(75,133.57)	500.92	(75,634.48)
31	Jul-04	2,601.60	(73,032.88)	486.91	(73,519.79)
32	Aug-04	(388.65)	(73,908.44)	492.75	(74,401.19)
33	Sep-04	(3.67)	(74,404.86)	496.06	(74,900.92)

**An Audit Report on –
Comcast Cable Franchise Fees
2002 through 2005**

**Computed Interest
Audit Period 01/01/2002 through 12/31/2005**

Month	Franchise Fee Over/(Under) Payment	Accumulated Over/Under	Interest Imposed in the month (8% annual)	Accumulated Over/Under with Compounded Interest
34 Oct-04	(1,676.71)	(76,577.63)	510.54	(77,088.17)
35 Nov-04	(614.84)	(77,703.01)	518.05	(78,221.06)
36 Dec-04	(506.72)	(78,727.78)	524.88	(79,252.66)
37 Jan-05	(525.62)	(79,778.28)	531.88	(80,310.16)
38 Feb-05	(1,019.56)	(81,329.72)	542.23	(81,871.94)
39 Mar-05	(1,624.47)	(83,496.41)	556.67	(84,053.08)
40 Apr-05	(793.41)	(84,846.49)	565.67	(85,412.17)
41 May-05	(1,879.50)	(87,291.67)	581.97	(87,873.64)
42 Jun-05	(1,980.70)	(89,854.34)	599.06	(90,453.40)
43 Jul-05	(3,075.30)	(93,528.70)	623.56	(94,152.25)
44 Aug-05	(2,167.09)	(96,319.34)	642.16	(96,961.50)
45 Sep-05	(1,916.74)	(98,878.24)	659.22	(99,537.47)
46 Oct-05	(1,849.96)	(101,387.43)	675.95	(102,063.38)
47 Nov-05	(1,633.92)	(103,697.30)	691.35	(104,388.65)
48 Dec-05	(1,850.70)	(106,239.35)	708.30	(106,947.64)
Total during the Audit Period	(92,151.20)		14,796.44	
49 Jan-06	(92,151.20)		713.02	(107,660.66)
50 Feb-06	(92,151.20)		717.77	(108,378.44)
51 Mar-06	(92,151.20)		722.56	(109,101.00)
52 Apr-06	(92,151.20)		727.38	(109,828.37)
53 May-06	(92,151.20)		732.23	(110,560.60)
54 Jun-06	(92,151.20)		737.11	(111,297.71)
55 Jul-06	(92,151.20)		742.02	(112,039.73)
56 Aug-06	(92,151.20)		746.97	(112,786.70)
57 Sep-06	(92,151.20)		751.95	(113,538.65)
58 Oct-06	(92,151.20)		756.96	(114,295.61)
59 Nov-06	(92,151.20)		762.01	(115,057.62)
60 Dec-06	(92,151.20)		767.09	(115,824.71)
61 Jan-07	(92,151.20)		772.20	(116,596.91)
62 Feb-07	(92,151.20)		777.35	(117,374.26)
63 Mar-07	(92,151.20)		782.53	(118,156.79)
64 Apr-07	(92,151.20)		787.75	(118,944.55)
65 May-07	(92,151.20)		793.00	(119,737.55)

**An Audit Report on –
Comcast Cable Franchise Fees
2002 through 2005**

**Computed Interest
Audit Period 01/01/2002 through 12/31/2005**

	Month	Franchise Fee Over/(Under) Payment	Accumulated Over/Under	Interest Imposed in the month (8% annual)	Accumulated Over/Under with Compounded Interest
66	Jun-07	(92,151.20)		798.29	(120,535.84)
67	Jul-07	(92,151.20)		803.61	(121,339.45)

Management's Response to the Draft Report

Memorandum

RECEIVED
APR 25 2007
CITY AUDITOR'S OFFICE



CITY OF DALLAS

Date April 25, 2007
To Craig Kinton
City Auditor
Subject Responses to Comcast Cable Franchise Fees 2002-2005 Audit

We have reviewed the comments and recommendations of the Comcast Cable Franchise Fees 2005-2005 audit report. As a result of this review we have included the following responses.

Recommendation 1:

We recommend the Director of the office of Financial Services (OFS) with the assistance of the City Attorney collect the \$118,944.55, which represents \$92,151.20 in underpaid franchise fees and interest of \$26,793.35 through April 2007.

Management's Response:

We concur. The Office of Financial Services (OFS) will make all reasonable efforts to collect the aforementioned sum and will if necessary obtain assistance from the City Attorney. The OFS became aware of monies being past due approximately six months ago through communications with the Auditors Office and the Franchisee. However, the "draft audit report" shared with the OFS does not contain sufficient detail for the OFS to verify the amount claimed due. Further, the OFS has not seen the auditor's work papers and underlying calculations pertaining to the amount due. As pointed out in the Audit Report, Section 9.e of the franchise requires the franchisee to pay amounts due "within forty-five (45) days of the City's submitting an invoice for such sum to the Company, with reasonable detail supporting the amount claimed." Once the Audit report is issued and the City Auditor's Office provides OFS with "reasonable detail supporting the amount claimed" an invoice will be generated and delivered to Comcast. The OFS will pursue all remedies available under the franchise to ensure that amounts owed are paid.

Recommendation 2:

We recommend the Director of OFS to implement monitoring procedures which include requesting the franchisee to provide supporting documentation on the methodologies.

Management's Response:

We concur. The OFS will request the current franchisee Comcast Cable of Dallas L.P. DBA Time Warner Cable, to provide a narrative description of the methodologies used to determine each category of revenues. Further, the OFS will request a mapping of

**An Audit Report on –
Comcast Cable Franchise Fees
2002 through 2005**

services offered to those categories of revenues. The OFS shall review the remittance advice of the company at least quarterly to determine if there has been any change in revenue codes and if there are such changes request explanations from the company. It should be noted that the auditors have found no errors in Comcast's methodology of calculating franchise fees. The underpayments discovered in this audit are a result of Comcast not being able to tie their historical monthly remittance advices to their underlying financial statements. Although the OFS will request and maintain this information, it is the opinion of the OFS that it will not improve the accuracy of the franchisees payments. If this information had been maintained historically it would not have detected the underpayments purported to have been discovered in this audit unless we request monthly information on adjustments for customer accounts. Time Warner Cable considers some of this information confidential information protected from disclosure by the federal privacy act.

Recommendation 3:

We recommend the Director of OFS to ensure that when late payments are received by OFS, staff determine the amount of interest and compare to the late fee to ensure the appropriate payment penalty is used.

Management's Response:

We concur. This process is already in place and is being followed by OFS. The OFS currently records the date each payment is received in the "Franchise Fee Payment Register" payment register. The payment due date is also entered in the register and a comparison made. If the payment is received after the due date, the OFS demands payment of a late payment penalty for the late payment, if the late payment penalty has not already been paid by the franchisee. The franchise requires a late payment penalty for late payments set at the greater of \$200.00 per day or interest at 10 percent (10%) annual percentage of the total amount past due. Simple math tells us that the \$200 per day amount will always be greater than 10% annual percentage of the total amount past due until such time as the monthly payment that is late is in excess of \$730,000. Currently the monthly franchise fee payments received from the franchisee are approximately \$420,000, far below the amount that would trigger an interest calculation. If the franchisee makes a late payment that is in excess of \$730,000 the OFS will calculate interest at ten percent annual percentage rate and demand payment thereof.

If you have any further questions please direct them to me of Nick Fehrenbach at 214-670-5173.



Maria Alicia Garcia, Director
Office of Financial Services

C: David Cook, Chief Financial Officer
Nick Fehrenbach, Manager of Regulatory Affairs
Edward Scott, CPA – City Controller

An Audit Report on –
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2002 through 2005



Comcast Cable
1500 Market Street
Philadelphia, PA 19102

Peter H. Feinberg
Associate General Counsel
215.320.7934 Tel
215.320.3572 Fax

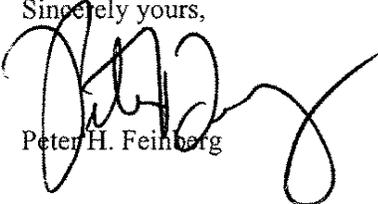
April 25, 2007

Craig Kinton, C.P.A.
City Auditor
City of Dallas
City Hall
Dallas, TX 7520

Dear Mr. Kinton:

You have requested that we provide comments to the draft Audit Report your office has prepared in connection with your audit of Comcast's cable franchise fees for the period 2002 through 2005.

Comcast takes no exception to the report's findings. We note, however, that because Comcast is no longer the franchisee in Dallas, it would not be appropriate for us to comment on any recommendations discussed under Item 2, Audit Results, as it would apply to future franchise fee collections.

Sincerely yours,

Peter H. Feinberg