

**Internal Audit Report 17-02**  
**Cable TV & OVS**  
**September 2017**



City of Sioux Falls  
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## **CABLE TV & OVS INTERNAL AUDIT REPORT 17-02**

### **INTRODUCTION**

The City of Sioux Falls is authorized by Ordinance to enter into Franchise Agreements with cable operators that permit the companies to use the public right of ways to install and maintain the equipment needed to provide cable television and related services to residents. These agreements describe the services to be provided and the Cable Television Franchise Fees and Open Video System (OVS) License Fees to be collected by the City. The Federal Communications Commission mandates some of the agreement terms and other terms are negotiated between the City and the franchisee.

### **BACKGROUND**

The City currently has a Cable System Franchise agreement with Midco. The term of the agreement was ten years and will expire December 31, 2019. Midco was originally founded in 1931 and is currently operated as a joint venture between Midcontinent Media and Comcast. They provide internet, cable TV, home phone and home automation services. They currently serve more than 300,000 customers in 335 communities in Minnesota, North Dakota, South Dakota, and Wisconsin and have recently expanded services into Kansas.

The City currently has an OVS license with Clarity Telecom d/b/a Vast Broadband. The License originally expired December 31, 2014 but was extended through a renewal for an additional five years and will expire on December 31, 2019. Vast Broadband was formed in 2014 after the acquisition of cable systems in South Dakota from Wide Open West which Wide Open West had previously picked up through its acquisition of Knology in 2012. They provide internet, cable TV and phone services in South Dakota, northwestern Iowa and southwestern Minnesota.

Cable Franchise & OVS Fees are self-reported and remitted to the City on a monthly basis. Revenues are reviewed by Multimedia Services and compared to historical payments for reasonableness and any unusual changes are researched. Cable Franchise & OVS Fees were last reviewed by Internal Audit in 2009.

#### **Total Cable TV Franchise & OVS Fees**

<b>2016</b>	<b>2015</b>	<b>2014</b>
\$ 989,207	\$ 969,689	\$ 947,213

## **OBJECTIVES**

The objectives of this audit were to:

1. Determine if the cable television fees and OVS license fees are properly calculated and paid on time.
2. Ensure compliance with various insurance requirements of the agreement.
3. Determine if the City has established and sufficiently defined roles and responsibilities to administer the agreements.

## **SCOPE AND METHODOLOGY**

The scope of this audit included a review of the franchise fee calculations and video system fee remittances from January 1, 2014 through December 31, 2016 and a review of other compliance requirements in place as of December 31, 2016. Our audit work included the following:

- Review of Franchise Agreements in place with service providers and Chapter 123: Cable Service of the Code Ordinances of the City.
- Interviews with the City's Central Services and Multimedia management.
- Interviews with service provider management and staff.
- Detailed testing of franchise fee calculations for a sample of individual customers to verify that the franchise fee is being billed to all applicable revenues as defined by section 123.050.
- Testing of supporting schedules for a sample of monthly remittances to ensure the franchise fees paid to the City were complete.
- Review of insurance certificates to confirm franchisees had adequate coverage.

## **RESULTS**

### **Recalculation and payment of fees**

We selected six months of cable franchise fees and OVS remittances and traced the amount paid to the City back to the detailed support schedules. Fees were properly supported and paid to the City in a timely manner.

We tested individual customer invoices for a sample of 31 Midco customers and recalculated the franchise fee for the same six months. The franchise fee was calculated properly against all services and fees defined as Gross Revenue with the following exception.

Midco identified a period from January 2011 through May 2015 when the franchise fee was calculated at 2 percent instead of 2.5 percent on the Local Broadcast Retransmission Fee. The retransmission fee is charged by local broadcast networks to cable operators for consent to retransmit their signal to customers. Although Midco performs an annual rate review, this miscalculation was not discovered until 2015 as the variance on individual customer bills was approximately \$0.005-\$0.02 for the first few years and was assumed to be a rounding issue. As the retransmission fee increased the difference in franchise fees on the individual customer bills rose to \$0.02 – \$0.03 and the issue was identified and corrected in May 2015. City Ordinance defines the period of limitation for recovery of franchise fees as three years. The tables below show the calculations for the uncollected franchise fees within the recovery period as well as the estimated uncollected fees for the three years outside the recovery period.

**Uncollected Franchise Fees for January 2014 -May 2015**

	Retran Fee per Customer	Difference in Franchise Fee	Uncollected Franchise Fee per Customer per Month	Number of Midco Cable Customers	Monthly Uncollected Franchise Fees	Annual Uncollected Franchise Fees
<b>2014</b>	4.52	0.50%	\$0.0226	31,035	\$701.39	\$8,416.69
<b>2015 (Jan-May)</b>	4.52	0.50%	\$0.0226	32,122	\$725.96	\$3,629.79
						\$12,046.48

**Estimated Uncollected Franchise Fees for 2011 - 2013**

	Retran Fee per Customer	Difference in Franchise Fee	Uncollected Franchise Fee per Customer per Month	Average Number of Midco Cable Customers*	Monthly Uncollected Franchise Fees	Annual Uncollected Franchise Fees
<b>2011</b>	0.66	0.50%	\$0.0033	31,578	\$104.21	\$1,250.49
<b>2012</b>	2.26	0.50%	\$0.0113	31,578	\$356.83	\$4,281.98
<b>2013</b>	4.32	0.50%	\$0.0216	31,578	\$682.08	\$8,185.02
						\$13,717.48

\* The average number of cable customers used is an average of actual customers from 2014 and 2015 above.

We also tested individual customer invoices for a sample of 30 Vast Broadband customers and recalculated the OVS fee for the same six months. The OVS fee was calculated properly against all services defined as Gross Revenue.

### **Insurance requirements**

The franchise agreements require certain insurance coverages that franchisee's must maintain such as Commercial General Liability, Worker's Comp, and Auto. The agreements also outline certain provisions and clauses that protect the City from undue liability. We reviewed the insurance certificates on file with the City and observed that proper coverage levels are in place and policies are up to date with both franchisees.

### **Contract monitoring**

The City does not have a centralized process for monitoring compliance with contracts. Monitoring is done at the departmental level based on the individual requirements of the contract. Internal Audit assists with this process through audit requests and routinely scheduled contract compliance audits. The Cable TV & OVS franchise agreements are managed by Multimedia Support with the assistance of the City's Finance and Legal departments when needed.

## **RECOMMENDATIONS**

We made the following recommendations that address the above referenced results.

- 1) We recommend that Midco remit the amount of uncollected franchise fees within the recovery period in the amount of \$12,046.48. These fees are to be remitted prior to December 31, 2017.

*Management's Response: Midco will remit the amount due by 12/31/2017.*

*Management Representative Responding:  
Nancy Vogel, Director of Regulatory Finance, Midco*

*Date of expected implementation: Prior to December 31, 2017*

- 2) We recommend that management and internal audit develop a plan for the routine review of revenue received from the Cable TV & OVS franchise agreements.

*Management's Response: The Multimedia Support division of Central Services completely agrees with this recommendation. We look forward to working with the Internal Audit team to develop a plan for routine reviews.*

*Management Representative Responding: Sue Quanbeck Etten, Director of Central Services and Brett Mathison, Multimedia Manager*

*Date of expected implementation: In collaboration with Internal Audit, we would like to develop a plan before the end of the year.*

## **CONCLUSION**

The Cable TV & OVS franchise agreements ensure community needs are met and cable systems are accessible throughout the City. They also allow the City to ensure that it can properly manage and controls rights-of-way use while allowing the prompt establishment of cable services. The City has established good working relationships with its franchisees. We would like to thank management and staff of the City, Midco, and Vast Broadband for their assistance throughout the course of this audit.

## **AUTHORIZATION**

The Sioux Falls City Council approved this audit by resolution in April 2017 as a carryforward audit from the 2016 Annual Audit Plan. The Internal Audit Division operates under the authority of an Internal Audit Charter adopted by City Council resolution 11-13.

## **AUDIT STANDARDS**

This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

## **STATEMENT OF INDEPENDENCE**

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per section 32.022 of the Code of Ordinances of Sioux Falls, SD.

## **DISTRIBUTION OF REPORT**

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record and its distribution is not limited.

## **PERFORMED BY**

Kimberly Schroeder, CIA  
Internal Audit Manager