

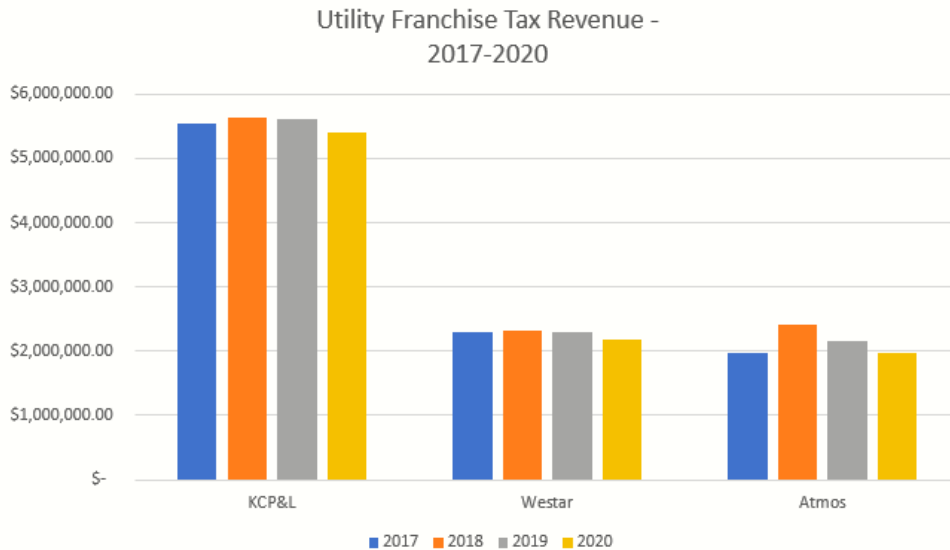


CITY AUDITOR REPORT ELECTRIC AND GAS UTILITY FRANCHISE AGREEMENT REVIEW DECEMBER 22, 2021

BACKGROUND

Franchise fees are derived through charging utility and telecommunication companies a fee for either right of way or site use within the City. These fees are paid for electricity, natural gas, and a mix of telecom services, including landline and wireless phone, cable television, and internet. The City Comprehensive Annual Financial Report indicates **\$39.8 million dollars in franchise fee revenue** was earned by electrical and gas utilities in 2020, composing approximately **9.5% of general fund revenue**.

Energy utility franchise fees are subject to fluctuation due to multiple factors, including weather patterns, tariff rates approved by the Kansas Corporation Commission, economic development, and residential housing trends. **Utility franchise revenue levels have stayed relatively steady in the past 4 years, as shown in the graph of E1 financial system franchise fee data below:**



AUDIT SCOPE

The scope of this audit reviewed:

- Franchise fee payment compliance with payment terms
- Major utility franchisee customer data (correlating customer billing with any available geographic information)
- Franchisee fee calculation methodology
- City processes to report annexation and applicable benefit/special purpose districts to franchisees, as applicable
- City processes for any applicable additional fees requiring notification/billing per franchise agreement terms (example: Google annual conduit invoicing)

AUDIT OBJECTIVES

The objectives of this audit were to determine whether:

- Fees are paid by franchisees accurately and timely in compliance with agreement payment terms
- Franchisee tax calculation methods are reasonable and comply with agreement terms
- City annexation processes are in place to report property boundary changes to applicable franchise fee stakeholders
- Location-based franchise tax fees due to the City are received and recorded as applicable

AUDIT CONCLUSIONS

Due to staff transition in the City Auditor's Office, audit conclusions will be presented to the City Council in this report on a summarized basis. **Details for suggested changes and/or future potential improvements have been furnished to appropriate City management and functional areas; information on adoption and future actions related to these recommendations should be directed to the departments mentioned in the following findings.**

- **With minor exceptions, utility franchise fees were paid accurately and timely in compliance with franchise agreement terms.** Data analytics were performed to compare sample months' utility customer billing addresses to the City's address database. No exceptions noted involved material dollar amounts.
 - 7 Evergy customers identified in Olathe were discovered to be outside Olathe City limits; correction was requested by the Auditor.
 - 11 Evergy customer accounts were classified as 'exempt' from franchise tax; however, no exemptions to franchise tax are in place/effect at this time. Correction of these accounts was requested by the Auditor.
- **Gas transport customer volumetric rate schedules were noted to be filed annually as required;** however, Audit requested that Atmos files these rates with the City Clerk as required by franchise notification terms; currently, the City Manager has been the incorrect filing addressee.
- **Franchise tax calculation was noted to be reasonable and in compliance with agreement terms.** Franchise tax calculation methods were subject to data analytic recalculation and reviewed for anomalies. Research into differences determined they were legitimate, and related to fees/charges which were not franchise taxable gross revenues.
 - **Evergy's Atmos and KCP&L subsidiaries use differing methods to calculate the 5% franchise tax due;** each company's franchise agreement does not specify whether the specific revenues/charges can or cannot be used as a base for the franchise tax calculation. **Therefore, the auditor finds no basis to conclude on the correctness of either method.** The monthly difference revenue caused by the two calculation methods was reviewed, and was immaterial. **Information on these differences was discussed with the Legal team for their consideration in future franchise term negotiation and definition.**
- **City processes to notify the gas and electric utility companies are not in place at this time.** Audit has notified the Clerk's office and its related management of the 'Compensation to the City' terms within these franchise agreements to enable future compliant annexation notification.
 - **The last 4 years of annexation activity were reviewed to determine whether any material tax revenue was lost due to lack of annexation notices; no significant revenue loss had occurred.** This is reasonable due to the specific annexations being sparsely developed or undeveloped.
- **Franchise tax fees from electric and gas utility companies were consistently paid timely, recorded in appropriate financial statement accounts, and agree to the utility companies' records of taxes paid.**