



AUDIT HIGHLIGHTS

Southwest Gas Franchise Agreement

September 14, 2018

Audit Report No. 1909

WHY WE DID THIS AUDIT

An audit of *Southwest Gas Franchise Agreement* was included on the City Council-approved fiscal year (FY) 2018/19 Audit Plan to evaluate the franchisee's compliance with the franchise agreement terms, focusing primarily on the franchise-related fees. This audit was requested by the Public Works Division Director.

BACKGROUND

In March 2012, Scottsdale voters approved a Southwest Gas Corporation franchise agreement, which allows Southwest Gas to construct, maintain and operate its natural gas system in the City-owned public rights-of-way. In exchange, the agreement requires Southwest Gas to pay the City a 2% franchise fee and a 0.5% Capital Expenditures Fund fee based on gross revenues derived from its sale and/or delivery of natural and artificial gas within the City.

Capital Expenditures Fund fees are held by the City and used to reimburse Southwest Gas annually for permit and inspection fees and costs related to relocating utilities for City projects. Any funds remaining belong to the City and are transferred to the General Fund.

Franchise-related fees totaled about \$7.8 million from April 2012 through March 2018.

City Auditor's Office

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WHAT WE FOUND

Some revenue types were excluded from the franchise fee calculation.

- Franchise-related fees were not paid on ancillary revenue, such as service change fees and late fees. These represented about \$75,000 in franchise fees.
- Certain customers were not charged franchise fees and the cause is not clear. These totaled nearly \$15,100 in unpaid franchise fees.

A small percentage of Southwest Gas service addresses were incorrectly identified as being within or outside of Scottsdale boundaries.

We tested service addresses for three zip codes, with the assistance of the GIS department mapping the addresses against the City boundaries. We found that:

- About 3% of these service addresses within Scottsdale boundaries were coded to other jurisdictions.
- About 5% of these service addresses not within Scottsdale boundaries were coded to Scottsdale.

Reimbursements from Capital Expenditures Fund fees appeared appropriate and reduced expenses for the Arizona region's rate base.

Based on our sample of costs, the reimbursement requests appeared adequately supported. Direct benefits to each jurisdiction vary, however, because franchise agreement terms differ, and reimbursements are applied to the combined region's rate base.

WHAT WE RECOMMEND

We recommend the Public Works staff:

- Work with the City Attorney's Office to evaluate whether these revenues should be included under the franchise agreement terms and, if applicable, recover any unpaid fees and associated late charges. As well, require Southwest Gas to provide more detailed documentation to support the franchise fees.
- Work with Southwest Gas to periodically verify the jurisdiction coding of selected service address areas.

MANAGEMENT RESPONSE

The department agreed with the audit recommendations.