

NRG Energy Center San Francisco LLC Complied With Its Franchise Obligations for 2015 and 2016

Board of Supervisors



AUDITS DIVISION



December 6, 2018

City & County of San Francisco
Office of the Controller
City Services Auditor

About the Audits Division

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the City and County of San Francisco (City) Charter that voters approved in November 2003. Within CSA, the Audits Division ensures the City's financial integrity and promotes efficient, effective, and accountable government by:

- Conducting performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of service delivery and business processes.
- Investigating reports received through its whistleblower hotline of fraud, waste, and abuse of city resources.
- Providing actionable recommendations to city leaders to promote and enhance accountability and improve the overall performance and efficiency of city government.

Audit Team:

Winnie Woo, Senior Auditor

Audit Consultant:

Sjoberg Evashenk Consulting, Inc.

For more information please contact:

Tonia Lediju, PhD
Chief Audit Executive
Office of the Controller
City and County of San Francisco
(415) 554-5393



<http://www.sfcontroller.org>



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Audit Authority

CSA conducted this audit under the authority of the San Francisco Charter, Section 3.105 and Appendix F, which requires that CSA conduct periodic, comprehensive financial and performance audits of city departments, services and activities.



OFFICE OF THE CONTROLLER

CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller

Todd Rydstrom
Deputy Controller

December 6, 2018

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

Dear President Cohen and Members:

The City Services Auditor Division (CSA) of the Office of the Controller (Controller) engaged Sjoberg Evashenk Consulting, Inc., to audit the franchise fees NRG Energy Center San Francisco LLC (NRG) paid to the City and County of San Francisco (City) to use city streets to install, construct, maintain, and operate steam pipe conduits for distributing steam for heating purposes. NRG is required to report its annual gross receipts and pay 2 percent of the gross receipts subject to the City's franchise fee. The San Francisco Public Utilities Commission (SFPUC) is responsible for overseeing the franchise, except for certain financial requirements, for which the Controller's Budget and Analysis Division is responsible.

Reporting Period: January 1, 2015, through December 31, 2016

Franchise Fees Paid: \$318,207

Results:

NRG complied with its obligations under the franchise agreement and the relevant provisions of the San Francisco Administrative Code. NRG reported \$31,143,698 in total gross receipts and \$15,911,343 in gross receipts subject to the franchise fee and paid \$318,207 in franchise fees to the City in accordance with the franchise agreement. The Controller's Budget and Analysis Division and San Francisco Public Utilities Commission also complied with the requirements in administering and monitoring the franchise agreement.

The responses of SFPUC and the Controller's Budget and Analysis Division are attached to this report. NRG verbally agreed with the audit results and chose not to submit a written response.

CSA appreciates the assistance and cooperation of NRG, SFPUC, and Controller's Budget and Analysis Division staff during the audit. For questions about the report, please contact me at Tonia.Lediju@sfgov.org or 415-554-5393 or CSA at 415-554-7469.

Respectfully,

A handwritten signature in black ink, appearing to read "Tonia Lediju".

Tonia Lediju, PhD
Chief Audit Executive

cc: Board of Supervisors
Budget Analyst
Citizens Audit Review Board
City Attorney

Civil Grand Jury
Mayor
Public Library

Board of Supervisors:
NRG Energy Center San Francisco LLC
Complied With Its Franchise Obligations for
2015 and 2016

December 3, 2018



EXECUTIVE SUMMARY

Purpose of the Audit

As required by the San Francisco Administrative Code, Chapter 11–Franchises, the City Services Auditor assessed (1) whether NRG Energy Center San Francisco LLC complied with the reporting requirements and payment obligations contained in Chapter 11 and in San Francisco Steam Franchise Ordinance 418-75 and (2) whether San Francisco departments complied with the relevant requirements for administering and monitoring the Steam Franchise Ordinance.

Highlights

The San Francisco Board of Supervisors may grant a franchise by ordinance to another entity to construct, install, and/or operate facilities in public rights-of-way within the City and County of San Francisco (City).

In 1993, NRG Energy Center San Francisco LLC (NRG) was granted a steam franchise authorizing it to install, maintain, and operate underground steam pipe conduits in order to carry steam and/or steam condensate for heating and other purposes through City streets, alleys, and other public places. In consideration for the franchise, NRG must submit a statement of gross receipts and a franchise fee payment to the City on an annual basis.

The San Francisco Public Utilities Commission is responsible for administering and reporting on non-financial aspects of the franchise, while the Office of the Controller’s Budget and Analysis Division is responsible for receiving and reviewing franchise statements and payments.

The audit found that NRG complied with its obligations under the steam franchise ordinance and the relevant provisions of the San Francisco Administrative Code. The audit also found that the Public Utilities Commission and Budget and Analysis Division fulfilled their obligations in administering and monitoring the franchise.

INTRODUCTION

Audit Authority

The Office of the Controller (Controller) is required under the San Francisco Administrative Code (Administrative Code), Chapter 11, Section 11.44(a) to file a report no less than every two years with the Board of Supervisors (Board) analyzing whether each franchisee is complying with the reporting requirements and payment obligations in Chapter 11 of the Administrative Code and the relevant franchise ordinance.

The City and County of San Francisco (City) also has the right under the Administrative Code, Chapter 11, Section 11.38 to access the books and records of a franchisee to monitor compliance with Chapter 11 of the Administrative Code, the franchise ordinance, or other applicable law.

Further, the San Francisco Charter provides the Controller's City Services Auditor Division (CSA) with broad authority to conduct audits. Sjoberg Evashenk Consulting, Inc. conducted this audit on behalf of CSA under these authorities.

Background

In 1975, the San Francisco Board of Supervisors granted Pacific Gas and Electric Company (PG&E) a franchise to install, maintain, and operate underground steam pipe conduits in order to carry steam and/or steam condensate for heating and other purposes through City streets, alleys, and other public places.¹

Nearly 20 years later, in 1993, the Board approved the transfer of the steam franchise from PG&E to NRG Energy Center San Francisco LLC (NRG).² NRG is a subsidiary of NRG Yield LLC owned by NRG Energy, Inc.

In consideration for the franchise, NRG must submit to the City a duly verified statement of its gross receipts subject to the franchise fee, which amount is based on the ratio of NRG's franchise assets to total operating assets valued at historical cost, by March 31st each year and must pay the City two percent of its annual gross receipts arising from the use, operation, or possession of the franchise (gross receipts subject to the franchise fee) annually by April 15th.

¹ Ordinance No. 418-75

² Ordinance No. 124-93

Franchise assets encompass all assets related to the sale of steam and located in public spaces, while assets located on private property are considered “non-franchise” assets. NRG maintains historical cost asset lists tracking the historical cost of each asset and distinguishing between franchise assets and non-franchise assets.

Chapter 11 of the Administrative Code designates the San Francisco Public Utilities Commission (SFPUC) as the entity responsible for administering and reporting to the Board on the City’s steam franchise, except for certain aspects which are administered by the Controller. The Controller’s Budget and Analysis Division (Division) is responsible for receiving NRG’s annual statement and collecting the franchise fees.

Objective and Scope

The objective of the audit was to determine whether NRG complied with the reporting requirements and payment obligations contained in Chapter 11–Franchises of the San Francisco Administrative Code and Steam Franchise Ordinance 418-75 (franchise agreement) and whether City departments complied with the relevant requirements for administering and monitoring the franchise.

Specifically, the audit determined whether:

1. NRG timely and accurately reported its gross receipts subject to the franchise fee under the terms of the franchise agreement;
2. NRG correctly calculated and timely paid the City the proper franchise fee under the terms of the franchise agreement;
3. SFPUC and the Division complied with all applicable requirements in administering and monitoring the franchise; and
4. NRG, SFPUC, and the Division corrected relevant findings and implemented recommendations from CSA’s prior audit covering 2013 and 2014.

This audit covered the period from January 1, 2015 to December 31, 2016.

Methodology

To conduct the audit, the auditors reviewed the applicable provisions of Chapter 11 of the Administrative Code and the franchise agreement as well as conducted interviews of NRG, SFPUC, and Division management and staff.

To determine whether NRG accurately reported its gross receipts, the auditors identified and analyzed NRG's internal controls over franchise activities and compared receipts reported to the City to amounts recorded in NRG's records (monthly billing spreadsheets, annual sales summaries, and year-end income statements). On a sample basis, the audit team tested whether NRG invoiced customers according to meter-reading records and applicable rates and whether invoiced amounts were appropriately recorded as gross receipts. Further, the auditors determined whether adjustments to receipts were adequately supported.

To determine whether NRG correctly calculated the gross receipts subject to the franchise fee based on the ratio of franchise assets to total operating assets, the audit team compared historical cost asset lists between years for reasonableness and completeness, as well as verified key formulas to ensure the lists encompassed all relevant values. The auditors also reviewed asset descriptions and evaluated whether NRG reasonably characterized assets as franchise and non-franchise. In addition, the auditors traced the historical cost assigned to each asset added in 2015 and 2016 to NRG's records (depreciation schedules, year-end trial balances, and year-end work in progress reports) and compared asset values on historical cost asset lists to values reported on NRG's statements of gross receipts.

To determine whether NRG correctly calculated and paid the City the proper franchise fee under the terms and deadlines specified in the franchise agreement, the audit team reviewed Division date stamps on NRG's annual statements of gross receipts and franchise fee payments; confirmed that the statements of gross receipts were duly verified; and checked each calculation in NRG's computation of its franchise fee to ensure mathematical accuracy. The audit team applied a materiality threshold set by CSA of the lessor of \$2,000 or two percent of NRG's calculated annual franchise fee due to any underpayments and overpayments identified.

To determine SFPUC and the Division's level of compliance with applicable requirements in administering and monitoring the franchise, the auditors reviewed the most recent compliance report that SFPUC submitted to the Board and the tools used by the Division to track and review franchise fee reports and payments.

Statement of Auditing Standards

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 the findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

Auditee Response

NRG verbally agreed with the audit results, but chose not to submit a written response. SFPUC and the Division also agreed with the results as shown in their responses attached to this report.

AUDIT RESULTS

Summary

For the period between January 1, 2015 and December 31, 2016, NRG complied with its obligations under the franchise agreement and the relevant provisions of the San Francisco Administrative Code.

In addition, SFPUC and the Division complied with their requirements for administering and monitoring the franchise, and the Division corrected relevant findings and implemented recommendations from CSA's prior audit covering 2013 and 2014.

NRG Timely Reported Its Gross Receipts and Paid Appropriate Franchise Fees to the City

For 2015 and 2016, NRG reported \$31,143,698 in total gross receipts and \$15,911,343 in gross receipts subject to the franchise fee and paid \$318,207 in franchise fees to the City, as shown in the exhibit below, in compliance with the franchise agreement and the relevant provisions of the San Francisco Administrative Code. Furthermore, NRG's submission of its statements of gross receipts and franchise fee payments to the City were generally timely, in accordance with deadlines set forth in the franchise agreement.

EXHIBIT				
NRG Reported Gross Receipts and Franchise Fees Paid: January 1, 2015 to December 31, 2016				
Year	(A) Total Gross Receipts	(B) Ratio of Franchise Assets to Total Operating Assets	(C) Gross Receipts Subject to Franchise Fee = (A) x (B)	Franchise Fee* = (C) x .02
2015	\$15,917,799	52.236228%	\$8,314,858	\$166,297
2016	\$15,225,899	49.885295%	\$7,595,485	\$151,910
Total	\$31,143,698	—	\$15,911,343	\$318,207

Figures have been rounded to the nearest dollar.

*Franchise fee due is two percent of NRG's annual gross receipts subject to the franchise fee.

Sources: NRG's annual steam franchise statements of gross receipt and Division payment records.

SFPUC Issued Its Statutorily Required Franchise Compliance Report

SFPUC is required by San Francisco Administrative Code, Chapter 11, Article 5, Section 11.44(b), to file a report with the Board of Supervisors (Board), no less than every two years, analyzing whether each franchise grantee is complying with all provisions of the chapter and its franchise, except for those addressed by the Controller's report.³ SFPUC issued a compliance report to the Board dated October 25, 2018.

The Controller's Budget and Analysis Division Complied with Its Requirements for Receiving Franchise Statements

The Division complied with its franchise agreement responsibility to receive and verify franchise statements of gross receipts and payments.

³ The Controller's Report refers to the report requirement under San Francisco Administrative Code, Chapter 11, Article 5, Section 11.44(a) analyzing whether each person owing a franchise fee is complying with the audit, reporting requirements, and payment obligations contained in the Chapter.

ATTACHMENT A: SFPUC'S RESPONSE



525 Golden Gate Avenue, 13th Floor
San Francisco, CA 94102
T 415.934.5707
F 415.554.1877

November 21, 2018

Tonia Lediju
Director of City Audits
Office of the Controller, City Services Auditor
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Management's Response to the Audit Report: Board of Supervisors: NRG Energy Center San Francisco LLC Complied With Its Franchise Obligations for 2015 and 2016

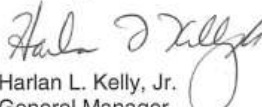
Ms. Lediju,

Thank you for providing us the opportunity to review the audit report, *Board of Supervisors: NRG Energy Center San Francisco LLC Complied With Its Franchise Obligations for 2015 and 2016*, prepared by the Controller's Office, City Services Auditor.

We appreciate the time your staff dedicated to this audit, and are pleased that there are no findings.

If there are any questions or additional information is needed, please do not hesitate to contact me at (415) 554-1600.

Sincerely,


Harlan L. Kelly, Jr.
General Manager

cc: Michael Carlin, Deputy General Manager
Barbara Hale, AGM Power Enterprise
Eric Sandler, AGM Business Services & Chief Financial Officer
Nancy L. Hom, Deputy Chief Financial Officer

OUR MISSION: To provide our customers with high-quality, efficient and reliable water, power and sewer services in a manner that values environmental and community interests and sustains the resources entrusted to our care.

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Mayor

Vince Courtney
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Ann Moller Caen
Vice President

Francesca Vietor
Commissioner

Anson Moran
Commissioner

Ike Kwon
Commissioner

Harlan L. Kelly, Jr.
General Manager



ATTACHMENT B: DIVISION'S RESPONSE



OFFICE OF THE CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller
Todd Rydstrom
Deputy Controller

November 29, 2018

Ms. Tonia Lediju
Chief Audit Executive
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

RE: 2015 and 2016 NRG franchise audit

Dear Ms. Lediju,

Thank you for the opportunity to review the audit of franchise fees and reports remitted to the City by NRG Energy Center San Francisco LLC for 2015 and 2016. We agree with the audit findings.

Sincerely,

A handwritten signature in cursive script that reads "Michelle Allersma".

Michelle Allersma
Director, Budget & Analysis Division