

BOARD OF SUPERVISORS:

Pacific Gas and Electric Company
Properly Paid Its Franchise Fees
From January 1, 2003, Through
December 31, 2005

FINANCIAL AUDITS



September 5, 2006
05062



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ed Harrington
Controller
Monique Zmuda
Deputy Controller

September 5, 2006

Audit Number 05062

Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

President and Members:

The Office of the Controller presents its report concerning the review of franchise fee payments Pacific Gas and Electric Company (PG&E) made to the City and County of San Francisco (City) to use its streets to transmit, distribute, and supply electricity and gas within the City. PG&E is required to report its gross receipts and pay each year a total of one-half percent of its gross receipts on the sales of electricity and one percent of its gross receipts on the sales of gas. In addition, PG&E collected electricity and gas surcharge fees pursuant to requirements in the California Public Utilities Code, and remitted those amounts to the City when PG&E paid its franchise fees.

Reporting Period: January 1, 2003, Through December 31, 2005

| | | |
|-------------------|----------------|------------------|
| Fees Paid: | Franchise Fees | \$15,464,891 |
| | Surcharge Fees | <u>2,728,817</u> |
| | Total | \$18,193,708 |

Results:

PG&E correctly calculated and paid its franchise fees to the City on a timely basis. PG&E also correctly collected and remitted electricity and gas franchise surcharge fees to the City.

Respectfully submitted,

Original signed by:
Ed Harrington
Controller

INTRODUCTION

BACKGROUND

In 1939, the City and County of San Francisco (City) granted Pacific Gas and Electric Company (PG&E) and its successors two franchises to use City streets to transmit, distribute, and supply electricity and gas. In consideration for the two franchises, PG&E agreed to pay the City annually a percentage of its gross receipts from the sales of electricity and gas in the City.

The electricity and gas franchise ordinances require PG&E to remit to the City, by April 15 of each year, a total of one-half percent of PG&E's gross receipts on the sales of electricity and one percent of PG&E's gross receipts on the sales of gas. In reporting the gross receipts subject to the City's franchise fees, PG&E deducts from its total revenues such amounts as uncollectible accounts and interdepartmental sales. Interdepartmental sales include the amounts recorded by PG&E for supplying electricity and gas to other PG&E departments within San Francisco.

In addition, PG&E collects electricity and gas surcharge fees pursuant to requirements in the California Public Utilities Code and remits those amounts to the City when it pays its franchise fees. PG&E collects the surcharge fee, which is a municipal surcharge for the use of public lands, from customers who purchase electricity and gas from a third party. The surcharge fee is to replace, but not to increase, franchise fees that would have been collected if not for changes in the regulatory environment such as the unbundling of the gas industry. PG&E started collecting and remitting surcharge fees for gas in 1994 and for electricity in 1998.

PG&E includes the electricity sales it makes to the City's Hetch Hetchy Water and Power system (Hetch Hetchy) as part of PG&E's gross receipts from the sales of electricity reported to the City. PG&E has an agreement with the City and County of San Francisco to transmit electricity generated by Hetch Hetchy inside and outside the City, distribute that electricity within the City, and sell supplemental power to the City. PG&E bills Hetch Hetchy for the electricity sales, as well as for transmission and distribution charges, supplemental power charges, demand charges, and other special charges.

SCOPE AND METHODOLOGY

The purpose of this audit was to determine whether PG&E correctly reported its gross receipts and paid on time to the City the correct franchise fees and surcharge fees under the terms of the electricity and gas franchise ordinances for the period from January 1, 2003, through December 31, 2005. To conduct the audit, we reviewed the applicable provisions of the franchise ordinances and tested, on a sample basis, selected PG&E revenue components with amounts that materially impact the franchise fees payable to the City. We also interviewed staff from PG&E and Hetch Hetchy to aid in documenting and testing PG&E's revenues.

To determine whether PG&E correctly reported its annual gross receipts, we compared the amounts PG&E reported to the City to the amounts PG&E recorded in its monthly summary reports and monthly detailed reports. We tested the reasonableness of electricity and gas surcharge fees collected by PG&E. We also tested, on a sample basis, the reasonableness of some of PG&E's deductions from total receipts, including uncollectible accounts. We limited our review of the Hetch Hetchy revenues to tracing the amounts reported by PG&E to its monthly summary reports. We did not test the accuracy of the detailed Hetch Hetchy billings because Hetch Hetchy staff is responsible for reviewing the billings to ensure they are accurate before paying PG&E.

AUDIT RESULTS

PACIFIC GAS AND ELECTRIC COMPANY CORRECTLY REPORTED ITS GROSS RECEIPTS AND PAID ITS FRANCHISE FEES ON A TIMELY BASIS

From January 1, 2003, through December 31, 2005, Pacific Gas and Electric Company correctly reported \$2,411,301,012 in electricity and gas sales within the City, and correctly paid \$15,464,891 in franchise fees on a timely basis. The table below shows the electricity and gas gross receipts and franchise fees that PG&E paid to the City for 2003, 2004, and 2005. PG&E also correctly collected and remitted to the City electricity and gas surcharge fees of \$2,728,817 for the period under review.

TABLE

**Reported Gross Receipts and Franchise Fees and Surcharge Fees Paid
January 1, 2003, Through December 31, 2005**

| | Gross Receipts | Franchise Fees (Note 1) | Surcharge Fees (Note 2) |
|--------------------------------------|---------------------------|------------------------------------|------------------------------------|
| January 1, through December 31, 2003 | | | |
| Electricity | \$579,131,920 | \$2,895,660 | \$152,373 |
| Gas | 205,839,060 | 2,058,391 | 817,805 |
| Sub-total for 2003 | 784,970,980 | 4,954,051 | 970,178 |
| January 1, through December 31, 2004 | | | |
| Electricity | 575,529,898 | 2,877,649 | 328,483 |
| Gas | 211,574,857 | 2,115,749 | 723,334 |
| Sub-total for 2004 | 787,104,755 | 4,993,398 | 1,051,817 |
| January 1, through December 31, 2005 | | | |
| Electricity | 574,962,056 | 2,874,810 | 213,316 |
| Gas | 264,263,221 | 2,642,632 | 493,506 |
| Sub-total for 2005 | 839,225,277 | 5,517,442 | 706,822 |
| Total | \$2,411,301,012 | \$15,464,891 | \$2,728,817 |

Note 1. Franchise fee rates are one-half percent of electricity receipts and one percent of gas receipts.

Note 2. PG&E billed and collected electricity and gas franchise surcharge fees based on the formula specified in state law from its customers who purchased electricity and gas from a third party.

PG&E Correctly Deducted Uncollectible Accounts

PG&E deducted \$4,910,731 as uncollectible amounts from its gross receipts subject to the franchise fees for the three years under audit. To assess the reasonableness of these deductions, we analyzed PG&E's audited financial statements for the years 2003, 2004, and 2005 to determine the ratio of uncollectible accounts to the total audited electric and gas revenues for PG&E's system as a whole. We found that the uncollectible accounts were 0.65 percent in 2003, 0.84 percent in 2004, and 0.66 percent in 2005. For San Francisco customers, we found that PG&E's reported ratio of uncollectible accounts to the total electric and gas revenues were 0.23 percent in 2003, 0.22 percent in 2004, and 0.16 percent in 2005. Based on our analysis, the ratio of uncollectible accounts for San Francisco customers appears to be reasonable. In addition, we traced uncollectible amounts to PG&E's monthly reports of uncollectible accounts. We examined eighteen accounts identified as uncollectible in three months of the audit period. We traced the uncollectible amounts to the records of closed accounts and determined that those accounts were for businesses in the City. Based on our tests, it appears that PG&E correctly deducted reasonable uncollectible amounts from its gross receipts.

We conducted this review according to the standards established by the Institute of Internal Auditors. We limited our review to those areas specified in the audit scope section of this report.

Staff: Robert Tarsia, Financial Audit Manager
Houman Boussina

PACIFIC GAS AND ELECTRIC COMPANY RESPONSE TO THE AUDIT:



77 Beale Street
P.O. Box 770000
San Francisco, CA 94177

415.973.7000

August 29, 2006

Ed Harrington, Controller
Office of the Controller
City and County of San Francisco
City Hall, Room 316
One Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Re: Audit of PG&E's Franchise Payments for 2003, 2004 and 2005

Dear Mr. Harrington:

Thank you for providing PG&E with an opportunity to comment on your draft report on the review of PG&E's franchise payments for 2003, 2004 and 2005. We have reviewed the report and have not identified any errors or omissions. We are pleased to see that you have concluded that PG&E has correctly reported and remitted its franchise fees and franchise fee surcharges.

Sincerely,

A handwritten signature in black ink, appearing to read 'Colin McDonagh'.

Colin McDonagh
Manager, Revenue and Statistics
Billing, Revenue and Records Department

CM:JB

Blank page intentionally inserted.

cc: Mayor
Board of Supervisors
Civil Grand Jury
Budget Analyst
Public Library