



MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager
VIA: Kathie G. Brooks, Budget and Performance Improvement Director
FROM: James J. Sutter, Internal Auditor

DATE: December 7, 2009
AUDIT: Communications Services Tax Audit
PERIOD: October 2007 to August 2009

This report is the result of a regularly scheduled audit of the Communications Services Tax payments received monthly from the State of Florida's Department of Revenue between October 1, 2007 and August 31, 2009. The State adopted a one tax rate for all communications services as of October 1, 2001 so the two separately scheduled audits for this fiscal year regarding telecommunications and cable franchise fee payments were combined into this one report.

INTRODUCTION

Prior to October 1, 2001, each of the 467 separate Florida municipalities and counties negotiated directly with cable providers and entered into franchise agreements thereby setting the applicable terms (including the franchise fee and/or utility tax rates). On 02/13/01, Miami Beach's cable provider was Charter Communications, Inc. per the City Commission's ratification of Resolution No. 2001-24233, who remitted quarterly payments approximating \$170,000 based on a franchise fee rate of 4%.

Meanwhile, City Ordinance No. 79-2152 authorized the Southern Bell Telephone and Telegraph Company (Southern Bell) to use the public streets and other public property of the City of Miami Beach, Florida, for the purpose of erecting, constructing, maintaining, and operating lines, poles, conduits, cables, and other fixtures of telephone and telegraph thereon and thereunder. This ordinance was in effect for a term of twenty-five years from and after January 11, 1978. The City was to receive annually a sum equal to one percent of the gross receipts received from monthly recurring service and regular residential and business measured service charges for the use of telephones. Telecommunication payments totaling \$4,099,489 were received for the fiscal year ending 09/30/01, the last fiscal year before the State's passage of the Communications Services Tax Simplification Law.

Florida Statute Chapter 202, which is also called the Communications Services Tax Simplification Law, was made effective on October 1, 2001. The law replaced and consolidated seven different state and local taxes (state sales tax, local option tax, gross receipts tax, public service tax, cable franchise fee, telecommunications franchise fee, and cable and telecommunication permit fees) with a single tax comprised of two parts: the state communications services tax and the local communications services tax.

It reformed the previous tax laws to provide a fair, efficient and uniform method for taxing communications services sold in the state as it accounted for the impact of federal legislation, industry deregulation and the convergence of service offerings that is now taking place among providers. The state's goal of simplifying taxes was to lower the cost of collecting taxes and fees, increase service availability and place downward pressure on price as well as ensuring that the growth of the industry is unimpaired by excessive governmental regulation.

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Florida Statute Section 202.11 (2) defines communications services as "the transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals, including cable services, to a point, or between or among points, by or through any electronic, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for such transmission or conveyance." Providers in Miami Beach include businesses that supply home and business telephone services, cellular phone services, cable television and internet services such as Southern Bell, AT&T Communications, New Cingular Wireless and Atlantic Broadband Miami.

These communications services providers and others invoice their customers monthly, which includes charging the applicable Communications Services Tax or CST percentage rate set by City/County Ordinances and approved by the Florida Legislature for the jurisdiction in which the customer's service address is located. Therefore, the CST percentage rates charged vary up to the current maximum percentage rate of 5.22% unless additional approval from the Florida Legislature is received to charge more. This percentage rate can be increased above 5.22% only to prevent local governments from having a shortfall in CST collections after the implementation of Florida Statute Chapter 202 on 10/01/01 implementation. Desiring cities and counties must perform the stated analysis and meet the lengthy criteria specified in Florida Statute Section 202.20(2)(a) before permission from the Florida Legislature will be granted to increase the percentage rate above the maximum. Miami Beach's current CST rate for the 2009/10 fiscal year is 5.22%.

The applicable monies due are to be remitted monthly to the State of Florida's Department of Revenue (DOR) based on the figures provided on the Florida Communications Services Tax Return (Form DR-700016). Returns and payments are due on the first of the month and are considered late after the twentieth day of the month following the collection period.

Customers' billing and address information is maintained in the providers' database. They can be certified by the DOR for their accuracy of assignment of street addresses to the proper jurisdiction. An accuracy rate of 95 percent at a 95 percent level of confidence based on the geographic area within Florida covered by the database is required for certification.

The DOR is also entitled to deduct administration costs that may not exceed one percent of the total revenue generated for all municipalities, counties, and school boards levying a tax pursuant to Florida Statute 202.19. Finally, they are able to charge interest and penalties as necessary for providers' late payments.

According to Florida Statute Section 213.053 (8), an employee of the local government is authorized to request, receive or review confidential communications service tax information from the department must acknowledge his/her of the confidentiality provisions associated with state tax information by signing the Addendum to the Agreement. The City's designated person is a Financial Analyst III who obtains the detailed information from the DOR's website, receives their CST wire transfer payment and then subsequently calculates the appropriate amounts to be entered into the five pre-designated City general ledger accounts through journal entries.

The DOR performs audits of selected companies based on such criteria as their size, the length of time that has elapsed since the last completed audit, the number of complaints that have been received against them and also random selections are done. These audits are also used to determine whether the applicable jurisdiction has been paid correctly. Any found audited differences, either over or under, are subsequently reported in the adjustment column of the

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supporting detail documentation posted on DOR's secure website for jurisdictions to view and download.

The City has received monthly wire transfers totaling the following amounts during the audit period:

FY 2007/08	10/01/08 – 08/31/09 *	Total
\$6,111,338	\$6,682,862	\$12,794,200

- The revenues listed are only for eleven months as the Department of Revenue's September 2009 payment has not been received and/or recorded as of yet.

OVERALL OPINION

In accordance with the Communications Services Tax Simplification Law, the City now depends on the State of Florida's Department of Revenue to accurately collect, remit and audit all communications services tax monies received. The City's corresponding revenues have increased since the inception of this law on October 1, 2001. Internal Audit's primary focus was on the accuracy, completeness and timeliness of the documentation and payments remitted to the City and we opine that the Department of Revenue appears to be performing sufficiently.

The following shortcomings were noted during testing which are in need of corrective action:

- The Finance Department should perform the analysis described in Florida Statute Section 202.20(2)(a)(1) to determine if the City's current prescribed rate of 5.22% should be increased.
- The City splits the communications services tax payment received between five different general ledger accounts which seems unwarranted as the largest entry is to the misnamed account entitled "utility tax – telephones (7%)" which in actuality records all the revenues remaining that were not placed into one of the other four accounts.
- The general ledger account entitled "utility tax – telephones (7%)" incorrectly contained thirteen months' entries in the 2007/08 fiscal year as the September 2007 payment of \$185,626.32 was inadvertently included.

PURPOSE

The purpose of this audit is to determine whether the Communications Services Tax reported by the State of Florida's Department of Revenue was correctly calculated, timely remitted and accurately recorded in the City's Financial System, and whether compliance was achieved with designated sections of the Florida Statutes.

SCOPE

1. Confirm that the State of Florida's Department of Revenue is providing complete and sufficient documentation to support the monthly payments made to the City.
2. Confirm that the City is receiving the correct percentage of taxable sales as designated annually by the Florida Legislature and City Ordinance No. 2001-3306.
3. Confirm that the monthly wire transfer payments are received timely by the City.

4. Confirm that the Finance Department is accurately recording the amounts received into the proper general ledger accounts in the City's Financial System.
5. Confirm compliance with designated sections of the Florida Statutes Chapter 220 or the Communications Services Tax Simplification Law.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding: Communications Services Tax or CST Rate

The CST Simplification Law was made effective October 1, 2001 and the following table shows the revenues collected by the City for the three years prior to implementation and for the fiscal years since:

Fiscal Year	Cable Revenues	Telecommunication Revenues	Total	Percentage Incr / (Decr) by Year
Prior to Implementation:				
1998/99	\$487,427	\$3,332,722	\$3,820,149	-
1999/00	\$541,095	\$3,779,636	\$4,320,731	13.1%
2000/01	* \$1,403,398	\$4,099,489	\$5,502,887	27.4%
After Implementation:				
2001/02	\$884,184	\$5,434,171	\$6,318,355	14.8%
2002/03	\$847,678	\$4,356,244	\$5,203,922	(17.6)%
2003/04	\$929,368	\$4,210,540	\$5,139,908	(1.2)%
2004/05	\$997,948	\$4,188,155	\$5,186,103	0.9%
2005/06	\$1,119,136	\$4,206,889	\$5,326,025	2.7%
2006/07	\$1,296,846	\$4,643,148	\$5,939,994	11.5%
2007/08	\$1,453,290	\$4,658,048	\$6,111,338	2.9%
2008/09 **	\$1,299,097	\$5,383,765	\$6,682,862	9.4%

* This figure includes a cable television lawsuit settlement of \$722,905.

** The revenues listed are only for eleven months as the Department of Revenue's September 2009 payment has not been received and recorded as of yet.

Miami Beach's current CST percentage rate for the 2009/10 fiscal year is 5.22% and has not changed since 01/01/03. This rate represents the highest that can be charged by a jurisdiction without requesting the implementation of an additional fee as was done by such other cities as Tallahassee (6.10%), Melbourne (5.93%) and Hialeah (5.87%) thereby effectively raising the CST percentage rate. This additional fee is used to prevent local governments from having a shortfall in CST collections and can be adjusted upwards based on calculations performed in accordance with Florida Statute Section 202.20(2)(a). It was determined that 18.92% (91/481) of Florida jurisdictions currently charge CST percentage rates in excess of the maximum 5.22% rate.

Conversely, 35.97% of Florida jurisdictions have set their CST rates below the 5.22% threshold. Examples include North Bay Village (4.90%), Cooper City (4.80%) and Palm Beach Gardens (1.50%). Closer review typically shows that these jurisdictions with lower rates tend to be either very small or unincorporated areas.

Inquiries found that the City has apparently not performed the analysis necessary to determine whether the 5.22% rate received is sufficient based on Florida Statute Section

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202.20(2)(a). A lawsuit was settled during the 2000/01 fiscal year with the cable company whereby the City received a payment of \$722,905 that would have to be factored in to the calculations, as well as locating the cable and telecommunication revenues for the 1996/97 and 1997/98 fiscal years. The current 5.22% rate could be subsequently increased at the City Commission's discretion if desired and the analysis shows that current CST receipts are not sufficient.

Recommendation(s):

The Finance Department should consider performing the analysis described in Florida Statute Section 202.20(2)(a) to determine if the City's current prescribed rate of 5.22% is able to be increased. If deemed too low and acceptable to the City Commission, then the steps outlined in Florida Statute Section 202.20(2)(a) should be followed to make the desired rate revision.

Management Responses:

As part of the 2011 budget process, the Finance Department will forward the Internal Auditor's recommendation to the Director of the Office of Budget and Performance Improvement. The Finance Department will prepare an analysis and seek guidance from the Office of Budget and Performance Improvement, as to whether the City Administration wishes to increase taxes on its residents and businesses who use telephone, cellular, cable and internet service.

2. Finding: General Ledger Accounts

The State of Florida's Department of Revenue (DOR) sends a monthly wire transfer to the City containing our portion of the collected CST. A Financial Analyst III is responsible for downloading the details of the companies' payments, penalties, interest, adjustments, etc. that comprise this wire transfer. Next, a spreadsheet is prepared calculating the amount to enter into each general ledger account through journal entry.

The current process is to have four singled out companies; Bell South Telecommunications, New Cingular Wireless PCS LLC, Atlantic Broadband and AT&T Communications; payments applied directly to four distinct general ledger accounts. Meanwhile, the remaining 231 communications services providers are placed into one account entitled "utility tax – telephones (7%)" which is usually about double the next largest entry. Finally, this account is misnamed as the 7% has been replaced by the 5.22% present rate and the utility tax for telephones is now called the CST.

Recommendation(s):

Internal Audit recommends that these five general ledger accounts be consolidated going forward into one thereby simplifying the entering process. Another possibility is to split the cable revenues from the telecommunications revenues placing them into two different accounts, if desired.

Management Responses:

The five general ledger accounts will be consolidated going forward into two accounts.

3. Finding: Accruals

Review of general ledger account 011-8000-314150 entitled "utility tax – telephones (7%)" for the 2007/08 fiscal year found that it incorrectly contained thirteen months' entries as it included September 2007's DOR wire transfer payment of \$185,626.32 thereby overstating

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the year end balance. This amount should have been accrued for and included in the 2006/07 fiscal year's entries instead.

Recommendation(s):

Finance Department supervisors should closely review general ledger entries at year end to help ensure that listed general ledger balances are accurate and properly accrued.

Management Responses:

The Finance Department has a new supervisor responsible for this function who will closely review general ledger entries at year end to help ensure that listed general ledger balances are accurate and properly accrued. The individual previously responsible for this task is no longer employed by the City.

EXIT CONFERENCE

An exit meeting was held on November 20, 2009 to discuss the audit report and to solicit management responses noted above. Attendees included Assistant Finance Director Georgina Echert, Revenue Manager Manuel Marquez Jr., Internal Auditor James Sutter, and Senior Auditor Mark Coolidge. Management responses were received shortly thereafter. All were in agreement with the contents of this report.

JJS:MC:CD

Audit performed by Internal Auditor James Sutter, Senior Auditor Mark Coolidge and Field Agent Carmin Dufour

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cc: Patricia Walker, Chief Financial Officer
Georgina Echert, Assistant Finance Director
Jose Cruz, Budget Officer