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CITY OF ST. LOUIS



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FILE COPY

March 18, 2014

Curtis B. Skouby, Director
Public Utilities Department
1640 S. Kingshighway Boulevard
St. Louis, Missouri 63110-2285

RE: Review of contract with MCI for use of City's Right-Of-Way

Dear Mr. Skouby:

Enclosed is the Internal Audit Section's report on the review of the contract with MCI Communications for the use of the City's right-of-way. The period under examination was from July 2012 through June 2013. A description of the scope of our work is included in the report.

Fieldwork was completed on November 22, 2013. Responses to the observations and recommendations noted in the report were received on February 6, 2014, and have been incorporated in the report.

This review was made under the authorization contained in Article XV, Section 2 of the Charter, City of Saint Louis, as revised, and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

If you have any questions, please contact the Internal Audit Section at (314) 657-3490.

Respectfully,

Dr. Kenneth M. Stone, CPA, CGMA
Internal Audit Executive

Enclosure:

Cc: Donna Brooks, Communications Commissioner



CITY OF ST. LOUIS

CITY OF ST. LOUIS

COMMUNICATIONS DIVISION

CONTRACT REVIEW

MCI COMMUNICATIONS, INC.

JULY 1, 2012 THROUGH JUNE 30, 2013

PROJECT #2014-CN03

DATE ISSUED: MARCH 18, 2014

**Prepared by:
The Internal Audit Section**



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HONORABLE DARLENE GREEN, COMPTROLLER

INTRODUCTION

Background

The first contract with MCI (the Licensee) was initiated on August 30, 1994 for a 15 year period. The current contract with the Licensee was initiated on August 21, 2012 also for 15 years. There is a three year gap between these two contracts. The contracts allow the Licensee to use the City's right-of-way to install and use communications lines in the operation of their telecommunications business. For this right, the Licensee pays the City an annual fee.

Purpose

The Internal Audit Section (IAS) selected this contract to review based upon the results of the annual risk assessment. The purpose was to determine whether the Licensee and the City were in compliance with the terms, conditions, and various provisions of the contract. The specific goals relate to the following:

- Compliance with laws, regulations, policies and procedures applicable to goals and objectives.
- Compliance with contract terms.
- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations and programs.

Scope and Methodology

The scope of the review included inquiries of management, observations, review of documents, recalculation's and other procedures from July 2012 through June 2013. Fieldwork was completed on November 22, 2013. The review procedures included the following:

- Allowable uses of the license area.
- Permits and other authorizations.
- License charge and payment.
- Compliance with the City's Revised Code Chapter 23.64.
- Bonds and insurance agreements.
- Contract reporting.

Exit Conference

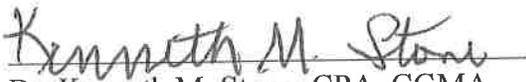
An exit conference was held at the Public Utilities Department on Wednesday, January 29, 2014. Personnel in attendance representing the Public Utilities Department were the Director of Public Utilities, and the Commissioner of the Communications Division. The City's Law Department was represented by an Associate City Counselor. The Internal Audit Section (IAS) was represented by the Internal Audit Executive and the Auditor-In-Charge.

Conclusion

There were opportunities to improve compliance with the contract identified below:

1. Opportunity to comply with the contract's use of the National Consumer Price Index.
2. Opportunity to verify the diameter of the conduit in writing.
3. Opportunity to provide disclosures with the Missouri Public Service Commission and Federal Communications Commission.

These observations are discussed in more detail in the *Detailed Observations, Recommendations and Management's Responses* section.


Dr. Kenneth M. Stone, CPA, CGMA
Internal Audit Executive


Date

**CITY OF ST. LOUIS
COMMUNICATIONS DIVISION
CONTRACT REVIEW
MCI COMMUNICATIONS, INC.
JULY 1, 2012 THROUGH JUNE 30, 2013**

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OBSERVATIONS

Status of Prior Observations

The Internal Audit Section has not performed a previous review of MCI.

Summary of Current Observations

1. Opportunity to comply with the contract's use of the National Consumer Price Index.
2. Opportunity to verify the diameter of conduit in writing.
3. Opportunity to provide disclosures with the Missouri Public Service Commission and Federal Communications Commission.

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT’S RESPONSES**

1. Opportunity To Comply With The Contract’s Use Of The National Consumer Price Index

During our examination, we noted that the correct National Consumer Price Index (NCPI) has not been used by the Communications Division. The contract with Licensees requires annual adjustment to the rate per linear foot based upon changes in the NCPI published by the United States Department of Labor.

Paragraph 15, subparagraph B, of the contract states that “the index to be used to calculate the rate is the “National Consumer Price Index, published by the United States Department of Labor.”

Using an incorrect price index resulted in an inaccurate billing rate and fee. The shortage in revenues for the previous five years are as stated below:

	2009	2010	2011	2012	2013	Total
Revenue shortage	\$21,109	\$18,786	\$20,385	\$6,947	\$7,318	\$74,546

There are 13 years remaining on the contract. The average revenue shortage for the past five years is \$14,909. Projecting this figure over the next 13 years will result in a revenue shortage of \$193,820.

The error in calculating the rate resulted from unfamiliarity with the contract requirements and lack of appropriate training.

Recommendation

It is recommended that the Communications Division begin using the correct National Consumer Price Index adjusted to the current period.

Management’s Response

The Agency practice, from the inception of the Ordinance in 1991, was to use an industry based CPI index published in the U. S. Department of Labor, which was used for over 18 years. The Agency has been using the U.S. Consumer Price Index for the past two billing cycles.

The Agency will continue to use the U.S. Consumer Price Index to calculate all future right of way fees.

The Agency believes that any discussion of additional fees owed is a legal matter that should be vetted through the City Counselors Office for review and disposition.

Auditors' Comments

The contract with MCI and the City's revised code pertaining to this agreement unequivocally define the Consumer Price Index to be used as the National Consumer Price Index published by the U.S. Department of Labor. Therefore, we assert that the fees be updated immediately to comply with the terms of the contract.

2. Opportunity To Verify The Diameter Of Conduit In Writing

Inquiries were made regarding the process of verifying the diameter of conduit. IAS found that inspectors in the Communications Division did not verify in writing conduit diameter prior to approving permits.

The City Revised Code provides in section 23.64.050, subparagraph A, number 6, that the diameter and projected length of the conduit shall be noted on the permit. Good management practices dictate that the actual size of the conduit should be verified and documented in writing, by an authorized City employee, prior to approving the permit.

The Communications Division did not have an effective system of internal control to ensure written documentation of the verification process.

Failure to maintain adequate permit approval forms could result in unreliable data and potentially lost revenues for the City. The document currently being used does not indicate the conduit diameter.

Recommendation

It is recommended that any future inspections should include written verification of conduit diameter.

Management's Response

The Auditor has drastically misrepresented the procedures in place related to the intake and processing of a permit application. The Agency cannot approve nor verify the size of the conduit prior to a permit being approved by BPS, nor actual construction beginning.

The permit application consists of a map and a narrative detailing the intended use of the right of way including materials to be used above or below ground. The Agency inspectors conduct a site visit of the proposed location and barring any foreseen problems with the site, submit the permit application to the BPS Secretary who then distributes it to the Streets Dept., and Water Division for further review. Once the Agency receives responses back from the departments with recommendations, the permit application is prepared for approval by BPS. Once BPS has approved the permit application, then the contractor can begin work and order supplies associated with the communications system to be built.

When construction begins, Agency inspectors are on site to verify that the contractor is working in the approved location and using the approved materials listed in the permit. The inspectors provide monthly right-of-way monitoring reports documenting such activities.

It is the Agency's position that proper verification systems already exists through our current reporting system. However, we will amend our field inspection report form to include language which states the inspector verified specific materials used in compliance with the permit during construction.

Auditors' Comments

We reviewed the revised Field Inspection Review Form, noting that it requires the inspectors to verify in writing the size of the conduit being employed and also provides for pictures of the conduit to aid in the confirmation process. These new procedures will enhance the internal control environment and better protect the City's interests.

3. Opportunity To Provide Disclosures With The Missouri Public Service Commission And Federal Communications Commission

During the examination, a request was made for the Licensee's filings with the Missouri Public Service Commission and Federal Communications Commission. The requested information has not been received as of the date of this report.

Paragraph 16, of the contract states the following: "Licensee shall provide the City with copies of all tariffs or other documents filed with the Missouri Public Service Commission or Federal Communications Commission pertaining to the City of St. Louis or this Agreement."

The information filed with Missouri Public Service Commission and Federal Communications Commission is invaluable to the City in that it will verify how the Licensee is using the City's right-of-way. Failure to provide this information could result in potentially lost revenues for the City and exposure to unforeseen risks.

The Communications Division may not have established a clear understanding of the contract requirements.

Recommendation

It is recommended that management take the necessary steps to obtain the requested information.

Management's Response

The Agency reviewed recent FCC open record filings made by Verizon/MCI Communications and note that none are related to the City of St. Louis right of way matters.

The Agency will seek to obtain an updated Certificate of Authorization from MCI Communications from the Missouri Public Service Commission.