

Pacific Gas and Electric Company Properly Paid Its Franchise Fees and Surcharges for 2015 and 2016

Board of Supervisors



December 21, 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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 <https://www.linkedin.com/company/sfaudits/>

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 21, 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 (CSA) of the Office of the Controller (Controller) engaged Sjoberg Evashenk Consulting, Inc., (SEC) to audit the franchise fees and surcharge fees Pacific Gas and Electric Company (PG&E) paid to the City and County of San Francisco (City) to use city streets to transmit, distribute, and supply electricity and gas. PG&E is required to report its gross receipts and pay each year a total of 0.5 percent of its gross receipts on the sales of electricity and 1 percent of its gross receipts on the sales of gas. PG&E collected electricity and gas surcharge fees on behalf of the City, pursuant to requirements in the California Public Utilities Code, and remitted those amounts to the City when PG&E paid its franchise fees.

Period: January 2015 Through December 2016	Fees Paid
Franchise Fees	\$11,683,765
Surcharge Fees	1,269,320
Total	\$12,953,085

PG&E correctly reported \$1,924,831,251 in gross receipts subject to the franchise fee and correctly calculated and paid the City the proper franchise and surcharge fees according to the terms and deadlines specified in the franchise agreements. The Controller's Budget and Analysis Division and San Francisco Public Utilities Commission (SFPUC) also complied with the requirements in administering and monitoring the franchise agreement. The responses of PG&E, SFPUC, and the Controller's Budget and Analysis Division are attached to this report.

CSA and SEC appreciate the assistance and cooperation of PG&E, 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,

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:
Pacific Gas and Electric Company Properly Paid Its
Franchise Fees and Surcharges for 2015 and 2016

December 2018



EXECUTIVE SUMMARY

Purpose of the Audit

As required by the San Francisco Administrative Code, Chapter 11 – Franchises, the Office of the Controller (Controller) is required to assess (1) whether Pacific Gas & Electric Company (PG&E) complied with the reporting requirements and payment obligations contained in Chapter 11 and in San Francisco Gas Franchise Fee Ordinance 413 and Electric Franchise Fee Ordinance 414 (2) whether San Francisco departments complied with the relevant requirements for administering and monitoring the Gas and Electric Franchise Ordinances.

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 1939, Pacific Gas and Electric Company (PG&E) was granted gas and electric franchises authorizing it to use City streets to transmit, distribute, and supply electricity and gas. In consideration for the franchise, PG&E must submit statements of gross receipts and gas and electric franchise fee payments to the City on an annual basis.

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

The audit found that PG&E complied with its obligations under the gas and electric franchise ordinances and the relevant provisions of the San Francisco Administrative Code, and that the San Francisco Public Utilities Commission and Controller's Budget and Audit Division also 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 analyzing whether each franchisee is complying with the reporting 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 Audit Division (CSA) with broad authority to conduct audits. Sjoberg Evashenk Consulting, Inc. (SEC) conducted this audit on behalf of CSA under these authorities.

Background

In 1939, the San Francisco Board of Supervisors 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 0.5 percent of PG&E's gross receipts on the sales of electricity and 1 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.

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 also has an Interconnection Agreement with the City to transmit electricity generated by the Hetch Hetchy Project (Hetch Hetchy) inside and outside the City, distribute the electricity within the City, and sell supplemental power to the City. PG&E bills the City for services, including transmission and distribution charges, supplemental power charges, demand charges, and other special charges. PG&E includes the transactions for services it provides to the City as part of PG&E's gross receipts from the sales of electricity reported to the City.

However the Interconnection Agreement expired in July 2015 and effective July 1, 2015, the City and PG&E began using PG&E's Wholesale Distribution Tariff (WDT) agreement for the City's Points of Delivery¹ for which it also requires interconnection to PG&E's Distribution System. The new agreement was filed unexecuted with the Federal Energy Regulatory Commission (FERC) because both parties could not agree on terms, rates, and conditions. As a result, the City and PG&E are currently undergoing the dispute resolution process with the FERC. PG&E continues to bill the City for services provided, and includes the revenue as part of its gross receipts.

The San Francisco Public Utilities Commission (SFPUC) is responsible for administering the Interconnection Agreement, WDT agreement, and franchise agreement with PG&E. Administration includes verifying the accuracy of monthly billings prior to payment.

Chapter 11 of the City Administrative code designates the SFPUC as the entity responsible for administering and reporting on the City's gas and electric franchises, except for certain financial aspects which are administered by the Office of the Controller. The Controller's Budget and Analysis Division is responsible for receiving PG&E's annual statement and collecting franchise fee payment.

¹ The physical locations where CCSF provides utility service delivery.

PG&E reports and remits gas and electric franchise fees to the City based on gross revenues that have been reduced by uncollectible accounts and interdepartmental sales. Uncollectible accounts are amounts billed to customers, but not received by PG&E. Interdepartmental sales are PG&E's costs to supply electricity and gas to properties it owns in the City. Since PG&E is not compensated for internal use of gas and electricity, no gross receipts are generated by these interdepartmental sales. For the two-year audit period, PG&E deducted from its gross revenue receipts approximately \$1,565,000 and \$9,088,000 in uncollectible accounts and interdepartmental sales, respectively. The amounts of uncollectible accounts and interdepartmental sales deducted for 2015 and 2016 would have resulted in additional franchise fees of approximately \$27,700 and \$29,700, respectively. The sum of these amounts represents less than 1 percent of the total franchise fees paid by PG&E to the City for 2015 and 2016.

Objectives and Scope

The objective of the audit was to determine whether PG&E complied with the reporting requirements and payment obligations contained in Chapter 11 – Franchises of the Administrative Code, Gas Franchise Ordinance 413-39, and Electric Franchise Ordinance 414-39 (franchise agreements), as well as whether City departments complied with the relevant requirements for administering and monitoring the franchise for the audit period of calendar years 2015 and 2016.

Specifically, the audit determined whether:

1. PG&E correctly reported all revenues from the sale of electric and gas sales within City limits, including Hetch Hetchy, under the terms of San Francisco Electric Franchise Ordinance 414-39 and Gas Franchise Ordinance 413-39;
2. PG&E properly calculated and supported any adjustments from gross receipts;
3. PG&E correctly calculated and paid the City the proper franchise fees under the terms and deadlines specified in the franchise agreements;
4. The San Francisco Public Utilities Commission and the Controller's Budget and Analysis Division of the San Francisco Office of the Controller complied with applicable requirements in administering and

monitoring the franchise agreements such as the San Francisco City Charter of 1996 and Chapter 11 of the San Francisco Administrative Code; and

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 PG&E, SFPUC, and Controller Budget and Analysis Division management and staff.

Additionally, to understand the environment, the auditors 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.

To determine whether PG&E correctly reported its annual gross receipts, the audit team:

- Compared the amounts PG&E reported to the City to the amounts PG&E recorded in its monthly summary reports, financial systems, and monthly detailed reports, including, but not limited to, underlying reports of gas and electric sales from its customer billing system, uncollectable accounts, and revenue derived from natural gas vehicle sales, Hetch Hetchy Wheeling, and Hetch Hetchy streetlights.
- Compared PG&E's system-wide uncollectable rate to the uncollectable rate for the City to determine whether a large variance between the rates existed. Reviewed the reasonableness of PG&E's collection and write-off processes.
- Analyzed historical franchise fees and surcharges over a five-year period to identify variances and reasons for any variances identified.
- Reviewed the reasonableness of electricity and gas surcharge fees collected by PG&E.
- Tested a sample of PG&E Customer Invoices from several gas and electric rate categories to ensure amounts were included in total revenue receipts.
- Assessed PG&E's internal controls over franchise requirements and systems used to calculate franchise fees.

- Performed high level tests of the completeness of PG&E's customer data set.
- Verified PG&E's internal reconciliation between its financial system and customer billing system.

The audit team's review of the Hetch Hetchy invoices consisted of verifying the amounts reported by PG&E to supporting monthly billing reports. The audit team did not test the accuracy of the detailed billings to the City because SFPUC staff is responsible for reviewing the billings to ensure they are accurate before paying PG&E; however, auditors compared actual invoices to monthly system billing reports.

To assess whether PG&E correctly calculated and paid the City the proper franchise fee under the terms and deadlines specified in the franchise agreement, the audit team reviewed Controller Budget and Analysis Division date stamps on PG&E's annual statements of gross receipts and franchise fee payments; confirmed that the statements of gross receipts were duly verified (i.e., signed and dated); and checked each calculation in PG&E's computation of its franchise fee to ensure mathematical accuracy.

To evaluate SFPUC and Controller Budget and Analysis Division's compliance with all applicable requirements and practices in administering and monitoring the franchise agreement, the auditors reviewed the most recent compliance report that SFPUC submitted to the Board of Supervisors and the tools used by the Controller Budget and Analysis 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 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.

AUDIT RESULTS

Summary

PG&E accurately reported its gas and electric gross receipts subject to the franchise fee and calculated and paid the City the proper franchise fees according to the terms and deadlines specified in the franchise agreements.

Both the Controller's Budget and Analysis Division and SFPUC complied with most of their requirements for administering and monitoring the PG&E franchise agreement.

PG&E Submitted Its Gross Receipts Reports and Paid Associated Franchise Fees and Surcharge Fees on Time

For the period January 1, 2015 through December 31, 2016, PG&E accurately reported \$1,924,831,251 in total gross electricity and gas sales receipts within the City by the annual March 31st deadline specified in the franchise agreement. As shown in the exhibit below, PG&E also correctly calculated and paid \$11,683,765 in franchise fees by the annual April 15th deadline specified in the franchise agreements. PG&E also correctly collected and remitted to the City electricity and gas surcharge fees of \$1,269,320 for the period under review.

EXHIBIT		Gross Receipts Reported and Franchise Fees and Surcharge Fees Paid January 1, 2015 Through December 31, 2016			
Year	Type	Gross Receipts ¹	Franchise Fees ²	Surcharge Fees ³	Over/(Under) Paid
2015	Electricity	\$742,324,578	\$3,711,623	\$376,849	\$0
	Gas	\$192,800,738	\$1,928,007	\$244,005	\$0
2016	Electricity	\$770,584,813	\$3,852,924	\$458,989	\$0
	Gas	\$219,121,122	\$2,191,211	\$189,477	\$0
Total		\$1,924,831,251	\$11,683,765	\$1,269,320	\$0

Notes:

¹ Gross receipts reported by PG&E are net of uncollectable accounts, interdepartmental sales, and reflect updated customer information adjustments.

² Franchise fee rates are 0.5 percent of electricity receipts and 1 percent of gas receipts.

³ 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

Source: PG&E Certification of Gross Receipts

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.² SFPUC issued a compliance report to the Board dated October 17, 2018. In its compliance report, SFPUC raised two concerns that PG&E was not meeting its obligations under Section 7 of its franchise agreement with the City.

First, the City disputed costs related to certain Golden Triangle historic streetlight poles in the Union Square area that PG&E removed for safety reasons. According to the City, it believes PG&E is solely responsible for the costs of removing and relocating the historic poles. At the end of audit fieldwork, the City and PG&E were still in discussion over the issue.

Second, the City and PG&E entered into an Gas Pipeline Cross Bore Agreement in 2014 and amended in 2016 to address issues where PG&E bored across the City's sewer system while installing gas pipelines. Despite PG&E's representation that it would remediate problems quickly, the City asserts that the proposed schedule provided by PG&E indicates it will take PG&E several year to complete repairs. At the end of audit fieldwork, the City and PG&E were in the process of drafting a second amendment to extend the agreement.

Controller's Budget and Analysis Division Established Processes to Validate and Verify PG&E Statements and Payments

San Francisco Controller's Budget and Analysis Division established practices to thoroughly review statements provided to verify the accuracy and completeness of gas and electric franchise fees and surcharges, verifying payments and reports were received on-time, and certifications provided were duly certified. The Budget and Analysis Divisions continued to utilize a spreadsheet to track key dates and payments. The Budget and Analysis Division also conducted data analyses to identify variances between expected franchise fee and surcharge revenue receipts and actual revenue receipts, including processes to investigate discrepancies greater than a 10 percent threshold. During the audit period, actual amounts received were within 10 percent of budgeted amounts.

² 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: PG&E'S RESPONSE



CC CO Revenue Operations
Revenue and Statistics

77 Beale Street
San Francisco CA 94105

December 18, 2018

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

RE: Response to Audit Report of franchise fees and franchise fee surcharges for 2015 and 2016

Dear Ms. Lediju:

Thank you for providing Pacific Gas and Electric Company (PG&E) with an opportunity to comment on your draft report on the audit of PG&E's franchise fees and surcharges for 2015 and 2016. We find the report comprehensive and acceptable in form, though we note that it is PG&E's position that neither of the two concerns identified on page 8 of the draft report (i.e., the relocation of Golden Triangle historic streetlight poles and cross-bore repairs) relate to, or are controlled by, PG&E's franchise agreement with the City.

Rather, it is PG&E's position that the provision of streetlights, and particularly their relocation, is controlled exclusively by PG&E's LS-1 tariff and that cross-bore repairs are controlled exclusively by the parties' 2014/2016 Gas Pipeline Cross-Bore Agreement. In any event, we are pleased that you have concluded that PG&E has properly reported and calculated the franchise fees and surcharges for the relevant audit period.

It was a pleasure working with the professionals at Sjoberg Evashenk Consulting and appreciate their time in performing this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Cecilia Guiman".

Cecilia Guiman
Revenue Operations
Pacific Gas and Electric Company

ATTACHMENT B: SFPUC'S RESPONSE



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

December 7, 2018

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

Subject: Management's Response to the Audit Report: Board of Supervisors: Pacific Gas and Electric Company Properly Paid Its Franchise Fees and Surcharges for 2015 and 2016

Ms. Lediju,

Thank you for providing us the opportunity to review the audit report, *Board of Supervisors: Pacific Gas and Electric Company Properly Paid Its Franchise Fees and Surcharges 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.

London N. Breed
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 C: CONTROLLER'S RESPONSE



OFFICE OF THE CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

Ben Rosenfield
Controller
Todd Rydstrom
Deputy Controller

November 26, 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 PG&E franchise fee and surcharge audit

Dear Ms. Lediju,

Thank you for the opportunity to review the audit of franchise fees and surcharges remitted to the City by Pacific Gas and Electric for 2015 and 2016. We agree with the findings and do not note any errors or omissions.

Sincerely,

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

Michelle Allersma
Director, Budget & Analysis Division