

**Audit of
Time Warner Communications
Cable Franchise Fees**

**Report by the
Office of County Comptroller**

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September 18, 2001

Richard T. Crotty, County Chairman
And
Board of County Commissioners

We have conducted an audit of the Time Warner Communications Cable Franchise Fees. The audit was limited to a review of the quarterly cable franchise fees paid to Orange County by Time Warner Communications for the period of October 1, 1999 through September 30, 2000. Our audit was conducted in accordance with generally accepted government auditing standards and included such tests as we considered necessary in the circumstances.

A response to our Recommendation for Improvement was received from the Orange County Cable Franchising Authority Communications Division and is incorporated herein.

We appreciate the cooperation of the personnel of the Orange County Cable Franchising Authority Communications Division and Time Warner Communications during the course of the audit.

Martha O. Haynie, CPA
County Comptroller

c: Ajit Lalchandani, County Administrator

EXECUTIVE SUMMARY

Executive Summary

Time Warner Communications provides cable television and high-speed Internet access to over 670,000 customers in nine counties throughout Central Florida. During the period October 1, 1999 through September 30, 2000, Time Warner reported gross revenues of \$64,403,532 from their Orange County subscribers. The cable provider paid the County \$3,220,177 as a five percent franchise fee on that revenue. The scope of the audit was limited to ensuring Time Warner Communications remitted the proper amount of cable franchise fees to the Orange County franchising authority based on the five percent requirement set forth in Chapter 12, Community Antenna Television Systems Cable Television, of the Orange County Code. The audit period was October 1, 1999 to September 30, 2000. Certain other matters outside the audit period were also reviewed. Based on the audit work performed, Time Warner remitted the proper amount of cable franchise fee revenues to Orange County for the period audited as required by the Orange County Code, except for those fees due on actual franchise fees charged, as noted below:

Time Warner charges each of its subscribers a separate line item amount equal to five percent of the customer's monthly bill. In essence, this is the franchise fee payable to the County. However, when Time Warner computes the amount of revenue subject to the franchise fee for all of its subscribers it does not include these monies, or pass-through revenue, in its calculation. During the period October 1999 through September 2000, Time Warner collected \$2,982,551 in pass-through revenue from its Orange County subscribers. If the five-percent levy had been applied to this revenue, the County would have been entitled to an additional \$149,128 of franchise fees.

On July 31, 1997, the United States Court of Appeals ruled that revenues from the operation of a cable system include collections that are allocated to the payment of franchise fees. In December 1997, the County sent a letter addressed to Time Warner requiring them to pay the franchise fee on all revenues, including franchise fees, beginning with the quarter ending December 31, 1997. Time Warner paid the County \$9,060,430 of franchise fees during the quarter ending December 31, 1997 through the quarter ending December 31, 2000. If franchise fees had been calculated on the basis required by the County, additional fees totaling \$415,200 and interest of \$97,696 through January 31, 2001 would be due the County.

The County concurred with our recommendation that the County franchising authority consults with appropriate legal counsel to determine whether the franchise fees and interest in arrears are collectible. In addition, the County agreed to more closely monitor future payments received.

ACTION PLAN

Audit of the Time Warner Communications Cable Franchise Fees
Action Plan

NO.	MANAGEMENT RESPONSE			IMPLEMENTATION STATUS		RECOMMENDATIONS
	CONCUR	PARTIALLY CONCUR	DO NOT CONCUR	UNDERWAY	PLANNED	
1.	X			X		We recommend the County franchising authority consults with appropriate legal counsel to determine whether the franchise fees and interest in arrears are collectible. In addition, the County should monitor future payments to ensure that the gross revenue (used to compute the franchise fee) includes franchise fees collected by the cable provider.

INTRODUCTION

Background

During the period October 1, 1999 through September 30, 2000, Time Warner Communications reported gross revenues of \$64,403,532 from their Orange County subscribers. The cable provider paid the County \$3,220,177 as a five percent franchise fee on that revenue.

Time Warner Communications provides cable television and high-speed Internet access to over 670,000 customers in nine counties throughout Central Florida. Within that service area, Time Warner provides free cable connections to schools allowing access to over 500 hours of commercial-free educational programming.

Nationally, Time Warner Cable provides service to almost 13 million customers and has to date expended more than \$300 million in upgrading its 13,000 mile cable network to state-of-the-art fiber optics. The recent introduction of digital cable service expanded Time Warner's programming to over 270 channels.

**Scope, Objectives,
and Methodology**

The scope was limited to ensuring Time Warner Communications remitted the proper amount of cable franchise fees to the Orange County franchising authority based on the five percent requirement set forth in Chapter 12, Community Antenna Television Systems Cable Television, of the Orange County Code. The initial audit period was October 1, 1999 to September 30, 2000. Certain other matters outside the audit period were also reviewed.

The audit objectives were to ensure that bona fide revenues are accounted for and revenue amounts were properly calculated.

We computed the total Orange County revenues for Time Warner from their billing system information for the month of July 2000.

We recalculated Time Warner's first (October through December, 1999) and fourth quarter (July through September, 2000) fee calculation worksheets for accuracy.



We verified that Orange County non-subscriber revenues were calculated correctly by ensuring that the allocation percentages attributable to Orange County were properly calculated.

We verified that streets coded as not within Orange County were located outside the geographic boundaries of the County by tracing the street name from the Homes Passed database provided by Time Warner to the Orange County street reports generated by the Orange County Geographic Information System.

Overall Evaluation

Based on the audit work performed, Time Warner remitted the proper amount of cable franchise fee revenues to Orange County for the period audited as required by the Orange County Code, except for those fees due on actual franchise fees charged, as noted herein this report.

RECOMMENDATION FOR IMPROVEMENT

1. The County Should Obtain Franchise Fees From All of Time Warner's Revenues

Time Warner charges each of its subscribers a separate line item amount equal to five percent of the customer's monthly bill. In essence, this is the franchise fee payable to the County. However, when Time Warner computes the amount of revenue subject to the franchise fee for all of its subscribers it does not include these monies, or pass-through revenue, in its calculation.

Orange County Code Chapter 12 Sec. 12-03AA defines gross revenues subject to the franchise fee as all revenues from any source or in any way derived from providing cable service in Orange County. Section 12-31(b) requires the franchisee to make payment for each quarter's operations not later than 45 calendar days after the end of each calendar quarter and Section 12-31(g) allows for the County to receive late charge fees from the franchisee in the amount of 18 percent per annum if payments are not received by the due date.

During the period October 1999 through September 2000, Time Warner reported collecting \$2,982,551 in pass-through revenue from its Orange County subscribers. If the five-percent levy had been applied to this revenue, the County would have been entitled to an additional \$149,128 of franchise fees.

On July 31, 1997, the United States Court of Appeals ruled that revenues from the operation of a cable system include collections that are allocated to the payment of franchise fees. The ruling reversed an earlier decision of the Federal Communications Commission (FCC) to exclude monies for franchise fee payments from gross revenue. In November 1997, Time Warner notified the County of the opposing positions and requested a decision from the County regarding the method it should use to compute the franchise fee. In December 1997, the County sent a letter addressed to Time Warner Communications requiring them to pay the franchise fee on all revenues, including franchise fees beginning with the quarter ending December 31, 1997.

RECOMMENDATION FOR IMPROVEMENT



An analysis for the quarter ending December 31, 1997, through the quarter ending December 31, 2000 (the quarter ending March 31, 2001 amount was paid in July 2001), found that a total of \$9,060,430 of franchise fees was paid to Orange County (see Appendix A). If franchise fees had been calculated on the basis required by the County, additional fees totaling \$415,200 would be due the County.

Applying the 18 percent annual interest rate to the delinquent fees (as noted above), the County would be allowed to collect an additional \$97,696 of interest charges through January 31, 2001.

We Recommend the County franchising authority consults with appropriate legal counsel to determine whether the franchise fees and interest in arrears are collectible. In addition, the County should monitor future payments to ensure that the gross revenue (used to compute the franchise fee) includes franchise fees collected by the cable provider.

Management's Response:

Concur. The Orange County Communications Division, Franchising Authority Office, concurs with the outcome of your recent audit of Time Warner Communications Franchise Fee Payments. We are in the process of collecting the total amount still owed the County. Also be advised that we will monitor future payments to ensure the proper amount is being collected.

APPENDIX -A
CALCULATION OF ADDITIONAL FRANCHISE FEE
REVENUE

