



2006-2007 SANTA CLARA COUNTY CIVIL GRAND JURY REPORT

SAN JOSE 911 SURCHARGE: TELEPHONE COMPANIES PUT THE CITY ON HOLD

Summary

In June 2006, the San Jose City Council approved and the Mayor signed an ordinance that extended the Emergency Communications System Support (ECSS) Fee until June 2009. The ECSS Fee was originally adopted in August 2004 and was set to expire at the end of December 2006. The 2006-2007 Santa Clara County Civil Grand Jury was interested in the origin and purpose of this fee and whether it was being collected and used exclusively for its intended purpose.

Interviews with officials from the San Jose City Manager's Budget Office, the San Jose City Finance Department, and the Emergency Communications Center (ECC) confirmed that the process of collecting the ECSS Fee from the telephone companies and the allocation of the funds to the ECC is done as stipulated in City Ordinance No. 27229. However, the Grand Jury is concerned that the ECC expense reimbursement from the fee is inaccurate because telephone companies do not report information about their telephone services as required by the ordinance. Telephone companies contend that information is confidential for business reasons, but the ordinance provides protection through the use of nondisclosure agreements with the City of San Jose.

The revenue from this fee for Fiscal Year 2006-2007 was projected at more than \$20.6 million and represented 88 percent of ECC funding. The San Jose City Auditor has never conducted an audit of the ECSS Fee; therefore, the Grand Jury recommends an audit of this process as an objective evaluation of the calculation, assessment, and administration of the ECSS Fee. The Grand Jury further recommends that the San Jose City Attorney and Finance Department negotiate an acceptable nondisclosure agreement with telephone companies that will ensure accurate telephone subscriber statistics for calculation of the fee.

Background

In the wake of Proposition 13, "People's Initiative to Limit Property Taxation" in June 1978, General Fund support of the City's public services has been reduced over the years as property tax revenues have decreased as a percentage of total revenues. As a result, many services have transitioned from tax supported to fee-for-service funding. These include a wide array of services from increased developer permit fees, to park and recreation facility fees, to planning, public works, and fire prevention. On August 17, 2004, the Mayor of San Jose signed an ordinance to establish an ECSS Fee to pay for the operation of the ECC. This ordinance required a small monthly fee from most telephone customers to help fund the City's 911 emergency dispatch services.

The justification for charging a fee to telephone subscribers is that only people who have telephones can call 911 for emergency services. As stated in the ordinance, "Subscribers to telephone service derive significant benefits from ongoing operation of the modernized integrated system installed at the San Jose Emergency Communications Center" in the form of more efficient dispatch of services to a 911 emergency request. The ordinance concludes that "...an Emergency Communications System Support Fee charged to subscribers to telephone service in the City is the most practical and equitable mechanism to provide revenue..."

The ECSS Fee ordinance was to expire on December 31, 2006. On June 20, 2006, the Mayor of San Jose signed City Ordinance No. 27785 to extend the fee through June 30, 2009.

The Grand Jury studied how the ECSS Fee is calculated, how it is collected from telephone subscribers through the telephone companies, and whether the money is being spent exclusively for those operating and project costs allowed by the ordinance.

Discussion

The ECSS Fee rate is calculated by the Budget Office. The City Council must approve the rate every year based on the Budget Office calculation and recommendation. Collection of the fee from telephone companies and reimbursement of ECC operating expenses from the ECSS Fee Fund is administered by the Finance Department. The Grand Jury interviewed two Budget Office officials and two Finance Department officials to understand the policies and procedures surrounding the assessment and administration of this fee.

The purpose of the fee is to recover operating costs of the ECC. The fee is charged on most personal and business telephone lines and cell phones in the City; certain telephone lines are exempt from this fee, including lifeline customers, telephone companies, pay phones, nonprofit hospitals and educational institutions, and government offices. Therefore, total operating costs of the ECC are not recovered and, by ordinance, the operating and program costs for exempt telephone lines may not be paid from ECSS Fee revenue.

All telephone companies that deliver service within the City are notified by the Finance Department of the ECSS Fee rate and which telephone lines are exempt from the charge. Each company must complete a monthly form detailing the amount collected and remit those funds to the Finance Department. This money is deposited in the ECSS Fee Fund and is transferred periodically to the General Fund to reimburse it for paying ECC operating expenses. In Fiscal Year 2005-2006, the ECSS Fee generated \$21.5 million from 80 telephone service providers in the City.

The fee amount is calculated by the Budget Office at the beginning of a fiscal year based on estimates, consisting of the annual expense budget for the ECC and the estimated annualized number of telephone lines in the City. The total allowable revenue from the fee is calculated at the end of the year from actual ECC costs and

telephone company statistics. Then, differences between the revenue generated by the rate based on estimates and reimbursement of actual ECC expenses are reconciled. The Grand Jury is satisfied that the financial component of the fee calculation and its allocation is accurate. However, the Grand Jury found that data on the actual number of telephone lines are inaccurate.

Without accurate telephone line data, it cannot be determined whether the fee is over- or under-collecting allowable expenses for the ECC. Collecting statistics about telephone subscribers relies on the cooperation of telephone companies. However, it is the responsibility of the Finance Department to ensure that data provided by the telephone companies are complete and accurate. If the actual number of telephone lines in the City is higher than the estimates used by the Budget Office, then too much revenue is being collected; likewise, lower actual telephone line counts means under collection of revenue. Further, if the distribution of exempt and nonexempt telephone lines is unknown, then disallowed ECC expenses might be paid from ECSS Fee revenues.

The Grand Jury was informed that most telephone companies have refused to provide the requested information necessary to accurately compute the ECSS Fee. The Finance Department has written letters to the telephone companies requesting detailed supporting documentation regarding their remittances, but the telephone companies assert that this information is confidential and would jeopardize their competitive advantage with other companies if made public. The Finance Department is authorized by the ordinance to sign nondisclosure agreements with telephone companies to ensure that all data would be kept confidential. The City Attorney's Office must approve the language of any nondisclosure agreement; however, in the two and one-half years since the ordinance went into effect, there has been only one attempt to negotiate such an agreement with a telephone company.

This failure to collect accurate telephone line data causes a potentially significant financial drain on the General Fund. In Fiscal Year 2005-2006, \$21.5 million was collected from the ECSS Fee to cover total ECC expenditures of \$25.3 million. In calculating the ECSS Fee rate, the Budget Office assumes that 10.36 percent of all telephone lines are exempt from the fee so, according to these estimated line counts, the City could have collected \$22.7 million from the fee. Although the actual amount collected was less than the estimated amount allowed, the Budget Office did not reimburse the General Fund even with this lower amount of total collections. Since the Budget Office knows its telephone line data are suspect, it increased its estimated exemptions to 22 percent to ensure that costs associated with exempt lines would not be paid from this fee. While an estimated \$22.7 million was allowed by the fee and \$21.5 million was collected, only \$19.8 million was actually repaid to the General Fund, representing a potential loss of \$2.9 million of taxpayer money that should have been collected from telephone subscribers.

Fiscal Year 2005-2006

ECC Expenses paid from General Fund	\$25.3 million
Estimated ECSS Fee Exemptions	10.36%
Allowable General Fund Reimbursements from ECSS Fee Revenue	\$22.7 million
Actual ECSS Fee Revenue	\$21.5 million
Actual Amount Reimbursed to General Fund from ECSS Fee Revenue	\$19.8 million
Allowable General Fund Reimbursements less Actual Amount Reimbursed	- \$2.9 million

In reality, actual telephone line counts might show that there are many more exempt lines than estimated and that the total allowable ECSS Fee revenue is much less than calculated. This would mean that the General Fund would be responsible for even more ECC expense than is currently covered. However, the conservative reimbursement strategy adopted by the City assumes that 22 percent of all telephone lines are exempt from the fee.

Conclusion

The Finance Department recognizes that failure to collect accurate telephone line data is a problem, but their efforts to correct the problem have been inadequate. The Finance Department sends letters to all telephone companies as part of its annual ECSS Fee review process that specifically identifies and requests missing information, but these letters are largely ignored. One avenue of investigation authorized by the ordinance is on-site compliance audits of telephone company data, but to date the Finance Department has never conducted such an audit. Even if telephone companies do comply with full reporting requirements, audits of source data are the only way to ensure that reported data are complete and accurate.

Those interviewed at the Budget Office and Finance Department believe that accurate subscriber data from the telephone companies would only result in an increase or decrease of 2 or 3 percent in the surcharge rate. That represents a change of as much as \$0.05 per telephone line in the monthly surcharge, an additional cost or savings of \$0.60 per year for each subscriber line. While this might represent an insignificant financial impact on the average individual telephone subscriber, the aggregate represents a significant impact on the City's General Fund. The updated projections in the Fiscal Year 2007-2008 City Manager's Budget Request indicate a \$16.2 million General Fund deficit. Accurate data in assessing the ECSS Fee could conservatively alleviate \$1 million to \$2 million of that shortfall depending on the actual exemptions allowed based on actual telephone company data.

The data collection process is compromised by lack of an acceptable nondisclosure agreement with the telephone companies. There has been no attempt to negotiate with telephone companies regarding their concerns about terms of a nondisclosure agreement. After the telephone company in question rejected the nondisclosure agreement proposed by the City Attorney, the Finance Department should have solicited suggestions from telephone companies on nondisclosure agreement language and facilitated a resolution with the City Attorney.

In Fiscal Year 2006-2007, the ECSS Fee revenue represents 88 percent of the ECC budget, that is, \$20.6 million of a \$23.5 million budget; the remaining 12 percent is paid from the General Fund and represents costs associated with subscribers exempt from the fee. The purpose of the ordinance, the amount of money involved, and the lack of full enforcement of the ordinance requires an objective review of the process. The City Auditor has never been asked to audit the assessment and management of the ECSS Fee. The Grand Jury concludes that the City should improve administration of this ordinance by having the Auditor examine the process and suggest improvements to internal controls.

Findings

The following findings were reviewed with the subject agency:

- F1:** Subscriber information necessary to enforce the ECSS Fee ordinance is not being collected from the telephone providers because the City has not negotiated a mutually acceptable nondisclosure agreement with the telephone companies.
- F2:** The Finance Department has never requested a compliance audit of any telephone company records either to collect the detailed data needed for calculations or to ensure that whatever information has been reported is accurate.
- F3:** The ordinance authorizing this fee is not being enforced because of inaccurate calculation of allowable revenue. The ECSS Fee is being collected based on an estimated number of exempt and nonexempt telephone lines rather than on actual line counts.

Recommendations

The Grand Jury recommends that the San Jose City Council require the following actions be taken:

- R1:** The Finance Department and the City Attorney actively negotiate with telephone companies who are subject to the ECSS Fee to conclude an acceptable nondisclosure agreement to allow complete and accurate data collection in support of the fee by December 31, 2007.
- R2:** The Finance Department perform compliance audits on subject telephone companies to determine reporting accuracy and completeness as directed by the ordinance.
- R3:** The San Jose City Auditor conduct a performance audit of the ECC to ensure that procedures for calculation, assessment, collection, and allocation of the ECSS Fee are in compliance with the City ordinance.

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City of San Jose Ordinance No. 27785. *Amending Sections 8.20.200 and 8.20.370 of Chapter 8.20 of Title 8 of the San José Municipal Code to extend the date for imposition of the Emergency Communications System Support Fee through June 30, 2009 and to clarify the requirements and procedures applicable to claims for refund of the fee, June 13, 2006.*

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Interviews

January 12, 2007 City of San Jose City Manager's Budget Office official
City of San Jose Finance Department official

March 26, 2007 City of San Jose City Manager's Budget Office officials
City of San Jose Finance Department officials

PASSED and **ADOPTED** by the Santa Clara County Civil Grand Jury on this 22nd day of May 2007.

Ronald R. Layman
Foreperson

David M. Burnham
Foreperson Pro tem

Kathryn C. Philp
Secretary