



# CITY OF SAN ANTONIO

P. O. BOX 839966  
SAN ANTONIO TEXAS 78283-3966

October 8, 2010

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Mayor

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Councilwoman, District 9

**John G. Clamp**  
Councilman, District 10

Mayor and Council Members:

SUBJECT: Finance Department, Audit Report of Grande Communications, Inc., Cable Franchise Fees

We are pleased to send you the *audit report of the Finance Department*. This audit began in January 2010 and concluded with an exit meeting with department management in August 2010. Management's verbatim response is included in Appendix B of the report. Management of the Finance Department and Grande Communications, Inc. should be commended for their cooperation and assistance during this audit.

The Office of the City Auditor is available to discuss this report with you individually at your convenience.

Respectfully submitted,

Park E. Pearson, CPA  
City Auditor  
City of San Antonio

**Distribution:**

**Sheryl L. Sculley, City Manager**  
**Ben Gorzell, Chief Financial Officer**  
**Jeff Pullin, Manager, Public Utilities Division, Finance Department**  
**Michael D. Bernard, City Attorney**  
**Leticia M. Vacek, City Clerk**  
**Robbie Greenblum, Chief of Staff, Office of the Mayor**  
**Jaime Castillo, Communications Director, Office of the Mayor**  
**Frances A. Gonzalez, Assistant to the Mayor, Office of the Mayor**  
**Edward Benavides, Chief of Staff, Office of the City Manager**  
**Stanley Blend, Audit Committee Member**  
**Manuel Long, Audit Committee Member**

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**CITY OF SAN ANTONIO**  
**OFFICE OF THE CITY AUDITOR**



Audit of the Finance Department

Grande Communications, Inc. - Cable Franchise Fees

Project No. AU09-005C

October 8, 2010

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## Executive Summary

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As part of our annual Audit Plan, we conducted an audit of the Finance Department, specifically cable franchise fees reported by Grande Communications, Inc. (Grande). The audit objective, conclusions, and recommendations follow:

***Are cable franchise and public, education, and government (PEG) fees properly remitted for all subscribers inside San Antonio city limits?***

Grande properly remitted cable franchise and public, education, and government (PEG) fees (franchise fees) for all subscribers inside San Antonio city limits. However, Grande underreported advertising revenues during the audit scope period by \$424,535, resulting in an underpayment to the City of San Antonio (COSA) of \$25,472.

Also, the reporting model used by Grande for remittance of quarterly franchise fee payments contains an error in the formula that resulted in an overpayment of franchise and PEG fees by \$994 to COSA over the four-year scope period.

We recommend that the Finance Department, Public Utility Division (PUD) work with Grande to collect the \$25,472 due from underreported advertising revenues. We also recommend that the PUD credit the \$994 overpayment and work with Grande to correct the reporting model for remittance of franchise fees.

Management's verbatim response is in **Appendix B** on page 6.

We would like to express our gratitude to Grande management and staff for their quick and thorough responses to our data requests and continuous cooperation throughout the audit.

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## Background

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Grande provides cable television service to customers in San Antonio. Cable system operators are required to pay franchise and PEG fees for use of public rights-of-way. Grande remitted approximately \$2.1 million in franchise and PEG fees to COSA for the calendar year period 2006 through 2009.

On May 18, 2000, COSA passed an ordinance giving Grande a 15-year franchise to use public rights-of-way to construct, operate, and maintain a cable/broadband communications system. Public rights-of-way consist of roads, streets, alleys, sidewalks, and other thoroughfares managed by COSA that are necessary for cable system operators to install and operate their facilities.

In September 2005, the Texas Public Utility Regulatory Act (PURA)<sup>1</sup> was enacted. As permitted by PURA Chapter 66, Grande elected to terminate its franchise agreement with COSA in favor of obtaining a state-issued certificate of franchise authority. Grande obtained the certificate of franchise authority allowing it to operate under PURA as of January 1, 2006. Consistent with PURA requirements, Grande pays COSA a franchise fee of five percent (5%) of its gross annual cable television revenues plus an additional one percent (1%) to support local public, educational, and governmental (PEG) access channel operations and equipment.

COSA's Public Utilities Division (PUD) of the Finance Department oversees the cable system operators that provide cable services to the residents of San Antonio. Accordingly, the PUD monitors, tracks, and accounts for all franchise fee payments to COSA made by cable system operators.

## Audit Scope and Methodology

The audit scope included calendar years 2006 through 2009.

We interviewed staff and management of the PUD and Grande. We created flowcharts of the processes used by Grande in calculating cable revenue and the related franchise and PEG fees. Testing criteria included PURA, Chapter 66.

We relied on computer-processed data in Grande's information systems to validate the amount of revenue subject to franchise and PEG fees. Grande's systems include the CSG subscriber-billing system, Omnia subscriber-billing system, and the J. D. Edwards financial system. We directly tested the data

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<sup>1</sup> State of Texas, Utilities Code, Title 2 Public Utility Regulatory Act, Subtitle C Telecommunications Utilities, Chapter 66 State-Issued Cable and Video Franchise.

rather than evaluate the systems' general and application controls. We do not believe that the absence of testing general and application controls had an effect on the results of our audit.

Using ACL data analysis software, we compared subscriber-billing data to the CSG system generated reports to confirm the completeness of the CSG reports. We traced cable revenue reported by Grande to CSG system generated revenue reports to confirm that the revenue was accurately and completely reported.

We tested subscriber-billing records and addresses for the entire San Antonio market. Using geographic information system (GIS) software, we compared all subscriber addresses in Grande's San Antonio market to COSA's street address database to determine if Grande had appropriately coded subscriber accounts with the proper municipality code.

We attempted to test bad debt write-offs as a component of "gross revenues" subject to franchise fees; however, Grande was unable to provide sufficient appropriate documentation for the receivables written off.

We traced advertising revenue to third-party source documentation and to Grande's financial system to determine if it had reported advertising revenue accurately and completely. Test work was expanded to include all months in the scope period because of reporting errors we identified.

We conducted this audit from January 2010 to August 2010 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 audit results and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our audit results and conclusions based on our audit objectives. Our audit included tests of management controls that we considered necessary under the circumstances.

## Audit Results and Recommendations

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### A. Advertising Revenue

Grande underreported advertising revenues subject to franchise fees during the scope period by \$424,535, resulting in an underpayment to COSA of \$25,472.

PURA, Sec. 66.002 (6) (A) reads in part “Gross revenue includes a pro rata portion of all revenue derived...pursuant to compensation arrangements for advertising.” It continues, “**Advertising commissions paid to third parties shall not be netted against advertising revenue included in gross revenue.**”

Grande sold the rights to its advertising airtime to a third-party company, which locates advertisers, coordinates the airing of commercials, and performs the accounts receivable function. The third party remits a portion of the advertising revenue to Grande. Grande considers the payment it receives to be its gross advertising revenue rather than the entire amount collected by the third party.

The City Attorney’s Office concurs with us that gross advertising revenue includes the entire amount collected by the third party, not just the portion remitted to Grande.

In addition, Grande did not include five invoices in its calculation of advertising revenue. Furthermore, Grande posted more advertising revenue in its general ledger than it had reported to COSA. Additional revenue subject to franchise fees payable to COSA totals \$424,535 resulting in an underpayment of \$25,472 as shown in the table below:

<b>Summary of Underreported Advertising Revenue</b>	
Reporting net instead of gross	\$334,327
Additional five invoices	51,303
General ledger amounts	39,402
Miscellaneous errors	-497
Total	<u>\$424,535</u>
Franchise Fees @ 6%	\$25,472

**Recommendation:** The PUD should work with Grande to collect the \$25,472 due to COSA from underreported advertising revenues.

## **B. Finance Reporting Model**

The reporting model used by Grande for remittance of quarterly franchise fee payments to COSA contains an error in the formula that results in an overpayment of Grande's franchise and PEG fees that relate to advertising and home shopping revenues.

PURA Sec. 66.005 requires the cable service provider to remit 5% of its gross revenues, while Sec. 66.006 requires the cable service provider to remit 1% of its gross revenues to municipalities that it services. Collectively, the cable provider is required to remit 6% of gross revenues.

Grande's use of the current reporting model resulted in franchise fees related to advertising and home shopping revenues being calculated at approximately 6.38% of advertising and home shopping revenue rather than 6% as required by PURA. Because of the error in the model, Grande overstated advertising and home shopping revenue and overpaid franchise fees by \$994 over the scope period.

**Recommendation:** The PUD should credit the \$994 overpayment and work with Grande to correct the reporting model for remittance of franchise fees.

*This concludes the Audit Results and Recommendations. Management's responses to the observations can be seen in **Appendix B.***

## Appendix A – Staff Acknowledgement

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Barry Lipton, CPA, DABFA, Deputy City Auditor  
Mark Bigler, CPA, CISA, CFE, Audit Manager  
Arlena Sones, CPA, CIA, CGAP, Auditor-in-Charge  
Alejandro Valadez, CISA, Auditor  
Gabriel Trevino, CISA, Auditor  
Rebecca Moulder, CIA, Auditor

## Appendix B – Management Response



# CITY OF SAN ANTONIO

SAN ANTONIO TEXAS 78283-3966

September 30, 2010

Park E. Pearson, CPA  
City Auditor  
San Antonio, Texas

RE: Management's Corrective Action Plan for the Grande Communications, Inc. – Cable Franchise Fees Audit

The Finance Department-Public Utilities Division has reviewed the audit report and has developed the Corrective Action Plans below corresponding to report recommendations.

Recommendation					
#	Description	Audit Report Page	Accept, Partially Accept, Decline	Responsible Person's Name/Title	Completion Date
A	<b>Advertising Revenue</b> Recommendation: The Public Utilities Division should work with Grande to collect the \$25,472 due to COSA from underreported advertising revenues.	3	Accept	Ben Gorzell, Jr. Chief Financial Officer	October 1, 2010
<b>Action plan:</b> Public Utilities will work with Grande to collect the \$25,472 due to COSA from underreported advertising revenues.					
B	<b>Finance Reporting Model</b> Recommendation: The Public Utilities Division should credit the \$994 overpayment and work with Grande to correct the reporting model for remittance of franchise fees.	4	Accept	Ben Gorzell, Jr. Chief Financial Officer	October 1, 2010
<b>Action plan:</b> Public Utilities will produce a new simplified reporting model utilized for remittance of quarterly franchise fee payments and forward it to the cable system operators submitting franchise fees (AT&T, Grande Communications, and Time Warner Cable). Public Utilities will also credit the \$994 overpayment to Grande.					

We are committed to addressing the recommendations in the audit report and the plan of actions presented above.

Sincerely,



Ben Gorzell  
Chief Financial Officer

9/30/2010

Date