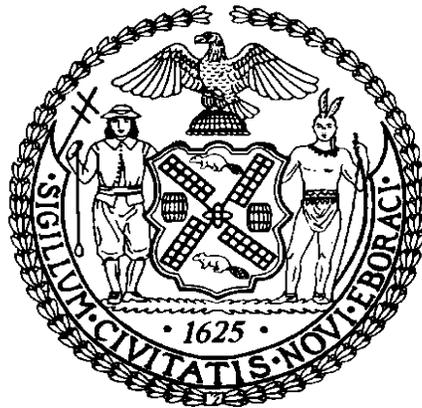


**CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER**

**John C. Liu  
COMPTROLLER**

**FINANCIAL AUDIT  
H. Tina Kim  
Deputy Comptroller for Audit**



**Audit Report on the Compliance of  
Looking Glass Networks, Inc.  
With Its City Franchise Agreement  
January 1, 2007–December 31, 2008**

*FN10-093A*

**October 28, 2010**



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
1 CENTRE STREET  
NEW YORK, N.Y. 10007-2341

John C. Liu  
COMPTROLLER

October 28, 2010

**To the Residents of the City of New York:**

My office has audited the compliance of Looking Glass Networks, Inc. (Looking Glass) with its City Franchise Agreement. We audit entities such as this as a means of ensuring that they comply with the terms of their agreements, properly report and allocate revenues, and comply with established policies and procedures.

Looking Glass is a facilities-based provider of metropolitan telecommunications transport services. Under a 15-year franchise agreement with the Department of Information Technology and Telecommunications (DoITT), Looking Glass provides telecommunications services in the City for which it pays the City a franchise fee consisting of the greater of either \$200,000 or five percent of its annual gross revenue.

Looking Glass did not maintain separate books and records in sufficient detail to determinate whether all revenue was properly reported to the City. While it was not possible to ascertain whether all revenue attributable to the franchise agreement was reported and all fees paid to the City, based on the available records, the audit concluded that Looking Glass underreported gross revenue by \$941,511. The audit recommended that Looking Glass pay fees and late charges due from understated revenue, submit for DoITT's approval a revenue allocation methodology, and maintain accounts and records in a manner that allows the City to determine Looking Glass's revenue reporting compliance. The report recommended that DoITT ensure that Looking Glass pays the City the fees and charges due and complies with the report's other recommendations.

The results of our audit, which are presented in this report, have been discussed with Looking Glass and DoITT officials, and their comments have been considered in preparing this report. Their complete written responses are attached to this report.

If you have any questions concerning this report, please email my audit bureau at [audit@comptroller.nyc.gov](mailto:audit@comptroller.nyc.gov).

Sincerely,

A handwritten signature in black ink, appearing to read "John C. Liu".

John C. Liu

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*The City of New York  
Office of the Comptroller  
Financial Audit*

**Audit Report on the Compliance of  
Looking Glass Networks, Inc.  
With Its City Franchise Agreement**

**FN10-093A**

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**AUDIT REPORT IN BRIEF**

On November 29, 2000, the City of New York through the Department of Information Technology and Telecommunications (DoITT) entered into a 15-year franchise agreement with Looking Glass Networks, Inc. (Looking Glass) to provide local high-capacity telecommunications services in the City. Looking Glass is a facilities-based provider of metropolitan telecommunications transport services. Its services include SONET/SDH, wavelength, Ethernet-based lit services, as well as Internet Protocol (IP) transit, high-capacity dark fiber, and collocation services. In August 2006, Looking Glass was acquired by Level 3 Communications, Inc. (Level 3).<sup>1</sup> Looking Glass provides telecommunications services to approximately 188 customers in the City.

Under the franchise agreement, Looking Glass is required to report to the City all gross revenue from telecommunications services that originate in and/or terminate in the City. Based on the agreement, Looking Glass is required to pay the City a franchise fee consisting of the greater of either \$200,000 or five percent of its annual gross revenue. In addition, Looking Glass is required to maintain a minimum combined amount of \$50 million in insurance for bodily injury and property damage, and an unconditional letter of credit and surety bond deposit totaling \$1 million.

**Audit Findings and Conclusions**

Looking Glass did not maintain separate books and records in sufficient detail to allow us to determine whether all revenue was properly reported to the City, particularly with respect to revenue generated from services that either originate or terminate in the City. Therefore, we were unable to ascertain whether all revenue attributable to the franchise agreement was reported, and all franchise fees were paid to the City. Nevertheless, based on the available records, we determined that Looking Glass underreported gross revenue in the amount of \$941,511. Consequently, Looking Glass owes the City at least \$68,654 in franchise fees and late charges as detailed in Appendices I and II. Additionally, our review found that Looking Glass did not consult

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<sup>1</sup> Looking Glass Networks, Inc. submits separate revenue reports and franchise fee payments to the City. Its financial statements are prepared on a consolidated basis with Level 3 Communications, Inc., its parent company.

with the City in determining a methodology to allocate its revenue and, as a result, it may not have reported to the City significant revenue from services with one endpoint outside the City.

Looking Glass, however, complied with the other non-revenue requirements of the franchise agreement, such as maintaining the required \$50 million property and liability insurance that named the City as an additional insured party and the required \$1 million in a security deposit.

### **Audit Recommendations**

Based on our findings, we recommend that Looking Glass:

- Pay the City \$68,654 in franchise fees and late charges due from understated revenue, and ensure that all revenue from customer accounts is properly included in its revenue reports submitted to the City.
- Submit to DoITT for its review and approval a methodology for allocating revenue for services that either originate or terminate in the City in accordance with the franchise agreement and pay to the City the amount it is owed using such methodology (plus late charges as appropriate).
- Maintain separate books of accounts and records of all City business activity in a manner that would allow the City to determine whether Looking Glass is reporting all its revenue in compliance with the franchise agreement.

We recommend that DoITT:

- Ensure that Looking Glass pays the City the \$68,654 in franchise fees and late charges due from understated revenue assessed in this report.
- Ensure that Looking Glass pays the City a “fair and equitable allocation” as determined for revenue generated from partial use of the system for the period covering 2007 and 2008, and that the allocation is performed based on a methodology in compliance with the proper City review and approval process as required in the agreement.
- Ensure that Looking Glass submits separate accounting records and financial statements to determine whether all compensation is being paid to the City.
- Establish procedures and controls to review Looking Glass’s revenue reporting and franchise fee payment calculations.

## INTRODUCTION

### **Background**

On November 29, 2000, the City of New York through the Department of Information Technology and Telecommunications (DoITT) entered into a 15-year franchise agreement with Looking Glass Networks, Inc. (Looking Glass) to provide local high-capacity telecommunications services in the City. Subject to the terms and conditions of the 15-year agreement, the City grants Looking Glass a nonexclusive franchise providing the right and consent to install, operate, repair, maintain, remove, and replace cable, wire, fiber, or other transmission media that may be used in lieu of cable, wire, or fiber for the same purposes, and related equipment and facilities on, over, and under the inalienable property of the City. Looking Glass is a facilities-based provider of metropolitan telecommunications transport services. These services include SONET/SDH, wavelength, Ethernet-based lit services, as well as Internet Protocol (IP) transit, high-capacity dark fiber, and collocation services. In August 2006, Looking Glass was acquired by Level 3 Communications, Inc. (Level 3). DoITT is responsible for monitoring Looking Glass's compliance with the franchise agreement.

Under the franchise agreement, Looking Glass is required to report to the City all gross revenue from telecommunications services that originate in and/or terminate in the City. Looking Glass is also required to pay the City a franchise fee consisting of the greater of either \$200,000 or five percent of its annual gross revenue, and to submit to the City quarterly gross franchise fee calculation reports with payments made no later than 45 days after the last day of March, June, September, and December. Furthermore, the agreement requires Looking Glass to keep comprehensive itemized records of all revenues received and of all services provided and to do so in sufficient detail to enable the City to determine whether all compensation owed the City is being paid. In addition, Looking Glass is required to comply with major non-revenue terms, such as maintaining a minimum combined amount of \$50 million in insurance for bodily injury and property damage, and maintaining an unconditional letter of credit and surety bond deposit totaling \$1 million.

Looking Glass provides telecommunications services to approximately 188 customers in the City. For the audit period January 1, 2007, through December 31, 2008, Looking Glass submitted gross revenue totaling \$12.9 million and related franchise fee payments totaling \$648,815 in its revenue reports to the City.

### **Objectives**

The objectives of this audit were to determine whether Looking Glass:

- accurately reported its gross revenue, properly calculated and paid the appropriate fees due the City, and paid fees on time, and
- complied with certain non-revenue-related requirements of its agreement (i.e., maintained the required insurance and maintained the proper letter of credit and surety bond).

## **Scope and Methodology**

We conducted this performance audit 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. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The scope of this audit was January 1, 2007, through December 31, 2008. To accomplish our audit objectives, we reviewed the telecommunications franchise agreement between Looking Glass and the City and identified the relevant terms and conditions. We reviewed Looking Glass's correspondence and franchise fee calculation reports on file with DoITT to ascertain whether Looking Glass submitted the required revenue reports and paid the fees due the City on time.

We evaluated the adequacy of Looking Glass's internal controls over its revenue recording and reporting functions. To obtain an understanding of Looking Glass's operating procedures, we interviewed Looking Glass officials, identified key control processes, and familiarized ourselves with the sales, billing, accounting, and record-keeping functions. We also reviewed Looking Glass's chart of accounts and trial balance and performed a preliminary review of its RevMart<sup>2</sup> billing report to identify any unusual trends and to provide a basis for our detailed testing. We documented our understanding of Looking Glass's operations and internal control processes through memoranda.

In assessing the reliability of Looking Glass's financial data reported to the City, we considered the opinion issued by KPMG, LLP on the fairness of Level 3's financial statements and the effectiveness of its internal controls over financial reporting for calendar year 2008.<sup>3</sup> We were not able to trace the revenue reported to the City to Looking Glass's financial statements since those statements consolidate revenue derived from all services, including those that do not originate or terminate in the City. Nor, according to Looking Glass officials, do they prepare individual financial statements for the City. Looking Glass's revenue data is generated by Oracle ERP accounting and reporting system. We did not test the reliability of this system. Therefore, our data reliability test was limited to the data reported in Looking Glass's RevMart billing report.

To determine whether Looking Glass accurately reported its gross revenue to the City, we conducted a limited test of controls over revenue transactions. For our evaluation, we judgmentally selected the monthly customer billing statements of 20 customer accounts with the highest billed revenue for the year 2008, representing \$6.1 million (58 percent) of the \$10.5

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<sup>2</sup> RevMart is a revenue database designed to disseminate revenue data reporting within the organization.

<sup>3</sup> The opinion issued by KPMG, LLP stated, "In our opinion, Level 3 Communications, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission."

million in total gross revenue before allocation that Looking Glass reported in its books and records for calendar year 2008, and traced the amounts to the billing reports for completeness and accuracy.

To determine whether Looking Glass reported its gross revenue to the City in accordance with the agreement, we identified and reviewed all revenue accounts in Looking Glass's chart of accounts and traced each account to the billing reports for completeness. We then summarized the revenue recorded on Looking Glass's billing reports and compared the totals to the revenue reported to the City for the period January 1, 2007, through December 31, 2008.

To ascertain the accuracy and reasonableness of Looking Glass's allocation of certain revenue to the City, we reviewed Looking Glass's billing reports, and identified and reviewed all the revenue accounts that were subject to the allocation. We also reviewed Looking Glass's methodology and analyzed the revenue from services that originated or terminated in the City as reported in Looking Glass's billing reports. We then compared the results to the amounts Looking Glass reported in the quarterly franchise fee calculation reports submitted to the City.

Finally, to determine whether Looking Glass complied with the other terms and conditions of its agreement, we reviewed insurance certificates to determine whether Looking Glass maintained the required insurance coverage. We also reviewed surety bond records to determine whether Looking Glass maintained the required security deposit with the City.

The results of our tests, while not projected to the populations from which the samples were drawn provide reasonable assurance that we have obtained sufficient and appropriate evidence to determine Looking Glass's compliance with the franchise agreement in reporting applicable revenue.

### **Discussion of Audit Results**

The matters covered in this report were discussed with Looking Glass officials during and at the conclusion of this audit. A preliminary draft report was sent to Looking Glass and DoITT officials and discussed at an exit conference held on July 29, 2010. After the exit conference, Looking Glass officials provided us with additional information regarding the issues addressed in the preliminary report. On August 30, 2010, we submitted a draft report to Looking Glass and DoITT officials with a request for comments.

We received a written response from Looking Glass on September 15, 2010. In its response, Looking Glass disagreed with the audit report findings.

We received a written response from DoITT officials on September 17, 2010. DoITT officials generally concurred with our audit's findings, and stated that they will undertake a follow-up review to verify and determine all amounts due. DoITT officials also stated that "DoITT will pursue a revised approach to franchise compensation using a more objective, measurable and certain methodology than that which is currently set forth in the agreement.

The full texts of the Looking Glass and DoITT responses are included as addenda to this final report.

## FINDINGS

Looking Glass did not maintain separate books and records in sufficient detail to allow us to determine whether all revenue was properly reported to the City, particularly with respect to revenue generated from services that either originate or terminate in the City. Therefore, we were unable to ascertain whether all revenue attributable to the franchise agreement was reported, and all franchise fees were paid to the City. Nevertheless, based on the available records, we determined that Looking Glass underreported gross revenue in the amount of \$941,511. Consequently, Looking Glass owes the City at least \$68,654 in franchise fees and late charges as detailed in Appendices I and II.

Additionally, our review found that Looking Glass did not consult with the City in determining a methodology to allocate its revenue and, as a result, it may not have reported to the city significant revenue from services with one endpoint outside the City.

Looking Glass, however, complied with the other non-revenue requirements of the franchise agreement, such as maintaining the required \$50 million property and liability insurance that named the City as an additional insured party and the required \$1 million in a security deposit.

These matters are discussed in detail in the following sections of this report.

### **Understated at least \$941,511 in Revenue It Received from Customers**

Our reconciliation of the revenue reported in Looking Glass's 2008 RevMart billing report (Looking Glass's basis for reporting revenue to the City) and the customers' bills we sampled found that not all the revenue related to telecommunications services that was received from Looking Glass's customers was properly included in the billing report. While the New York City customers' bills show revenue activities for telecommunications services, Looking Glass RevMart billing report did not include all such revenue activity. According to Looking Glass officials, the discrepancy was the result of a migration of customer account numbers following Level 3's acquisition of other companies and the consolidation of customer accounts. However, even after taking into consideration the consolidation of certain accounts, our review of the customers' bills identified a total of \$941,511 in additional revenue that was not recorded in the RevMart billing report and consequently not reported to the City. Therefore, Looking Glass owes the City at least an additional \$68,654 in franchise fees and late charges, as detailed in Appendix I.

***Looking Glass Response:*** "LGN [Looking Glass] disagrees that it owes additional fees to the City for the audit period. LGN's initial analyses of the data in the preliminary draft audit report consisted of queries from the revenue reports previously provided to the City audit team. The under reporting claimed by the City audit team appears to be driven by the inclusion of revenue streams to which the City is not entitled under the definition of Telecommunications Services in the Franchise Agreement."

***Auditor Comment:*** We continue to affirm that the revenue in question represents reportable revenue to the City. After providing Looking Glass

officials with our analysis of their revenue data for their review, at their request, Looking Glass provided us no additional documentation that would contradict our results or would support their claim that the City is not entitled to this revenue under the franchise agreement. Additionally, Looking Glass failed to provide us with its “initial analyses” of this revenue despite our numerous requests. Therefore, we reaffirm our position that the \$941,511 represents additional revenue that Looking Glass improperly excluded from its revenue reports to the City. As a result, DoITT should seek to ensure that Looking Glass pays the City at least the \$68,654 in franchise fees and late charges as assessed in this report.

***DoITT Response:*** “To resolve this matter, DoITT will undertake a follow-up review to verify whether Looking Glass owes the City franchise compensation due to underreporting of revenue. Specifically, DoITT will request from the Comptroller’s Office the supporting data for the Draft Audit; and, upon reviewing such data, will meet with Looking Glass to understand the company’s own, detailed interpretation regarding those revenue streams from which it believes the City is not entitled to receive franchise compensation.”

***Auditor Comment:*** We are pleased that DoITT officials agree to undertake their own review of the revenue data. We also welcome the opportunity to provide our supporting data to assist DoITT in performing such a review. As noted, Looking Glass received a significant amount of additional revenue from services provided in connection with its franchise agreement and never reported it to the City. As also noted in our review, Looking Glass did not provide supporting detail information to substantiate its claim regarding the exclusion of this revenue from the reports it submits to the City. Our audit results were based on a sample of customer bills; therefore, DoITT should seek to obtain and review Looking Glass’s revenue analyses to identify all the revenue Looking Glass generates from services provided to New York customers, and determine what amounts Looking Glass is entitled to exclude, if any, based on the terms of the franchise agreement.

### **Inappropriate Methodology in the Allocation of Its Revenue to the City**

Our review of Looking Glass’s books and records determined that Looking Glass did not comply with its obligations under the franchise agreement to develop and submit to the City for its review and approval a revenue allocation methodology for the revenue it generates from services that either originate or terminate in the City (i.e., that use part of Looking Glass’s system), which methodology must comport with the “fair and equitable” standard in the agreement. Specifically, our review found that, for calendar years 2007 and 2008 Looking Glass generated gross revenue totaling at least \$4,857,583 from telecommunications services that use part of Looking Glass’s system. However, Looking Glass reported that it obtained only \$851,824 in gross revenue for those services—a mere 18 percent of actual revenue—of which it paid the City franchise fees totaling \$42,591, less than one percent of its total revenue.

According to the definition of gross revenue under §1.15 of the franchise agreement, “Gross Revenue shall include all revenue . . . that is received directly or indirectly by the Company or by any Affiliated person from or in connection with any Telecommunications Services provided in accordance with this Agreement which originate in and/or terminate in the City (which shall include a proportional allocation, which allocation shall be fair and equitable, of revenues received by, or that should have been received by, the Company, any Affiliated person or any other Person for Services utilizing any part of the system, provided, however that such proportional allocation shall in no case be less than the fair market value for such Service). The Company shall within two years following the Effective Date, submit to the City for the City’s review and approval the method by which such allocation is to be made.”

We assert that Looking Glass’s methodology for allocating the revenue it receives in connection with services that originate or terminate in the City is neither fair nor equitable. Furthermore, the methodology was never reviewed or approved by the City as required in the franchise agreement. Looking Glass’s telecommunications services that originate or terminate in the City may only extend short distances outside the City’s borders or may extend hundreds or thousands of miles beyond City limits, but Looking Glass’s methodology for allocating revenue to the City arbitrarily “assumes a distance of 12.8 miles as the longest distance between two circuits within the City limits.” In other words, the amount of revenue attributable to the City that is derived from any given circuit (i.e., cable, wire, fiber or other means of transmission) may never be greater than a relatively short part of that circuit (i.e., 12.8 miles).

Looking Glass did not provide us with documentation that would support its basis for a methodology that assumes a distance of 12.8 miles. In a prior audit of another telecommunication franchise, we noted that revenue received from services utilizing part of the system was equally allocated among the two end points using a 50 percent allocation. However, although Looking Glass’s franchise agreement includes the same provisions regarding the two end points, it did not allocate its revenue using the 50-percent methodology, which would have resulted in Looking Glass having to report at least an additional \$1,576,967 in revenue to the City. Looking Glass should therefore submit to DoITT for its review and approval a methodology for a “fair and equitable” allocation of this type of revenue, including a detailed justification for the proposed methodology.

***Looking Glass Response:*** “LGN disagrees that it is not following a ‘fair and equitable’ allocation methodology as set forth in the Franchise Agreement. In accordance with Section 1.15 of the Franchise Agreement, LGN submits payments based on a fair and equitable allocation methodology. LGN’s methodology allocates revenue by the proportionate length of any such circuit within the City’s jurisdiction. LGN’s allocation favors the City by assuming all circuits are the maximum length of any two points within the City, i.e. 12.8 miles.”

***Auditor Comment:*** Looking Glass’s contention that its allocation methodology is not only fair and equitable, but favors the City is not based on the requirements of the franchise agreement. One of the key provisions of the

revenue allocation requirement is that the methodology for allocating the revenue received in connection with services that originate or terminate in the City be submitted to the City for its review and approval. Looking Glass never obtained the required approval from the City. As noted in our review, Looking Glass generated a total of \$4,857,583 from telecommunications services that use part of its System in the City. However, Looking Glass reported only \$851,824 in gross revenue for those services, and paid the City less than one percent of its total revenue in related franchise fees totaling \$42,591. Therefore, we again assert that because Looking Glass did not adhere to the revenue allocation requirement of its franchise agreement, potential revenue amounts may not have been reported to the City.

***DoITT Response:*** “DoITT generally concurs. However, it should be recognized that significant advancements in telecommunications technology have occurred since the Looking Glass franchise was entered into in November 2000. These changes have made measuring where and how much of a telecommunications service ‘originates’ and ‘terminates’ a particularly difficult exercise, and highly dependent on the particular methodology being used. . . . DoITT will explore with Looking Glass the potential for implementing an alternative methodology that is more objective, measurable and certain.”

***Auditor Comment:*** We are pleased that DoITT officials agree to explore the potential for implementing a more appropriate methodology that would better help to determine what is a fair and equitable revenue amount in accordance with the agreement.

#### **Did Not Maintain Its Books and Records As Required by the Franchise Agreement**

Looking Glass did not provide detailed financial records that would properly support the amount of revenue activity it reported to the City. Specifically, Looking Glass’s accounting reports, such as trial balance and general ledger, are prepared on a consolidated basis. According to §7.1.3 of the franchise agreement, “the Company shall keep comprehensive itemized records of all revenues received and of all services provided, in sufficient detail to enable the City to determine whether compensation owed the City . . . is being paid to the City.” However, the commingling of various regional revenues in Looking Glass’s financial records prevented us from determining whether all revenue generated in connection with its City agreement was reported to the City as required in the agreement. Because of the complexity of Looking Glass’s operations as a multi-national organization, it should ensure that separate books and records are maintained for its City revenue activity. Therefore, without the proper procedures to ensure that revenue derived from doing business with the City is separately maintained, we would not be able to confirm that Looking Glass is reporting all revenue to the City and that the company is in compliance with the franchise agreement.

***Looking Glass Response:*** “LGN disagrees that it has not maintained records in accordance with the Franchise Agreement. LGN’s records are maintained in

accordance with Section 7.1.3 of the Franchise Agreement. Section 7.1.3 of the Franchise Agreement obligates LGN to ‘keep comprehensive itemized records of all revenues received and of all Services provided, in sufficient detail to enable the City to determine whether all compensation owed the City pursuant to Section 7.1 is being paid to the City’ rather than maintain separate books of account and records of all City business activity as described and recommended in the Audit Report. In particular, LGN maintains unique identifiers for each dollar of revenue generated on a circuit terminating or originating in the City. Using existing accounting systems, revenue generated within the City and the associated records can be readily accessed by querying the broader revenue data set. LGN uses these systems to ensure it captures all revenue activity within the City.”

***Auditor Comment:*** Despite Looking Glass’s response disclosing the existence of certain reports and Looking Glass’s ability to generate such reports, Looking Glass has never made such reports or documents available to us for review. During the course of our audit, we were expressly informed that Looking Glass’s Accounting Department was unable to supply us with requested financial records, including its general ledger and trial balance for the New York market because, according to Looking Glass officials, only consolidated reports were maintained.

In addition, we identified transparency issues in Looking Glass’s reporting of its revenue that need to be addressed. For example, Looking Glass failed to provide us with its own revenue analyses that would determine the amount of revenue Looking Glass deems reportable to the City. Looking Glass reports to the City the revenues it deems to be reportable and only reports revenue only after applying an allocation that the City has not approved. As stated in Section 8.7.2 of the franchise agreement, “The Company shall also maintain and provide additional books and records as the Comptroller or Commissioner deem reasonably necessary to ensure proper accounting of all payments due the City.” Due to the lack of adequate records, we were not able to ascertain whether Looking Glass properly accounted for all payments to the City under the franchise agreement. Therefore, we strongly recommend that Looking Glass complies with the agreement and maintains separate accounting records that would allow the City to ascertain at all times that all revenue derived from doing business with the City is properly accounted for and reported to the City.

***DoITT Response:*** “DoITT concurs that Looking Glass should separately account for revenues properly attributable to its operations pursuant to the franchise, and will require such reporting.”

***Auditor Comment:*** We are pleased that DoITT officials agree with our position.

## **Other Issue**

### **DoITT's Oversight of Looking Glass**

As discussed in our audit of Level 3 Communication, Inc. (Looking Glass's parent company), DoITT did not ensure that it properly monitored Looking Glass's performance to determine whether the revenue reported and franchise fees submitted to the City were in compliance with the franchise agreement.

Under the City Charter, the agency designated to have primary expertise and responsibility for the franchise must monitor the performance of the grantee and enforce the terms and conditions of the franchise under its jurisdiction. The agreement between Looking Glass and the City requires Looking Glass to establish and maintain managerial and operational records, standards, procedures, and controls to enable it to prove in reasonable detail and to the reasonable satisfaction of the oversight agency, in this case DoITT, that Looking Glass is in compliance with the agreements at all times throughout the term. In addition, the agreement requires that when Looking Glass generates revenue from services that either originate or terminate in the City (i.e., that use part of Looking Glass's System), Looking Glass should submit to the City for its review and approval a revenue allocation methodology.

However, as noted in this report, in allocating certain revenue to the City, Looking Glass used a methodology that resulted in a disproportionate small portion of revenue being reported to the City for calendar years 2007 through 2008. Furthermore, we found no evidence that DoITT has required Looking Glass to submit detailed financial records to support the revenue reported to the City. Instead, DoITT accepted the amounts Looking Glass reported as well as the related payments Looking Glass made without exercising the proper oversight review. Such oversight review would have determined the accuracy and completeness of the revenue amounts that Looking Glass reported to the City.

In recent audits of similar DoITT's franchise agreements, we also found DoITT deficient in its enforcement of the terms of the franchise agreements. Specifically, a recent audit contained similar findings regarding the proportional allocation of revenue. In its response to that audit, dated May 22, 2009, DoITT stated that it "intends to have further discussions on [the issue of proportional allocation of revenue with an end point outside the City] during upcoming franchise negotiations with other current and potential franchisees with the objective of clarifying issues related to calculation of franchise fees that would reduce the likelihood of further disputes with regards to such matters going forward." DoITT is in continuous talks with franchisees regarding this and other telecommunications issues; however, a resolution of this issue has not been reached. With some franchise agreements already expired and operating under temporary agreements, and others soon to expire, DoITT should avoid future revenue loss by resolving the matter in a timely and effective manner.

## RECOMMENDATIONS

We recommend that Looking Glass:

1. Pay the City \$68,654 in franchise fees and late charges due from understated revenue, and ensure that all revenue from customer accounts is properly included in its revenue reports submitted to the City.
2. Submit to DoITT for its review and approval a methodology for allocating revenue for services that either originate or terminate in the City in accordance with the franchise agreement and pay to the City the amount it is owed using such methodology (plus late charges as appropriate).
3. Maintain separate books of accounts and records of all City business activity in a manner that would allow the City to determine whether Looking Glass is reporting all its revenue in compliance with the franchise agreement.

**Looking Glass Response:** Looking Glass did not directly address the report's recommendations; however, it generally disagreed with the audit findings as discussed in the report.

We recommend that DoITT:

4. Ensure that Looking Glass pays the City the \$68,654 in franchise fees and late charges due from understated revenue assessed in this report.

**DoITT Response:** "DoITT will pursue from Looking Glass payment of all past due amounts and late charges that the Agency determines the City is entitled to receive."

5. Ensure that Looking Glass pays the City a "fair and equitable allocation" as determined for revenue generated from partial use of the system for the period covering 2007 and 2008, and that the allocation is performed based on a methodology in compliance with the proper City review and approval process as required in the agreement.

**DoITT Response:** "DoITT generally concurs with this recommendation."

6. Ensure that Looking Glass submits separate accounting records and financial statements to determine whether all compensation is being paid to the City.

**DoITT Response:** "DoITT concurs and will require submission of such accounting records and financial statements."

7. Establish procedures and controls to review Looking Glass's revenue reporting and franchise fee payment calculations.

***DoITT Response:*** “DoITT has well established and effective procedures and controls in this regard and will continue to review them to ensure proper revenue reporting and franchise payments by its franchisees.”

## Looking Glass Networks, Inc.

**Schedule of Total Franchise Fees Due from Revenue Excluded  
From Services with Both Endpoints in the City**

**January 1, 2008, through December 31, 2008**

<b>Calendar Year 2008</b>	<b>A  Revenue Reported on Sampled Customer Bills</b>	<b>B  Revenue Reported on RevMart Billing Report</b>	<b>C = A - B  Revenue Excluded from Amounts Reported to the City</b>	<b>D = C x 5%  5% Franchise Fees Due</b>
1 <sup>st</sup> Quarter	\$ 866,638	\$ 357,542	\$ 509,096	\$ 25,455
2 <sup>nd</sup> Quarter	903,508	441,402	462,106	23,105
3 <sup>rd</sup> Quarter	1,100,774	1,165,884	(65,110)	(3,256)
4 <sup>th</sup> Quarter	1,073,083	1,037,664	35,419	1,771
<b>Total</b>	<b>\$ 3,944,003</b>	<b>\$ 3,002,492</b>	<b>\$ 941,511</b>	<b>\$ 47,075</b>
<b>Total Late Charges (See Appendix II)</b>				<b>\$ 21,579</b>
<b>Total Franchise Fees and Late Charges Due</b>				<b>\$ 68,654</b>

## Looking Glass Networks, Inc.

Schedule of Late Fees Calculation for Revenue Excluded  
From Services with Both Endpoints in the City

January 1, 2008, through December 31, 2008

Date	Additional 5% Fees Due City	Accumulated Balance Due	Payment Due Date	Cover Period		Number of Days Overdue	(a)	(b)
				From	To		Interest Rate	Late Interest Charge
<b>2008</b>								
1 <sup>st</sup> Quarter	\$ 25,455	\$ 25,455 26,623	5/15/2008	5/16/2008	8/14/2008	91	18.00%	\$ 1,168
2 <sup>nd</sup> Quarter	23,105	49,728 52,036	8/14/2008	8/15/2008	11/14/2008	92	18.00%	2,308
3 <sup>rd</sup> Quarter	(3,256)	48,780 51,044	11/14/2008	11/15/2008	2/14/2009	92	18.00%	2,264
4 <sup>th</sup> Quarter	1,771	52,815	2/14/2009	2/15/2009	7/31/2010	532	18.00%	15,839
<b>Total</b>	<b>\$ 47,075</b>							<b>\$ 21,579</b>

(a) Section 7.4 of the Franchise agreement requires that “in the event that any payment required by this Agreement is not actually received by the City on or before the applicable dated fixed in this Agreement, interest thereon shall accrue from such date until received at a rate equal to rate of interest then in effect charged by the City for late payment of real estate taxes.

(b) Late interest charges were calculated through July 31, 2010.



September 14, 2010

*Via UPS Overnight Service and Email*

City of New York  
Office of the Comptroller  
Mrs. Tina Kim  
One Center Street, Room 1100  
New York, NY 10007-2341

*RE: Response to the Draft Audit Report of the Looking Glass Networks, Inc ("LGN")  
Franchise Agreement*

Dear Mrs. Kim,

This letter is in response to the City's draft audit report dated August 30, 2010 (the "Audit Report"). As discussed in prior meetings with the City, LGN disagrees with the findings but is willing to continue to work with the City's Department of Information Technology and Telecommunications ("DoITT") to ensure compliance under the Franchise Agreement.

First, LGN would like to note that material discrepancies exist between the supporting data for the preliminary draft audit report and the Audit Report. LGN and the City discussed the preliminary draft audit report and its supporting data in great detail. LGN provided a response to that data, disagreeing with the City's findings, on August 4, 2010. LGN is unclear as to how the findings and associated support in the Audit Report were determined due to the material changes in the supporting data. LGN can only assume that the factors driving the discrepancies between LGN's reporting during the audited years and those found by the City are similar to those discussed with the City during the preliminary draft audit review. As such, LGN will restate its objections to the Audit Report based on this assumption.

The Audit Report cites three areas of concern: revenue reported, revenue allocation, and recordkeeping. LGN disagrees with the findings in each of these areas for the reasons below.

*Revenue Reported*

LGN disagrees that it owes additional fees to the City for the audit period. LGN's initial analyses of the data in the preliminary draft audit report consisted of queries from the revenue reports previously provided to the City audit team. The under reporting claimed by the City audit team appears to be driven by the inclusion of revenue streams to which the City is not entitled under the definition of Telecommunications Services in the Franchise Agreement.

September 13, 2010  
Page 2

*Allocation Methodology*

LGN disagrees that it is not following a “fair and equitable” revenue allocation methodology as set forth in the Franchise Agreement. In accordance with Section 1.15 of the Franchise Agreement, LGN submits payments based on a fair and equitable allocation methodology. LGN’s methodology allocates revenue by the proportionate length of any such circuit within the City’s jurisdiction. LGN’s allocation favors the City by assuming all circuits are the maximum length of any two points within the City, i.e. 12.8 miles.

*Recordkeeping*

LGN disagrees that it has not maintained records in accordance with the Franchise Agreement. LGN’s records are maintained in accordance with Section 7.1.3 of the Franchise Agreement. Section 7.1.3 of the Franchise Agreement obligates LGN to “keep comprehensive itemized records of all revenues received and of all Services provided, in sufficient detail to enable the City to determine whether all compensation owed to the City pursuant to Section 7.1 is being paid to the City” rather than maintain separate books of account and records of all City business activity as described and recommended in the Audit Report. In particular, LGN maintains unique identifiers for each dollar of revenue generated on a circuit terminating or originating in the City. Using existing accounting systems, revenue generated within the City and the associated records can be readily accessed by querying the broader revenue data set. LGN uses these systems to ensure it captures all revenue activity within the City.

Notwithstanding anything herein, LGN continues to believe that this Franchise Agreement between LGN and the City, and the fees assessed thereunder, may violate the Telecommunications Act of 1996, 47 USC § 253. Accordingly, LGN reserves all of its rights as a certified telecommunications provider in the State of New York under applicable state and federal law.

Should you have any questions concerning this submission, please do not hesitate to contact me. LGN looks forward to resolving these matters promptly.

Sincerely,



Steve Gordon  
Senior Director, Network Infrastructure Services

Cc: Charles Wesley, Senior Corporate Counsel  
Alma Fana, City of New York, Bureau of Audit  
Joseph Bonanno, City of New York, Bureau of Audit



**Information  
Technology &  
Telecommunications**

Carole Post  
*Commissioner*  
75 Park Place  
New York, NY 10007  
212-788-6600

September 17, 2010

Ms. Tina Kim  
Deputy Comptroller for Audit  
The New York City Office of the Comptroller  
Audits, Accounts & Contracts  
1 Centre Street, Room 1100  
New York, NY 10007

Re: **Audit Report on the Compliance of  
Looking Glass Networks, Inc.  
With Its City Franchise Agreement  
January 1, 2007 – December 31, 2008  
FN10-093A**

Dear Deputy Comptroller Kim:

I am writing in response to the above-captioned draft audit report ("draft audit") dated August 30, 2010. DoITT has reviewed the draft audit's findings and recommendations and would like to comment on the recommendations that pertain both to Looking Glass Communication's compliance with its high-capacity telecommunications franchise obligations and to DoITT's oversight of the Looking Glass franchise.

#### **RECOMMENDATIONS PERTAINING TO LEVEL 3**

**Recommendation 1:** Looking Glass should "[p]ay the City \$68,654 in franchise fees [\$47,075] and late charges [\$21,579] due from understated revenue, and ensure that all revenue from customer accounts is properly included in its revenue reports submitted to the City."

**DoITT Response:** To resolve this matter, DoITT will undertake a follow-up review to verify whether Looking Glass owes the City franchise compensation due to underreporting of revenue. Specifically, DoITT will request from the Comptroller's office the supporting data for the Draft Audit; and, upon reviewing such data, will meet with Looking Glass to understand the company's own, detailed interpretation regarding those revenue streams from which it believes the City is not entitled to receive franchise compensation.

**Recommendation 2:** Looking Glass should “[s]ubmit to DoITT, for its review and approval, a methodology for allocating revenue for services that either originate or terminate in the City in accordance with the franchise agreement and pay to the City the amount it is owed using such methodology (plus late charges as appropriate.)”

**DoITT Response:** DoITT generally concurs. However, it should be recognized that significant advancements in telecommunications technology have occurred since the Looking Glass franchise was entered into in November 2000. These changes have made measuring where and how much of a telecommunications service “originates” and “terminates” a particularly difficult exercise, and highly dependent on the particular methodology being used. Looking Glass reports that 18% of its revenue originated or terminated in the City; the draft audit, using a different methodology believes that 50% is a more appropriate figure. DoITT will explore with Looking Glass the potential for implementing an alternative methodology that is more objective, measurable and certain. Such discussion may be joined with a determination of the past due amount that is fairly owed to the City.

**Recommendation 3:** Looking Glass should “[m]aintain separate books of accounts and records of all City business activity in a manner that would allow the City to determine whether Looking Glass is reporting all its revenue in compliance with the franchise agreement.”

**DoITT Response:** DoITT concurs that Looking Glass should separately account for revenues properly attributable to its operations pursuant to the franchise, and will require such reporting.

#### RECOMMENDATIONS PERTAINING TO DoITT

**Recommendation 4:** DoITT should “[e]nsure that Looking Glass pays the City \$68,654 in franchise fees and late charges due from understated revenue assessed in this report.”

**DoITT Response:** DoITT will pursue from Looking Glass payment of all past due amounts and late charges that the Agency determines the City is entitled to receive. As discussed in more detail above, with reference to Recommendation 1, DoITT will request from the Comptroller’s office access to the supporting data for the Draft Audit, and thereafter meet with Looking Glass to ensure that the City has received franchise compensation from all revenue streams on which Looking Glass was obligated to pay.

**Recommendation 5:** DoITT should “[e]nsure that Looking Glass pays the City a “fair and equitable allocation” as determined for revenue generated from partial use of the System for the period covering 2007 and 2008, and that the allocation is performed based on a methodology in compliance with the proper City review and approval process as required in the agreement.”

**DoITT Response:** DoITT generally concurs with this recommendation as discussed above in response to Recommendation 2. Specifically, DoITT will pursue a revised approach to franchise compensation using a more objective, measurable and certain methodology than that which is currently set forth in the agreement.

**Recommendation 6:** DoITT should “[e]nsure that Looking Glass submits separate accounting records and financial statements to determine whether all compensation is being paid to the City.”

DoITT Response: DoITT concurs and will require submission of such accounting records and financial statements.

Recommendation 6: DoITT should “[e]stablish procedures and controls to review Looking Glass’s revenue reporting and franchise fee payment calculation.”

DoITT Response: DoITT has well established and effective procedures and controls in this regard and will continue to review them to ensure proper revenue reporting and franchise payments by its franchisees.

Sincerely,

A handwritten signature in black ink, appearing to read "Mitchel Ahlbaum", with a horizontal line extending to the right.

Mitchel Ahlbaum

- c: Carole Post, Commissioner/NYC DoITT
- Stanley Shor, Assistant Commissioner/NYC DoITT
- George Davis III, Deputy Director/NYC Operations
- Bruce Regal, Senior Counsel/NYC Law Department