

ATMOS GAS FRANCHISE FEES

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EXECUTIVE SUMMARY

OBJECTIVES:

- To examine the current franchise agreement and evaluate compliance with the terms and conditions.
- To determine the accuracy of franchise fee calculations and vendor remittances.
- To evaluate the terms of the agreement for future negotiations.

OVERALL CONCLUSION:

We conclude ATMOS is in compliance with the Franchise Fee Agreement and owes the City no additional fees for our audit period. We do recommend several contract modifications to the gas franchise agreement with ATMOS.

OPPORTUNITIES FOR IMPROVEMENT:

WE IDENTIFIED FOUR POTENTIAL AREAS FOR CONTRACT MODIFICATION IN THE NEW NOVEMBER 2009 CONTRACT.

We Recommend that the City consider:

- A. Requiring ATMOS to pay for and provide the City with an annual independent audit of City franchise fee revenue.
- B. Increasing the current franchise fee of 4% to 5%.
- C. Clarifying language in the franchise agreement regarding the Right-Of-Way Management Ordinance.
- D. Including a provision that would allow the City to charge penalty and interest on late payments.

Management Response:

- A. I concur. I will draft a letter by January 1, 2009 asking ATMOS to provide and pay for an annual independent audit of City franchise fee revenue.
- B. I concur. I will ask for consideration of this recommendation during the FY2010 budget deliberations.
- C. I concur. I will ask the City Attorney's Office to consider this recommendation when the franchise agreement is reviewed for renewal.
- D. I concur. I will ask the City Attorney's Office to consider this recommendation when the franchise agreement is reviewed for renewal.

Authorization

We have conducted an audit of the Atmos Gas Franchise Fees. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Scope and Methodology

We conducted the audit in accordance with Generally Accepted Government Auditing Standards, with the exception that no peer review has been performed on this audit entity in the past three years. 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. These included procedures of examining the current franchise agreement, determining accuracy of franchise fee calculations, observation of gas meters and evaluating the current agreement to determine if there are any needed We believe that the evidence obtained provides a contract modifications. reasonable basis for our findings and conclusions based on our audit objectives. Our audit covered January 1, 2005 – December 31, 2007.

While we report to the Mayor and City Council and present the results of our work to the Audit Committee, we are located organizationally outside the staff or line management functions we are auditing. Therefore, this Audit organization may be considered free of organizational impairments to independence to audit internally and report objectively to those charged with governance.

The objectives of our audit were:

- To examine the current franchise agreement and evaluate compliance with the terms and conditions.
- To determine the accuracy of franchise fee calculations and vendor remittances.
- To evaluate the terms of the agreement for future negotiations.

To adequately address the audit objectives, we:

- Reviewed each franchise payment report with the revenue data given by Atmos. Data was collected for two quarters of each calendar year under audit period. The quarters reviewed are as follows:

 - 2005 1st & 3rd quarter
 2006 2nd & 4th quarter
 - > 2007 1st & 4th guarter

- ➤ Interviewed appropriate City personnel to determine if there were issues related to Construction and Maintenance, Maps, Quality of Service and Default sections of the franchise agreement.
- ➤ Tested billing addresses provided from ATMOS against the City's GIS (geographic information system) information to determine whether customer records within Garland city limits were correctly coded as Garland customers.
- Traced a sample of 33 customer invoices, verified they matched ATMOS billing records and were calculated accurately.

Overall Conclusion

We conclude ATMOS is in compliance with the Franchise Fee Agreement and owes the City no additional fees for our audit period. We do recommend several contract modifications to the gas franchise agreement with ATMOS.

Background

ATMOS Energy, Inc. has a franchise agreement with the City of Garland (City) to operate a natural gas distribution system within the City. The streets, right-of-way and public easements used by the gas companies within the boundaries of the City are valuable public properties acquired and maintained by the City. The City collects a 4% franchise fee on the companies' total reported gross revenues each calendar quarter as rental payments for use of the public rights-of-way and to recover costs incurred by the City for regulating and administering the gas franchise agreements. The total gross revenue comes from the sale of gas to residential, commercial, industrial, and transportation customers. The miscellaneous service charges and 3rd party value of gas is also included in the gross revenue reported by ATMOS. Miscellaneous revenue includes charges to connect and reconnect gas, bad debt and returned checks.

Type of customer Atmos serves in the City of Garland:

- Residential Houses where people live
- Commercial Non-resident customers with small volumes
- Industrial Non-resident customers with large volumes who contract with Atmos to get a lower rate
- Transportation Customers that have purchased gas from a 3rd party gas marketer but contracted with Atmos to deliver gas to them through Atmos' Gas pipeline system.
- 3rd Party Value of Gas These are the same customers as transportation. They have purchased gas from a 3rd party gas marketer but they are paying Atmos for the value of gas.

The City received \$5.8 million in franchise fee revenue from ATMOS Gas for the period of January 2005 through December 2007. The franchise fee revenue totals for the last three years were:

Year	Franchise Fee Revenue Paid
2005	\$1,973,188.30
2006	\$1,894,892.73
2007	\$1,988,621.90

The ATMOS Gas franchise agreement originally belonged to TXU Gas Company. ATMOS acquired TXU's natural gas and pipeline holdings in October 2004. The ATMOS Gas franchise agreement is up for renewal November 16, 2009. In the City of Garland, ATMOS Gas serves 43,280 customers.

We want to thank Atmos Gas and the City of Garland's management and staff for their assistance in this audit. Their assistance was essential for the successful completion of our work.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

1. WE IDENTIFIED FOUR POTENTIAL AREAS FOR CONTRACT MODIFICATION IN THE NEW NOVEMBER 2009 CONTRACT.

A. The Financial Department does not currently perform activities to verify accuracy and completeness of franchise fee revenue received from ATMOS. In order to validate revenue completeness our Finance Department would need an understanding of how the data is collected, calculated, processed and paid by ATMOS, as well as knowing how to process the information. Due to the time involved to gain an understanding of the ATMOS processes it is not a realistic objective for the City's Financial Department to perform an audit of franchise fee revenue.

There are no written policies or procedures in place to monitor the validity and accuracy of ATMOS franchise fee revenue. Obtaining sufficient information from ATMOS for audit verification can be costly in terms of effort and time for the City and ATMOS. An annual independent audit should be performed to validate revenue accuracy and completeness to make sure the City is collecting the appropriate revenue.

- B. Currently, the City collects a 4% franchise fee on the total gross revenues reported from ATMOS. We gathered information from other metropolitan cities to see what they were charging for franchise fees. While our costs have increased and other metropolitan cities have raised their franchise fee, City of Garland has used the maximum allowable percent for the last ten years. The following cities currently charge a 5% franchise fee:
 - Addison
 - Austin
 - Bedford
 - Desoto
 - Mesquite
 - McKinnev

Based on the 2007 gross revenue reported from ATMOS, if we increase the current franchise fee of 4% to 5% we would increase the City's revenue by approximately \$400,000. The additional

revenue was calculated by taking 2007 gross revenue receipts and multiplying it by 5%. The total was then subtracted from the current 2007 franchise fee revenue to find the difference.

- C. It may be helpful to clarify that the Right-Of-Way ordinance applies to the franchise agreement by stating in the agreement that "to the extent not inconsistent with the terms of the ATMOS Franchise Agreement, the terms and conditions of the Right-Of-Way Management Ordinance will apply."
- D. Overall, ATMOS remits franchise fee payments on time. The franchise fee is due to be paid quarterly to the City on or before the 15th day of the second month following the end of the quarter period for which payment is due. City of Garland's general ledger report indicated all quarterly payments were paid on time by ATMOS.

However, as an incentive for ATMOS to pay on time and be in compliance with the contract agreement include a provision that would allow the City to charge interest on late payments.

We Recommend that the City consider:

- A. Requiring ATMOS to pay for and provide the City with an annual independent audit of City franchise fee revenue.
- B. Increasing the current franchise fee of 4% to 5%.
- C. Clarifying language in the franchise agreement regarding the Right-Of-Way Management Ordinance.
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Management Response:

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