

**Performance Audit 19-05:  
Franchise Fees**

**January 2020**

**City Auditor**

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# OFFICE OF INTERNAL AUDIT

## Stan Sewell, City Auditor

January 31, 2020

To: Mayor Andy Berke  
City Council Members

Subject: Franchise Fees Audit (Report #19-05)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of Franchise Fees. Our audit found the Finance Department and City Treasurer are generally doing a good job managing the franchise fee collection process. However, we found there is value in exploring opportunities for improvement.

In order to address the noted areas for improvement, we recommended actions to establish written policies and procedures, strengthen franchise agreement management, implement procedures to confirm accurate city service addresses, develop a process to identify additional entities that should have franchise agreements and obtain detailed information with franchise fee payments.

We thank the management and staff of the Finance, Treasury, CDOT and Land Development departments for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE  
City Auditor

Attachment

cc: Audit Committee Members  
Kerry Hayes, Chief of Staff  
Maura Sullivan, Chief Operating Officer  
Daisy Madison, Chief Financial Officer  
Tanikia Jackson, City Treasurer  
Jim Arnette, Tennessee Local Government Audit

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## AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2019 Audit Agenda. The objective of this audit was to determine if the City is receiving all the franchise fees it is entitled to.

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## BACKGROUND

Franchise fees are assessed on utility and telecommunication providers by the City of Chattanooga for the use of public rights-of-way. The fees are imposed by the City pursuant to a franchise agreement with each provider for a defined amount of time.

Utility and Telecommunications (Franchisees) providers included in this audit are:

1. BellSouth Telecommunications, Inc. D/B/A AT&T Tennessee (BellSouth)
2. CenturyLink Communications, LLC
3. Comcast of the South
4. Electric Power Board of Chattanooga
5. Chattanooga Gas Company
6. Zayo Group, LLC

BellSouth has a State (Tennessee) issued certificate of franchise authority, while the other providers were granted a franchise by the City of Chattanooga.

### Financial Information

Franchise fees were \$4,824,817 according to the June 30, 2018 Comprehensive Annual Financial Report (CAFR). The Franchisees included in this audit report represent 97.7% (\$4,715,162) of franchise fees revenue for fiscal year 2018.

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## FINDINGS AND RECOMMENDATIONS

### Establish Policies and Procedures

We found a lack of written policies and procedures specifically for the franchise process. State law and City Code establish requirements for the assessment of franchise fees on utility and telecommunication providers by the City of Chattanooga for the use of the public right of way. The fees are imposed by the City pursuant to a franchise agreement with each provider for a defined amount of time. The City has numerous policies and procedures, but they do not include policies and procedures specifically related to the franchise process.

Franchise oversight, performance and control is informal and based primarily on institutional knowledge of staff. Without written policies and procedures, there is a risk for inconsistent practices among employees and discontinuity that could increase should there be employee turnover. Additionally, there is a risk the franchise process may be mismanaged and result in a loss of revenue.

The Government Finance Officers Association (GFOA) Best Practice indicates, “Every government should document its accounting policies and procedures”.

#### Recommendation 1:

We recommend the Finance Department establish written policies and procedures for the franchise process. The purpose of the policy is to establish procedures, accountability and controls for the franchise process.

***Auditee Response:** The Chief Operating Officer will lead an initiative to establish written policies and procedures that ensure accountability and controls for management of the Franchise Agreements in collaboration with City Attorney, LDO, CDOT and Finance Office.*

### Strengthen Franchise Agreement Management

We found no particular department or individual employee has responsibility for managing or monitoring the franchise agreements. Contract management is important to ensure parties adhere to the terms and conditions in the agreement.

Due to lack of monitoring, two franchise agreements have expired, including CenturyLink (November 2009) and the Electric Power Board (November 2018). Both Franchisees indicate a new agreement is being negotiated with the City.

In addition, not all of the Franchisees' insurance coverages meet the requirements of City Code. Only three of the franchise agreements examined delineated insurance requirements.

Lack of monitoring terms of the agreements resulted in the contracts not being renewed in a timely manner. Best practice is to negotiate and renew contracts prior to the expiration of the current one. The lack of monitoring agreement expiration dates may result in a loss of revenue.

Also, lack of monitoring terms of the agreements resulted in insufficient insurance coverage. Required insurance coverage is delineated in the City Code (Section 32-242). The lack of monitoring insurance coverage may result in a loss due to insufficient coverage.

### **Recommendation 2:**

We recommend the Finance Department establish who is responsible for managing and monitoring the franchise agreements.

***Auditee Response:** City Code Section 2-66 states the Clerk of the City Council shall keep in a separate book a record of franchises granted by the city. The City Attorney will work in concert with the City Council Clerk to maintain a book of record and to work with Finance and Purchasing to manage existing agreements including renegotiating renewals.*

### **Recommendation 3:**

We recommend all franchise agreements should include a requirement to provide the City with insurance documentation.

***Auditee Response:** The City Attorney has provided a note regarding the insurance documentation on Franchise agreements which vary based on the type of Franchises which are in existence. All Franchise Agreements are drafted by the City Attorney's office and adopted by the City Council by Ordinance under Section 7.2 of the City Charter. All Executed Ordinances of the City Council are then maintained by the City Council Clerk and are available online since 1990 on the City website.*

*City Attorney Note: Franchise agreements may exist for up to 40 years under City Charter Section 7.1. All Franchise agreements are adopted by Ordinance of the Chattanooga City Council pursuant to City Charter Section 7.2. There are different types of Franchise agreements regarding the types of uses or rights to use public property of the City by corporations or utilities which need access to alleys, streets, ways, or public property in the City which are generally found in the*

*requirements for Streets and Sidewalks under Chapter 32 in the City Code. Certain uses require specific permits and insurance for excavations and restoration of City streets; driveways and curb cuts that access City streets; and poles and wires that are installed on City rights of ways. The most recent revisions to Chapter 32 involved Telecommunications Services and specific Franchise requirements for Telecommunications services which are found at Chattanooga City Code 32-231 et. seq. Prior to those revisions Franchise agreements have been provided for utility companies and electrical companies who have had service lines installed in public rights of ways. Those Telecommunication Franchise provisions since 1/30/2018 have required specific insurance provisions which have been incorporated into the Franchise Ordinances for insurance and bonds which are set out in Chattanooga City Code Section 32-243. The City's Telecommunications Services ordinance changed in 2018, therefore all renewed or new Telecommunication Franchise agreements include the appropriate language but different types of Franchise agreements may not have the same insurance requirements as it would require a change in the applicable ordinances which do not have the same requirements as Telecommunications Franchise agreements.*

**Auditor Comment:** While the January 30, 2018 amendment provided substantially more detail, the original ordinance (February 6, 1996) required franchisees maintain and provide proof of insurance.

**Implement  
Procedures to  
Confirm Accurate  
City Service  
Addresses**

The franchise area (service addresses within the City of Chattanooga's city limits) is set forth in the agreements between the Franchisees and the City of Chattanooga. The Franchisees use codes in their billing systems to differentiate between jurisdictions within a specific franchise area.

We found discrepancies when comparing the franchisee service addresses to the City of Chattanooga GIS records. The discrepancies result from incorrect coding of franchisee city service addresses. A list of discrepancies identified was provided to the Franchisees.

The miscoding of customer service addresses could result in the loss of revenue. For example, the franchise fees associated with the miscoded streets could be remitted to the wrong local government entity.

**Recommendation 4:**

We recommend the Finance Department work with the Franchisees to assure customer service addresses are correctly coded.

***Auditee Response:** Finance will work with the City Attorney's office to develop standard language that will address the required data fields needed to perform an audit of the service including the frequency of reports and applicable insurance requirements throughout the life of the Franchise Agreement.*

**Develop Process to Identify Additional Entities That Should Have Franchise Agreements**

We found there is not a mechanism in place to identify additional entities that should have a franchisee agreement with the City of Chattanooga. No City department reviews records to determine if additional entities should have franchise agreements. In the normal course of business, CDOT and Land Development grant permits to contractors that use the City's rights of way.

Utility and telecommunications providers using the City's rights of way are required to have a franchise agreement (Chattanooga City Code 32-234). As a result, the City places the burden of applying for a franchise agreement on the utilities and telecommunication companies using the City's rights of way.

The lack of review of City records to identify possible franchisees, results in a risk of the loss of franchise fee revenue.

**Recommendation 5:**

We recommend the Finance Department work with CDOT and Land Development to implement a process to identify possible additional entities that should have franchise agreements. For example, a periodic review of contractors granted street cut permits could identify additional utility and telecommunication providers requiring a franchise with the City.

***Auditee Response:** City Attorney will provide to the City Council Clerk, Finance, CDOT and LDO a comprehensive list of all existing Franchise agreements. Additionally, LDO will work to modify the existing application for street cutting permits to include questions that will clarify if the applicant request requires a temporary use agreement or relates to a franchise agreement.*

**Detailed Information Should Be Included with Payments**

Sufficient detailed information is not consistently included with payment remittances in order to determine compliance with the franchise agreement. As a result, City personnel do not have access to information needed to determine the accuracy or completeness of the funds received. Comcast of the South and the Electric Power Board of



Chattanooga both provide sufficient payment detail, and are good examples of what information should be included.

The franchise agreements should include a section that requires the franchisee to provide the City with all the supporting information to confirm the accurate payment of franchise fees. By not having sufficient payment details with remitted payments, there is a risk of lost revenue.

**Recommendation 6:**

We recommend the Finance Department work with the Franchisees to provide sufficient supporting information with payments to determine if the franchise agreements and payments are in compliance. Also, all franchise agreements should include a requirement to provide adequate supporting information with payments to the City.

***Auditee Response:** Finance will work with the City Attorney's office to develop standard language that will address the data fields needed for supporting documentation to be maintained by the City Council Clerk and/or Finance based on the negotiated terms of the agreements.*

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## APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Franchise Fees from July 1, 2018 to June 30, 2019. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from the Finance and Treasury Departments, Department of Transportation, Land Development Office, Geographic Information System and Franchisees. Original records as well as copies were used as evidence and verified through physical examination.

To determine if the City is receiving all the franchise fees it is entitled to: We reviewed the franchise agreements for the overwhelming majority of Franchisees, compared the franchisee service addresses to the GIS addresses, and made inquiries concerning additional entities that should have franchise agreements.

To develop our recommendations, we reviewed industry best practice documents, researched state and local law and interviewed City employees. We also reviewed prior internal audit reports and other local government franchise audit reports.

We used non-statistical sampling to determine the sample size and selection of addresses for testing. Non-statistical sampling is the selection of a test group based on the auditor's judgment, rather than a formal statistical method. We did not extrapolate the results of our testing to draw conclusions over the population as a whole.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in the Oracle E-Business Suite and the GIS system. We assessed the reliability of the data contained in the two systems and conducted sufficient tests of the data. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

We conducted this performance audit from June 2019 to November 22, 2019 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.

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