PHILADELPHIA GAS WORKS

(A Component Unit of the City of Philadelphia)

Basic Financial Statements and Supplementary Information

August 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

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KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

The Controller of the City of Philadelphia and
Chairman and Members of the Philadelphia
Facilities Management Corporation
Philadelphia, Pennsylvania:

Report on the Financial Statements

We have audited the accompanying financial statements of Philadelphia Gas Works (the Company), a component unit of the City of Philadelphia, Pennsylvania, as of and for the years ended August 31, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the Company's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philadelphia Gas Works, as of August 31, 2015 and 2014, and the changes in its financial position, and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of Matter

As discussed in note 1(u) to the financial statements, in 2015 the Company adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, and applied the provisions of those standards retrospectively as of September 1, 2013. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 3-14 and the schedules of changes in net pension liability and related ratios, pension contributions, and other postemployment benefits funding progress on pages 58-60 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Philadelphia, Pennsylvania
December 29, 2015

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2015 and 2014 have been prepared by PGW's management. The information presented here is unaudited and should be read in conjunction with additional information contained in PGW's financial statements.

Financial Highlights

- The Fiscal Year (FY) 2015 reflected a 4.4% colder than normal winter. The FY 2015 period was 0.9% colder than the prior year; however, firm gas sales decreased by 0.1 billion Cubic Feet (Bcf). In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2014 through May 2015, resulted in heating customers receiving credits totaling $10.7 million as a result of the temperatures experienced during the period. The FY 2014 reflected a 3.2% colder than normal winter. The FY 2014 period was 13.3% colder than the prior year and firm gas sales increased by 3.8 Bcf. In addition, the WNA, which was in effect from October 2013 through May 2014, resulted in heating customers receiving credits totaling $12.3 million as a result of the temperatures experienced during the period.
- PGW achieved a collection rate of 97.1% in the current period, 95.0% in FY 2014, and 91.9% in FY 2013. The increase in the collection rate of 2.1% between FY 2015 and FY 2014 was primarily driven by total gas billings that were 11.9% lower than the 10-year average. Total gas billings are down primarily due to significantly lower commodity prices for natural gas. Over the past 10-years the cost of fuel has fallen approximately 56.0%. The cost of natural gas is a significant portion of total gas billings. The collection rate is calculated by dividing the total gas receipts collected in FY 2015 by the total gas billings that were applied to PGW customers' accounts from September 1, 2014 through August 31, 2015. The same methodology was utilized in FY 2014 and FY 2013.
- PGW continues to have various business initiatives that pertain to improving collections, productivity, and operational efficiencies throughout the Company. PGW, at the end of FY 2015 had $30.0 million of tax-exempt capital project commercial paper outstanding. At the end of FY 2014 and FY 2013, there was no tax-exempt commercial paper outstanding. The cash balances at the end of FY 2015 and FY 2014 were $114.3 million and $105.7 million, respectively. This reflects overall increases of $8.6 million and $4.8 million at the end of FY 2015 and FY 2014, respectively. PGW had a cash balance of $100.9 million at the end of FY 2013.
- *Liquidity/Cash Flow* – At December 17, 2015, $90.0 million was available from the commercial paper program. The cash balance at December 17, 2015 was $81.3 million.
- The Company's FY 2016 Capital Budget was approved by the City Council of the City of Philadelphia and funding was provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program (CIMR). Main replacement cost for this program in FY 2016 is expected to be $22.4 million. The total six-year cost of the CIMR is forecasted to be $134.0 million.
- On August 18, 2015, the City of Philadelphia (the City) issued Gas Works Revenue Bonds, Thirteenth Series (1998 General Ordinance) in the amount of $261.8 million for the purpose of redeeming, refunding, or defeasing all outstanding City of Philadelphia Gas Works Revenue Bonds under the 1975 Ordinance and to redeem all of the outstanding Fourth Series Bonds and Fifth Series A-1 Bonds (1998 General Ordinance). The proceeds of the bonds also were used to defease a portion of the outstanding Seventh Series Bonds (1998

General Ordinance), and were used to pay the costs of issuing the bonds. The Thirteenth Series Bonds, with fixed interest rates that range from 3.0% to 5.0%, have maturity dates through 2034. The loss on this refunding of $13.5 million will be amortized over the life of the Thirteenth Series Bonds. This transaction provided net present value debt service savings of $34.3 million utilizing an arbitrage yield of 2.91%. The savings as a percentage of refunded bonds was 11.02%.

- In FY 2015, the Company retrospectively adopted new required pension accounting standards, Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68), and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* (GASB 71), as of September 1, 2013. The adoption of these standards resulted in the following:
  - Recognition of a net pension liability for the single employer Philadelphia Gas Works Pension Plan (Pension Plan) of $148.7 million at September 1, 2013, which increased to $164.3 million at August 31, 2014 and $239.9 million at August 31, 2015. The net pension liability represents the total actuarially determined liability less the Pension Plan's fiduciary net position.
  - A decrease in unrestricted net assets as of September 1, 2013 of $147.2 million, which resulted in a negative unrestricted net position of $12.4 million.
  - Recognition of deferred inflows and outflows related to the pension resulting in balances of $78.1 million and $46.1 million in deferred outflows and $11.7 million and $31.8 million in deferred inflows at August 31, 2015 and 2014, respectively. These deferred inflows and outflows of resources are related to differences between actual and expected investment returns, assumption changes, differences between expected and actual experience, and pension contributions made after the measurement date. GASB 68 requires changes in expected versus actual investment returns to be amortized into pension expense over five years, and actuarial assumption changes and experience differences to be amortized over the average remaining years of active employment for Pension Plan participants. The impact of this amortization over time will be increased volatility in annual amounts recognized as pension expense compared to amounts recognized under prior accounting standards.
  - An increase in the pension expense previously reported for the year ended August 31, 2014 of $2.7 million to $27.2 million from $24.5 million.
  - Pension expense was $43.7 million for the year ended August 31, 2015.

Overview of the Financial Statements

The discussion and analysis are intended to serve as an introduction and overview of PGW's basic financial statements. PGW's financial statements comprise the following:

Financial statements provide both long-term and short-term information about PGW's overall financial condition, results of operations, and cash flows.

The notes to basic financial statements provide additional information that is essential to a full understanding of the data presented in PGW's financial statements. The notes can be found immediately following the basic financial statements.

The financial statements report information about PGW as a whole using accounting methods similar to those used by private sector business. The three statements presented are as follows:

The statements of revenues and expenses and changes in net position present revenues and expenses and their effects on the change in net position during the fiscal year. These changes in net position are recorded as soon as the underlying event giving rise to the change occurs, regardless of when cash is received or paid.

The balance sheets include all of PGW's assets, liabilities and deferred inflows/outflows of resources, with the difference between the assets and deferred outflows and liabilities and deferred inflows reported as net position. Over time, increases or decreases in net position are indicators of whether PGW's financial position is improving or deteriorating.

The statements of cash flows provide relevant information about the cash receipts and cash payments of an enterprise during a period and the impact on PGW's financial position.

Condensed Statements of Revenues and Expenses

(Thousands of U.S. dollars)

		Years ended August 31		
		2015	**2014***	**2013**
Total gas revenues	$	676,027	736,138	675,154
Other revenues		21,220	22,998	18,317
Total operating revenues		697,247	759,136	693,471
Fuel expense		252,169	304,051	255,501
All other operating expenses		354,357	336,892	318,510
Total operating expenses		606,526	640,943	574,011
Operating income		90,721	118,193	119,460
Interest and other income		3,784	3,597	1,147
Total interest expense		(56,523)	(57,135)	(59,965)
Distribution to the City of Philadelphia		(18,000)	(18,000)	(18,000)
Excess of revenues over expenses	$	19,982	46,655	42,642

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements.)

Operating Revenues

Operating revenues in FY 2015 were $697.2 million, a decrease of $61.9 million or 8.2% from FY 2014. While natural gas sendout was higher in FY 2015 as compared to FY 2014, operating revenues decreased due to a lower Gas Cost Rate (GCR). Natural gas sendout was approximately 1.9% higher in FY 2015 when compared to FY 2014. Operating revenues in FY 2014 were $759.1 million, an increase of $65.6 million or 9.5% from FY 2013. The increase in FY 2014 was mainly due to increased heating demand and increased revenues associated with gas transportation service. Please see the discussion of the cost of fuel in the *Operating Expenses* Section below.

Total sales volumes, including gas transportation deliveries, in FY 2015 increased by 0.1 Bcf to 79.2 Bcf or 0.1% from FY 2014 sales volumes of 79.1 Bcf. Total sales volumes, including gas transportation deliveries, in FY 2014 increased by 6.9 Bcf to 79.1 Bcf or 9.6% from FY 2013 sales volumes of 72.2 Bcf. In FY 2015, firm gas sales of 48.4 Bcf were 0.1 Bcf or 0.2% lower than FY 2014. Firm gas sales of 48.5 Bcf in FY 2014 were 3.8 Bcf or 8.5% higher than firm gas sales in FY 2013. Interruptible customer sales decreased by 0.5 Bcf compared to FY 2014, which increased by 0.2 Bcf compared to FY 2013. The decrease in FY 2015 interruptible sales was caused by decreased opportunities for Liquefied Natural Gas (LNG) sales. Gas transportation sales in FY 2015 increased by 0.9 Bcf to 30.3 Bcf from the 29.4 Bcf level experienced in FY 2014. Gas transportation sales in FY 2014 increased by 2.9 Bcf to 29.4 Bcf from the 26.5 Bcf level experienced in FY 2013.

In FY 2015, the number of customers served by PGW increased from the previous year and was approximately 501,000 customers. The number of customers served by PGW at the end of FY 2014 and FY 2013 was approximately 500,000 and 501,000, respectively. Commercial accounts were approximately 25,000 customers, reflecting no change from the previous two fiscal years. Industrial accounts were unchanged, from the previous two fiscal years at 700 customers. The number of residential accounts in FY 2015 increased to approximately 475,300 customers, an increase of 1,000 customers from the FY 2014 level, and no change from the 2013 level.

Operating Expenses

Total operating expenses, including fuel costs, in FY 2015 were $606.5 million, a decrease of $34.4 million or 5.4% from FY 2014. The decrease for FY 2015 reflects lower natural gas commodity prices. Total operating expenses, including fuel costs, in FY 2014 were $640.9 million, an increase of $66.9 million or 11.7% from FY 2013. The increase for FY 2014 reflects higher natural gas demand and higher costs associated with the gas processing, field services, and distribution departments.

Cost of Fuel – The cost of natural gas utilized decreased by $51.9 million or 17.1% to $252.2 million in FY 2015 compared with $304.1 million in FY 2014. The average commodity price per Thousand Cubic Feet (Mcf) decreased by $0.79 or $39.8 million, while the volume of gas utilized decreased by 2.4 Bcf, 4.5% or $11.1 million. There were no pipeline supplier refunds in FY 2015 as compared to $4.4 million in FY 2014 while demand charges decreased by $5.4 million, compared to FY 2014. Cost of fuel includes all commodity charges and demand charges net of pipeline refunds.

The cost of natural gas utilized increased by $48.6 million or 19.0% to $304.1 million in FY 2014 compared with $255.5 million in FY 2013. The average commodity price per Mcf increased by $0.83 or $44.3 million, while the volume of gas utilized increased by 2.8 Bcf, 5.6% or $10.6 million. In addition, pipeline supplier refunds in FY 2014 increased by $4.4 million while demand charges decreased by $1.9 million, compared to FY 2013.

(Continued)

Variations in the cost of purchased gas are passed through to customers under the GCR provision of PGW's rate schedules. Over recoveries or under recoveries of purchased gas costs are subtracted from or added to gas revenues and are included in other current assets or other current liabilities, thereby eliminating the effect that recovery of gas costs would otherwise have on net income.

The average natural gas commodity prices for utilized gas for FY 2015, FY 2014, and FY 2013 were \$3.84, \$4.63, and \$3.80 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2015 were \$93.7 million, a \$0.4 million or 0.4% decrease from the FY 2014 total of \$94.1 million. The decrease in FY 2015 was caused by lower labor costs associated with running the LNG plants. The FY 2014 total of \$94.1 million was \$11.3 million higher than the FY 2013 total of \$82.8 million as a result of higher labor costs for distribution, field services, and higher costs associated with running the LNG plants.

Additionally, expenses of \$123.8 million related to collection and account management, customer services, marketing, and the administrative area increased by \$7.6 million or 6.5% in FY 2015 primarily due to higher healthcare expenses, costs of customer programs, and an increase in customer services. This category increased by \$8.8 million or 8.2% in FY 2014 compared to FY 2013 primarily due to higher healthcare expenses and an increase in insurance costs.

Pension costs increased in FY 2015 due to a number of factors including the implementation of GASB 68 and GASB 71 as of September 1, 2013, a decrease in the discount rate from 7.95% to 7.65%, new mortality tables, and an unusually large number of retirees at the end of calendar year 2014. The covered payroll reflected a decrease of \$4.6 million as compared to the FY 2014 level of \$104.1 million. Pension costs on a GASB 68 basis increased by \$16.5 million or 60.7% to \$43.7 million in FY 2015 as compared to FY 2014. Pension costs increased \$3.6 million to \$27.2 million in FY 2014 as compared to FY 2013. FY 2013 pension costs do not include the impact of GASB 68.

Other Postemployment Benefits (OPEB) costs remained the same in FY 2015 when compared to FY 2014. OPEB costs decreased \$3.1 million to \$37.1 million in FY 2014 when compared to FY 2013. OPEB costs decreased in FY 2014 due to lower normal cost, lower unfunded liabilities, which are amortized over a 30-year period, and lower interest on the net OPEB obligation. For FY 2015 and FY 2014, the Company utilized a discount rate of 7.95%. For FY 2013, the Company utilized a discount rate of 8.0%. The higher OPEB Trust Fund (the Trust) balances created higher investment income and lower unfunded liabilities. These factors lowered OPEB costs.

The annual OPEB cost is recorded in the statements of revenues and expenses and changes in net position. For the year ended August 31, 2015, approximately \$6.7 million was recorded to other postemployment benefits expense and \$30.4 million was allocated to administrative and general expense. For the year ended August 31, 2014, approximately \$11.2 million was recorded to other postemployment benefits expense and \$25.9 million was allocated to administrative and general expense.

The net OPEB obligation was \$90.0 million for the fiscal year ended August 31, 2015, an \$11.8 million decrease from the \$101.8 million obligation at August 31, 2014. The net OPEB obligation of \$101.8 million at August 31, 2014, decreased $7.3 million from the $109.1 million obligation at August 31, 2013. This decrease was caused by a decrease in the annual OPEB cost and an increase of contributions made during the year.

Provision for Uncollectible Accounts – The provision for uncollectible accounts in FY 2015 totaled $34.8 million, a decrease of $4.0 million or 10.3% from FY 2014. The provision for uncollectible accounts in FY 2014 totaled $38.8 million, a decrease of $1.2 million or 3.0% from FY 2013. The decrease in the provision for uncollectible accounts is mainly due to higher collection rates achieved in FY 2015 and FY 2014. The accumulated provision for uncollectible accounts at August 31, 2015 reflects a balance of $102.0 million, compared to the $107.3 million balance in FY 2014 and $105.6 million in FY 2013. PGW is committed to continuing its collection efforts in an attempt to reduce outstanding delinquent account balances and to provide assistance to those customers who qualify for low-income grants and payment programs to help those customers maintain their gas service.

Net Depreciation Expense – Net depreciation expense increased by $2.1 million in FY 2015 compared with FY 2014. Net depreciation expense increased by $0.7 million in FY 2014 compared with FY 2013. The effective composite depreciation rates were 2.2% for FY 2015, FY 2014, and FY 2013. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income in FY 2015 was $0.2 million higher than FY 2014, primarily due to an increase in income from pipeline capacity releases. Interest and other income in FY 2014 was $2.5 million higher than FY 2013, primarily due to a loss in FY 2013 as a result of the termination of the Guaranteed Investment Contract related to the 1998 General Ordinance Bonds.

Interest Expense – Total interest expense was $56.5 million in FY 2015 a decrease of $0.6 million or 1.1% when compared with FY 2014. Interest expense was lower in FY 2015 primarily due to lower principal debt balances. Total interest expense was $57.1 million in FY 2014 a decrease of $2.9 million or 4.8% when compared with FY 2013. Interest expense was lower in FY 2014 primarily due to lower principal debt balances. Other interest costs increased in FY 2015 by $2.1 million or 22.3%, primarily due to the issuance expenses related to the Thirteenth Series bonds. Other interest costs decreased in FY 2014 by $1.3 million or 12.1%, primarily due to the reduction of expenses for losses on reacquired debt and other variable bond fees.

Excess of Revenues over Expenses – In FY 2015, the Company's excess of revenues over expenses was $20.0 million, a decrease of $26.7 million from FY 2014. This decrease is primarily due to the additional pension expenses recognized in FY 2015 as a result of the implementation of GASB 68. In FY 2014, the Company's excess of revenues over expenses was $46.7 million, an increase of $4.1 million from FY 2013.

Condensed Balance Sheets

(Thousands of U.S. dollars)

	Years ended August 31		
Assets	**2015**	**2014***	**2013**
Current assets:			
Accounts receivable (net of accumulated provision for uncollectible accounts of $102,029, $107,349, and $105,577 for 2015, 2014, and 2013, respectively)	$ 86,853	101,457	97,749
Restricted investment funds	5,820	5,820	49,875
Cash and cash equivalents, cash designated for capital expenditures, gas inventories, materials, and supplies and other current assets	178,831	204,944	197,363
Total current assets	271,504	312,221	344,987
Noncurrent assets:			
Utility plant, net	1,232,370	1,193,552	1,154,987
Unamortized bond insurance costs	3,473	14,136	15,736
Sinking fund, revenue bonds	90,141	105,909	105,280
Other assets	37,646	37,528	33,097
Total noncurrent assets	1,363,630	1,351,125	1,309,100
Total assets	1,635,134	1,663,346	1,654,087
Deferred Outflows of Resources			
Accumulated fair value of hedging derivatives	20,948	18,879	12,059
Unamortized losses on reacquired debt	37,471	37,051	44,868
Deferred outflows related to pension	78,128	46,131	—
Total deferred outflows	136,547	102,061	56,927
Total assets and deferred outflows of resources	$ 1,771,681	1,765,407	1,711,014

Condensed Balance Sheets

(Thousands of U.S. dollars)

Net Position, Liabilities, and Deferred Inflows		Years ended August 31 2015	2014*	2013
Net position	$	277,984	258,002	358,587
Long-term revenue bonds		914,719	980,749	1,033,976
Other noncurrent liabilities		168,399	179,265	177,431
Net pension liability		239,869	164,256	—
Total noncurrent liabilities		1,322,987	1,324,270	1,211,407
Current liabilities:				
Current portion of revenue bonds		43,030	53,227	52,406
Notes payable		30,000	—	—
Other current liabilities		86,027	98,100	88,614
Total current liabilities		159,057	151,327	141,020
Deferred inflows related to pension		11,653	31,808	—
Total net position, liabilities, and deferred inflows	$	1,771,681	1,765,407	1,711,014

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements)

Assets

Accounts Receivable – In FY 2015, accounts receivable (net) of $86.9 million decreased by $14.6 million or 14.4%, from FY 2014 due to lower gas billings during FY 2015, which resulted from lower commodity prices for natural gas. In FY 2014, accounts receivable (net) of $101.5 million increased by $3.8 million or 3.9%, from FY 2013 due to higher gas billings during FY 2014, which resulted from a robust winter heating season. The accumulated provision for uncollectible accounts, totaling $102.0 million decreased by $5.3 million in FY 2015 and totaled $107.3 million in FY 2014 and $105.6 million in FY 2013.

Cash and Cash Equivalents, Cash Designated for Capital Expenditures, Gas Inventories, Materials, and Supplies, and Other Current Assets – In FY 2015, cash and cash equivalents totaled $114.3 million, an increase of $8.6 million from the FY 2014 total of $105.7 million and totaled $100.9 million in FY 2013. In FY 2015, gas inventories, materials, and supplies totaled $50.9 million, a decrease of $19.1 million from the FY 2014 total of $70.0 million. In FY 2014, gas inventories, materials, and supplies totaled $70.0 million, a decrease of $10.2 million from the FY 2013 total of $80.2 million. In FY 2015, gas storage decreased by $19.3 million or 32.1% when compared to FY 2014. The decrease in gas inventory reflects lower volumes of gas in storage and a decrease in the cost per Mcf. In FY 2014, gas storage decreased by $10.6 million or 14.9% when compared to FY 2013. The decrease in gas inventory reflects lower volumes of gas in storage and a decrease in the cost per

Mcf. Other current assets totaled $13.6 million in FY 2015, a decrease of $5.6 million from FY 2014, primarily as a result of a decrease in the deferred GCR. Other current assets totaled $19.2 million in FY 2014, an increase of $3.0 million from FY 2013, primarily as a result of an increase in the deferred GCR.

Restricted Investment Funds – Restricted Investment Funds include the Capital Improvement Fund, Workers Compensation Escrow Fund, and the Health Insurance Escrow Fund. The Capital Improvement Fund had no balance at the end of FY 2015 and FY 2014 due to $44.1 million being drawn from the Capital Improvement Fund to fund capital expenditures in FY 2014. Interest income on all funds, to the extent not drawn, is reflected as an increase of $0.5 million in FY 2015, $0.4 million in FY 2014, and $0.4 million in FY 2013. Pursuant to the Pennsylvania Department of Labor and Industry Bureau of Workers' Compensation Self-Insurance policy, the Company has established and maintained a restricted trust account. As of August 31, 2015, 2014, and 2013, the trust account balances were $2.6 million. PGW is self-insured for the healthcare of active employees and retirees under the age of 65. Retirees over the age of 65 are insured on an experience rated basis. Per the terms of the self-insured program, PGW established a Health Insurance Escrow Fund that as of August 31, 2015, 2014, and 2013, was funded in the amount of $3.2 million. The Health Insurance Escrow Fund was closed in September 2015. PGW negotiated the closing of this account by providing an advance deposit of $0.8 million to the healthcare provider.

Utility Plant and Other Noncurrent Assets – In FY 2015, noncurrent assets including utility plant, net, and unamortized bond insurance costs totaled $1,363.6 million, an increase of $12.5 million from FY 2014. In FY 2014, noncurrent assets totaled $1,351.1 million, an increase of $42.0 million from FY 2013. Utility plant, net, totaled $1,232.4 million in FY 2015, an increase of $38.8 million or 3.3% compared with the FY 2014 balance of $1,193.6 million. Utility plant, net, totaled $1,193.6 million in FY 2014, an increase of $38.6 million or 3.3% compared with the FY 2013 balance of $1,155.0 million. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $82.6 million in FY 2015 compared to $80.2 million in FY 2014 and $70.4 million in FY 2013. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amounts of $34.1 million and $44.8 million in FY 2014 and FY 2013, respectively. There were no Capital Improvement Fund drawdowns in FY 2015. The major capital expenditures are associated with PGW's gas supply infrastructure, namely, gas mains, and customer service lines, including capital expenditures for the Long-Term Infrastructure Improvement Plan for which PGW will request recovery through a Distribution System Improvement Charge (DSIC).

In early 2012, Act 11 was enacted by the Pennsylvania Legislature, which permitted public utilities to file a request with the Pennsylvania Public Utility Commission (PUC) for the implementation of a DSIC. A DSIC permits natural gas distribution companies to recover the costs related to main and service replacement not already recovered in base rates. This legislation provides utility companies with a supplemental recovery mechanism for costs related to incremental/accelerated distribution system repair, improvement, and replacement. Act 11 permits gas utilities to recover 5.0% of their nongas revenues via the recovery mechanism and permits greater percentage increases if approved by the PUC. The Company started billing customers a DSIC surcharge as of July 1, 2013. In FY 2015, the Company billed customers $14.0 million for the DSIC surcharge. In FY 2014, the Company billed customers $19.4 million for the DSIC surcharge. The DSIC surcharge is fully reconcilable on a calendar-year basis and at the fiscal year end, the over billed or under billed amount is recorded as an adjustment to revenue. For additional information, see note 1(h) *Revenue Recognition* of the basic financial statements.

Deferred Outflows of Resources – Deferred outflows of resources represent amounts that relate items that will result in a reduction of net position in a subsequent period. Deferred outflows include the fair value of hedging derivatives that will be recognized in the statement of revenues and expenses and changes in net position upon termination of the hedging relationship; unamortized losses on reacquired debt; and increases in the pension liability that will be amortized into pension expense in future periods. Deferred outflows increased $34.5 million or 33.8% from FY 2014 to FY 2015, and $45.1 million or 79.3% from FY 2013 to FY 2014 primarily due to the recognition of deferred outflows of resources related to pension due to the implementation of GASB 68 and GASB 71 as described above.

Liabilities

Long-Term Revenue Bonds – Long-term revenue bonds, including the current portion and unamortized discount and premium, totaled $957.7 million in FY 2015. This was $76.3 million less than the previous year primarily as a result of normal debt principal payments and refunding and advanced payments. This represents 77.5% of total capitalization in FY 2015. Long-term debt, including the current portion and unamortized discount and premium, totaled $1,034.0 million in FY 2014. This was $52.4 million less than the previous year primarily as a result of normal debt principal payments. Long-term debt, including the current portion and unamortized discount and premium, totaled $1,086.4 million in FY 2013. Long-term debt represented 80.0% of total capitalization in FY 2014 and 75.2% of total capitalization in FY 2013. For additional information see note 8, *Long-Term Debt and Other Liabilities* of the financial statements.

Debt Service Coverage Ratio and Ratings – PGW has a mandatory debt service coverage ratio of 1.50 times debt service on both the 1975 and 1998 Ordinance Bonds. At August 31, 2015, only Senior 1998 Ordinance Bonds were outstanding. At the date of the refunding of all outstanding 1975 Ordinance Bonds, the debt service coverage was 6.57 times debt services for these bonds, compared to 6.15 and 5.58 times at August 31, 2014 and 2013, respectively. At August 31, 2015, the debt service coverage was 2.14 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 2.11 times at August 31, 2014 and 2.90 times at August 31, 2013. PGW's current bond ratings are "Baa1" from Moody's Investors Service (Moody's), "A-" from Standard & Poor's Rating Service (S&P), and "BBB+" from Fitch Ratings.

Current Portion of Revenue Bonds and Notes Payable – Pursuant to the provisions of the City of Philadelphia Note Ordinances, PGW may sell short-term notes to either support working capital requirements or pay the costs of certain capital projects and other project costs. PGW may issue short-term notes in a principal amount, which, together with interest, may not exceed $150.0 million outstanding to support working capital requirements. PGW may also sell additional short-term notes in an aggregate principal amount, which may not exceed $120.0 million outstanding at any time to pay the costs of certain capital projects and other project costs. All notes are supported by two irrevocable letters of credit and a security interest in PGW's revenues. The letter of credit supporting PGW's combined commercial paper programs fixed the maximum level of outstanding notes plus interest at $120.0 million in FY 2015 and FY 2014. In FY 2013, the letter of credit supporting PGW's working capital commercial paper program fixed the maximum level of outstanding notes plus interest at $60.0 million. There was $30.0 million of tax-exempt capital project commercial paper outstanding at August 31, 2015. At the end of FY 2014 and FY 2013, there was no tax-exempt commercial paper outstanding.

Other Current Liabilities – In FY 2015, other current liabilities totaled $14.1 million, a decrease of $5.2 million from FY 2014, mainly due to a refunding of a deposit to a third-party supplier. In FY 2014, the total was

$19.3 million, and $9.1 million in FY 2013. In FY 2015, accounts payable totaled $56.0 million, a decrease of $2.9 million or 4.9% compared with FY 2014 primarily due to a decrease in natural gas payables of $2.5 million and a decrease in trade payables of $0.4 million. In FY 2014, accounts payable totaled $58.9 million, a decrease of $0.5 million or 0.8% compared with FY 2013 primarily due to a decrease in natural gas payables of $4.5 million, which was offset by an increase in trade payables of $4.0 million.

Other Noncurrent Liabilities – In FY 2015, other noncurrent liabilities totaling $168.4 million, a decrease of $10.9 million compared to FY 2014. The decrease in FY 2015 is primarily due to the change in the value of the OPEB liability. In FY 2014, other noncurrent liabilities totaled $179.3 million, an increase of $1.9 million compared to FY 2013, which was primarily due to the change in the fair value of the interest rate swaps.

Net Pension Liability – A net pension liability was recognized at August 31, 2014 and August 31, 2015 due to the implementation of GASB 68 and GASB 71. The increase in the net pension liability of $75.6 million or 46.0% from FY 2014 to FY 2015 was primarily driven by a decrease in the discount rate from 7.95% to 7.65%, adoption of a new mortality table, and an unusually large number of retirees at the end of calendar year 2014.

Deferred inflows of resources – Deferred inflows of resources represent amounts that will result in an increase of net position in a subsequent period. Deferred inflows were recognized as a result of the implementation of GASB 68 and GASB 71 and represent the difference between actual and expected earnings on pension plan investments. The decrease in deferred inflows of $20.2 million or 63.4% between FY 2014 and FY 2015 is related to changes in investment performance. There were no deferred inflows of resources at August 31, 2013.

Net position – Net position as of September 1, 2013 was restated due to the implementation of GASB 68 and GASB 71 to reflect a total net position of $211.3 million, including a negative unrestricted net position of $12.4 million. Total net position increased $46.7 million or 22.1% to $258.0 million at August 31, 2014 and $20.0 million to $278.0 million at August 31, 2015, primarily due to increases in the Company's net investment in capital assets. Unrestricted net position decreased $0.9 million or 7.3% to negative $13.3 million at August 31, 2014 and $79.3 million or over 100.0% to negative $92.6 million at August 31, 2015, primarily due to the recognition of the net pension liability in accordance with GASB 68 and GASB 71. Negative unrestricted net position indicates that liabilities to be paid from unrestricted assets exceed the unrestricted assets available to pay them. Due to the long-term nature of the Company's net pension liability, this negative unrestricted net position is not indicative of the Company's near-term liquidity.

Other Financial Factors

Recent Rate Filings

On December 18, 2009, PGW submitted a base rate filing with the PUC (1) to maintain the $60.0 million base rate increase that the PUC granted in 2008; and (2) to fund PGW's OPEB liability in the amount of $42.5 million. PGW also moved to consolidate the Company's Demand Side Management Program, an energy efficiency and conservation plan, into the base rate filing. On May 19, 2010, PGW, along with all active parties to the proceeding, submitted a Petition for Proposed Settlement of the proceeding (the Settlement) and the PUC approved the Settlement on July 29, 2010. Under the Settlement, PGW will be permitted to maintain virtually all of the extraordinary base rate relief, will receive an incremental rate increase of $16.0 million annually, and will be required to fund $18.5 million of the OPEB liability in each of the fiscal years 2011 through 2015 (the incremental rate increase of $16.0 million annually is related to an OPEB surcharge, which was approved to continue beyond 2015 in PGW's most recent GCR Proceeding; PGW also agreed to continue funding the OPEB liability at $18.5 million annually). The Settlement also permitted the implementation of the Demand Side Management Program.

Refunding, Defeasance, and Redeeming of Debt

On August 18, 2015, the City issued Gas Works Revenue Bonds, Thirteenth Series (1998 General Ordinance) in the amount of $261.8 million for the purpose of redeeming, refunding, or defeasing all outstanding City of Philadelphia Gas Works Revenue Bonds under the 1975 Ordinance and to redeem all of the outstanding Fourth Series Bonds (1998 General Ordinance), Fifth Series A-1 Bonds (1998 General Ordinance), defease a portion of the Outstanding Seventh Series Bonds (1998 General Ordinance), and paying the costs of issuing the bonds. The Thirteenth Series Bonds, with fixed interest rates that range from 3.0% to 5.0%, have maturity dates through 2034.

Contacting the Company's Financial Management

This financial report is designed to provide the citizens of Philadelphia, customers, investors, and creditors with a general overview of PGW's finances and to demonstrate PGW's accountability for the money it receives. If you have questions pertaining to this report or need additional financial information, please contact Philadelphia Gas Works, 800 W. Montgomery Avenue, Philadelphia, PA 19122 or on the Web at www.pgworks.com.

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Balance Sheets

August 31, 2015 and 2014

(Thousands of U.S. dollars)

Assets		**2015**	**2014**
Current assets:			
Cash and cash equivalents	$	114,327	105,734
Cash designated for capital expenditures		—	10,000
Accounts receivable (net of provision for uncollectible accounts of $102,029 and $107,349 for 2015 and 2014, respectively)		86,853	101,457
Gas inventories, materials, and supplies		50,908	69,989
Workers' compensation escrow fund		2,597	2,597
Health insurance escrow fund		3,223	3,223
Other current assets		13,596	19,221
Total current assets		271,504	312,221
Noncurrent assets:			
Utility plant, at original cost:			
In service		2,093,112	2,018,234
Under construction		64,254	57,206
Total		2,157,366	2,075,440
Less accumulated depreciation		924,996	881,888
Utility plant, net		1,232,370	1,193,552
Unamortized bond insurance costs		3,473	14,136
Sinking fund, revenue bonds		90,141	105,909
Other noncurrent assets		37,646	37,528
Total noncurrent assets		1,363,630	1,351,125
Total assets		1,635,134	1,663,346
Deferred Outflows of Resources			
Accumulated fair value of hedging derivatives		20,948	18,879
Unamortized losses on reacquired debt		37,471	37,051
Deferred outflows related to pension		78,128	46,131*
Total deferred outflows of resources		136,547	102,061
Total assets and deferred outflows of resources	$	1,771,681	1,765,407

See accompanying notes to basic financial statements.

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements).

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Balance Sheets

August 31, 2015 and 2014

(Thousands of U.S. dollars)

Liabilities	**2015**	**2014**
Current liabilities:		
Current portion of revenue bonds	$ 43,030	53,227
Notes payable	30,000	—
Accounts payable	56,027	58,888
Customer deposits	2,858	2,245
Other current liabilities	14,091	19,321
Accrued accounts:		
Interest, taxes, and wages	10,051	14,646
Distribution to the City	3,000	3,000
Total current liabilities	159,057	151,327
Noncurrent liabilities:		
Long-term revenue bonds	914,719	980,749
Other noncurrent liabilities	168,399	179,265
Net pension liability	239,869	164,256*
Total noncurrent liabilities	1,322,987	1,324,270
Total liabilities	1,482,044	1,475,597
Deferred Inflows of Resources		
Deferred inflows related to pension	11,653	31,808*
Total liabilities and deferred inflows of resources	1,493,697	1,507,405
Net Position		
Net investment in capital assets	274,621	159,576
Restricted (debt service)	95,962	111,729
Unrestricted	(92,599)	(13,303)*
Total net position	277,984	258,002
Total liabilities, deferred inflows of resources, and net position	$ 1,771,681	1,765,407

See accompanying notes to basic financial statements.

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements).

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Statements of Revenues and Expenses and Changes in Net Position

Years ended August 31, 2015 and 2014

(Thousands of U.S. dollars)

		2015	2014
Operating revenues:			
Gas revenues:			
Nonheating	$	30,753	39,610
Gas transport service		39,588	41,217
Heating		605,686	655,311
Total gas revenues		676,027	736,138
Appliance and other revenues		8,727	8,317
Other operating revenues		12,493	14,681
Total operating revenues		697,247	759,136
Operating expenses:			
Natural gas		252,169	304,051
Gas processing		18,180	19,637
Field services		36,874	37,577
Distribution		38,629	36,929
Collection and account management		11,192	11,273
Provision for uncollectible accounts		34,833	38,848
Customer services		12,262	11,187
Marketing		6,956	7,783
Administrative and general		93,347	85,872
Pensions		43,748	27,214*
Other postemployment benefits		6,726	11,228
Taxes		7,823	7,687
Total operating expenses before depreciation		562,739	599,286
Depreciation		49,371	47,428
Less depreciation expense included in operating expenses above		5,584	5,771
Net depreciation		43,787	41,657
Total operating expenses		606,526	640,943
Operating income		90,721	118,193
Interest and other income		3,784	3,597
Income before interest expense		94,505	121,790
Interest expense:			
Long-term debt		45,756	48,261
Other		11,548	9,380
Allowance for funds used during construction		(781)	(506)
Total interest expense		56,523	57,135
Distribution to the City of Philadelphia		(18,000)	(18,000)
Excess of revenues over expenses		19,982	46,655*
Net position, beginning of year		258,002	211,347*
Net position, end of year	$	277,984	258,002*

See accompanying notes to basic financial statements.

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements).

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Statements of Cash Flows

Years ended August 31, 2015 and 2014

(Thousands of U.S. dollars)

		2015	2014
Cash flows from operating activities:			
Receipts from customers	$	700,500	724,500
Payments to suppliers		(430,729)	(458,344)
Payments to employees		(113,275)	(114,366)
Claims paid		(2,042)	(2,965)
Other receipts		17,700	17,300
Net cash provided by operating activities		172,154	166,125
Cash flows from noncapital financing activities:			
Income from nonutility operations		3,177	3,118
Interest and fees		1,011	(2,290)
Distribution to the City of Philadelphia		(18,000)	(18,000)
Net cash provided by (used in) noncapital financing activities		(13,812)	(17,172)
Cash flows from investment activities			
Sinking fund reserve deposits		(16,644)	—
Sinking fund reserve withdrawals		33,042	—
Interest income from short-term investments		96	221
Interest (loss) on capital improvement fund		—	(23)
Interest income (loss) on sinking fund		511	(349)
Net cash provided by (used in) investment activities		17,005	(151)
Cash flows from capital and related financing activities:			
Issuance of commercial paper		30,000	—
Redemption, refunding or defeasance of long-term debt		(319,687)	—
Proceeds from long-term debt issued		294,267	—
Long-term debt issuance costs		(2,467)	—
Purchases of capital assets		(82,606)	(80,222)
Principal paid on long-term debt		(50,975)	(49,800)
Interest paid on long-term debt		(46,067)	(48,540)
Drawdowns on capital improvement fund		—	44,055
Drawdowns (deposits) on restricted capital expenditures		10,000	(10,000)
Allowance for funds used during construction		781	506
Net cash used in capital and related financing activities		(166,754)	(144,001)
Net increase in cash and cash equivalents		8,593	4,801
Cash and cash equivalents at the beginning of the year		105,734	100,933
Cash and cash equivalents at the end of the year	$	114,327	105,734
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	90,721	118,193*
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization expense		43,787	41,658
Provision for uncollectible accounts		34,833	38,848
Change in assets and liabilities:			
Receivables, net		(20,229)	(42,556)
Gas inventories, materials, and supplies		19,081	10,245
Other current assets		5,626	(3,026)
Other assets		(119)	(11,250)
Accounts payable		(2,861)	(491)
Customer deposits		614	(60)
Other current liabilities		(5,230)	10,214
Accrued accounts		(4,595)	(177)
Other liabilities		10,526	4,527*
Net cash provided by operating activities	$	172,154	166,125

See accompanying notes to basic financial statements.

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 1 (u) to the basic financial statements).

(1) Summary of Significant Accounting Policies

The accounting methods employed by the Philadelphia Gas Works (the Company or PGW) are in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and are in conformity with City of Philadelphia (the City) reporting requirements.

As described in note 2, the Company is accounted for as a component unit of the City, and consequently follows accounting principles promulgated by the Governmental Accounting Standards Board (GASB) as they apply to business type activities. Under the Regulated Operations guidance within GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), assets or liabilities may be created by certain actions of regulatory bodies.

The principal accounting policies within this framework are described as follows:

(a) Regulation

Prior to July 1, 2000, the Company was under the regulatory jurisdiction of the Philadelphia Gas Commission (PGC). The PGC had the authority to set the Company's rates and tariffs. The PGC also approved the Company's annual Operating Budget and reviewed the Company's Capital Budget prior to approval by the City Council of the City (City Council).

Effective July 1, 2000, and pursuant to the passage of the Pennsylvania Natural Gas Choice and Competition Act (the Act), the Company came under the regulatory jurisdiction of the Pennsylvania Public Utility Commission (PUC). Under the PUC's jurisdiction, the Company filed a restructuring plan on July 1, 2002, which among other things, provided for an unbundled tariff permitting customer choice of the commodity supplier by September 1, 2003. Under the Act, the PUC is required to follow the "same ratemaking methodology and requirements" that were previously applicable to the PGC when determining the Company's revenue requirements and approving overall rates and charges. The PGC continues to approve the Company's Operating Budget and review its Capital Budget. The Company's Capital Budget must be approved by City Council.

The Company, as of September 1, 2003, is operating under its Restructuring Compliance Tariff. The Restructuring Compliance Tariff Rates are designed to maintain revenue neutrality and the Tariff Rules and Regulations are designed to comport with the Pennsylvania Public Utility Code.

(b) Operating Budget

On May 22, 2015, PGW filed a proposed Fiscal Year (FY) 2016 Operating Budget with the PGC. The PGC Hearing Examiners conducted Informal Discovery (ID) sessions beginning on June 6, 2015 and an additional ID meeting took place on June 23, 2015. On July 23, 2015, a public hearing was convened by the Hearing Examiners to address PGW's Operating Budget. On August 20, 2015, a recommended decision was rendered by the Hearing Examiners, which proposed adjustments to the Operating Budget as filed. On October 20, 2015, the PGC approved, with adjustments, PGW's FY 2016 Operating Budget. PGW filed a Compliance Budget with the PGC on October 20, 2015.

On May 23, 2014, PGW filed a proposed FY 2015 Operating Budget. After appropriate discovery and hearings, the PGC approved the FY 2015 Operating Budget on September 23, 2014.

On May 24, 2013, PGW filed a proposed FY 2014 Operating Budget. After appropriate discovery and hearings, the PGC approved the FY 2014 Operating Budget on September 17, 2013.

(c) Capital Budget

On January 2, 2015, PGW filed with the PGC its proposed FY 2016 Capital Budget in the amount of \$181.6 million. The PGC staff initiated its customary due diligence review and related ID process on January 23, 2015 and February 9, 2015. A public hearing was then held on February 24, 2015. The PGC's review culminated in deliberations taken at a public meeting held on April 27, 2015 whereby the PGC endorsed a FY 2016 Capital Budget in an amount not to exceed \$115.0 million.

On March 20, 2015, PGW filed a request to amend the proposed FY 2016 Capital Budget and related Forecast in an amount of \$8.2 million to increase spending for its Cast Iron Main Replacement (CIMR) program. The PGC staff established an expedited review schedule, including an ID meeting held on April 1, 2015. The PGC's review concluded with deliberations taken at a public meeting held on May 11, 2015 whereby the PGC endorsed an amended FY 2016 Capital Budget in an amount not to exceed \$123.1 million. The endorsed budget was approved by City Council and the Bill was signed by the Mayor on June 18, 2015.

On January 2, 2014, PGW filed with the PGC its proposed FY 2015 Capital Budget in the amount of \$89.2 million. The PGC's review culminated in deliberations taken at a public meeting held on April 8, 2014 whereby the PGC endorsed a FY 2015 Capital Budget in an amount not to exceed \$89.5 million. The endorsed budget was approved by City Council on June 12, 2014. The Bill was signed by the Mayor on June 19, 2014.

On January 2, 2013, PGW filed with the PGC its proposed FY 2014 Capital Budget in the amount of \$110.5 million. The PGC's review culminated in deliberations taken at a public meeting held on April 15, 2013 whereby the PGC endorsed a proposed FY 2014 Capital Budget in an amount not to exceed \$102.5 million. The endorsed budget was approved by City Council on June 6, 2013. The ordinance was signed by the Mayor on June 17, 2013.

Subsequent to City Council's approval, the PGC endorsed a FY 2014 Capital Budget amendment in the amount of \$0.4 million to support the purchase of 24 Compressed Natural Gas (CNG) sedans and a CNG refueling station. This amendment to the FY 2014 Capital Budget was approved by City Council on October 17, 2013. The Mayor signed the ordinance on October 30, 2013.

On January 6, 2014, PGW filed with the PGC a request to further amend the FY 2014 Capital Budget by \$3.4 million to provide for the incremental replacement of approximately three additional miles of small diameter cast iron main. The PGC endorsed an amendment to the FY 2014 Capital Budget that inserted a new line item, Long-Term Infrastructure Plan – Accelerated Cast Iron Main for \$3.4 million, and concurrently reduced two other line items that resulted in no increase in the FY 2014 Capital Budget. This second amendment was approved by City Council on June 12, 2014 and signed by the Mayor on June 19, 2014.

(d) Base Rates

In FY 2015, the PUC approved the Company's Gas Cost Rate (GCR) settlement petition, which included the following provision: "PGW's Other Postemployment Benefits (OPEB) Rider recovery shall remain at $16.0 million annually and PGW shall continue the annual deposit of this $16.0 million; the Company will continue to make a minimum $2.5 million annual contribution into the OPEB Trust (for an annual total of $18.5 million)." Additionally, PGW's petition to continue the Demand Side Management Program is pending before the PUC.

On December 18, 2009, PGW submitted a base rate filing with the PUC (1) to maintain the $60.0 million base rate increase that the PUC granted in 2008 and (2) to fund PGW's OPEB liability in the amount of $42.5 million. PGW also moved to consolidate the Company's Demand Side Management Program, an energy efficiency and conservation plan, into the base rate filing. On May 19, 2010, PGW, along with all active parties to the proceeding, submitted a Petition for Proposed Settlement of the proceeding (the Settlement) and the PUC approved the Settlement on July 29, 2010. Under the Settlement, PGW will be permitted to maintain virtually all of the extraordinary base rate relief, will receive an incremental rate increase of $16.0 million annually, and will be required to fund $18.5 million of the OPEB liability in each of the fiscal years 2011 through 2015. The new rates were effective September 1, 2010. The Settlement also permitted the implementation of the Demand Side Management Program.

(e) Weather Normalization Adjustment Clause

The Weather Normalization Adjustment Clause (WNA) was approved by PUC Order dated August 8, 2002. The purpose of the WNA is to neutralize the impact of weather on the Company's revenues. This allows the Company to achieve the recovery of appropriate costs as authorized by the PUC. The WNA results in neither a rate increase nor a rate decrease, but acts as a billing adjustment. The main benefits of the WNA are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA is applied to customer invoices rendered during the period of October 1 through May 31 of each year for each billing cycle. The adjustment for the year ended August 31, 2015 was a decrease in billings of $10.7 million. The WNA resulted in a decrease in billings of $12.3 million for the year ended August 31, 2014.

(f) Gas Cost Rate

The Company's single greatest operating expense is the cost of natural gas. The rate charged to the Company's customers to recover these costs is called the GCR. The GCR reflects the increases or decreases in natural gas costs and other costs. This GCR mechanism provides the flexibility to rapidly reflect current conditions without the time delay inherent in full base rate alteration. The intent is to achieve an annual balance between the costs incurred for fuel and their pass through to customers.

At the end of the fiscal year, costs recovered through the GCR and surcharges adjustment are compared to the actual cost of fuel and other specific costs. Customers are then credited or charged for the over recovery or under recovery of costs. The GCR and surcharges charge/credit may be updated quarterly or in the subsequent fiscal year to reflect the under recovery or over recovery. Changes in the GCR impact the reported amounts of gas revenues but do not affect operating income or net income because

(Continued)

they are passed through to the customer without markup. At August 31, 2015, approximately $2.5 million was recorded in other current assets for the GCR and surcharges under recovery. At August 31, 2014, approximately $15.2 million was recorded in other current assets for the GCR and surcharges under recovery. The GCR comprises the purchased gas costs plus the gas adjustment charge minus the interruptible revenue credit.

GCR Effective Dates and Rates

(Amounts in U.S. dollars)

Effective date		GCR rate per Mcf*	Change
December 1, 2015	$	3.6934	(0.3790)
September 1, 2015		4.0724	(0.0997)
June 1, 2015		4.1721	(0.5338)
March 1, 2015		4.7059	(1.2917)
December 1, 2014		5.9976	0.1306
September 1, 2014		5.8670	(0.6972)
June 1, 2014		6.5642	0.5626
March 1, 2014		6.0016	0.5543
December 1, 2013		5.4473	0.0214
September 1, 2013		5.4259	—

* Mcf – thousand cubic feet

(g) Utility Plant

Utility plant is stated at original cost. The cost of additions, replacements, and betterments of units of property is capitalized and included in the utility plant accounts. The cost of property sold or retired is removed from the utility plant accounts and charged to accumulated depreciation. Normal repairs, maintenance, the cost of minor property items, and expenses associated with retirements are charged to operating expenses as incurred.

In a previous rate order, the PGC disallowed the accrual of the net negative salvage component in depreciation. Cost of removal in the amounts of $2.9 million and $2.7 million was charged to expense as incurred in FY 2015 and FY 2014, respectively, and is included in depreciation expense in the statements of revenues and expenses and changes in net position. Depreciation is calculated on an asset-by-asset basis on the estimated useful lives of plant and equipment on a straight-line method. The composite rate for FY 2015 and FY 2014 was 2.2%. The composite rates are supported by a depreciation study of utility plant as of August 2014. The effective composite depreciation rates, as a percentage of cost, for FY 2015 were as follows:

Production plant	2.09%
Transmission, distribution, and storage	2.04
General plant	3.05

The most recent depreciation study was completed in FY 2015 for the plant activity subsequent to the last depreciation study and through FY 2014.

Allowance for Funds Used During Construction (AFUDC) is an estimate of the cost of funds used for construction purposes. The AFUDC, as calculated on borrowed funds, reduces interest expense. The AFUDC rate applied to construction work in progress was 4.87% and 4.93% in FY 2015 and FY 2014, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2015 and 2014 (thousands of U.S. dollars):

	August 31, 2015			
	Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$ 5,595	—	—	5,595
Distribution and collection systems	1,539,224	63,593	(3,633)	1,599,184
Buildings and equipment	473,415	15,327	(409)	488,333
Total utility plant, at historical cost	2,018,234	78,920	(4,042)	2,093,112
Under construction	57,206	86,154	(79,106)	64,254
Less accumulated depreciation for:				
Distribution and collection systems	(730,048)	(33,378) *	1,931	(761,495)
Buildings and equipment	(151,840)	(11,554) *	(107)	(163,501)
Utility plant, net	$ 1,193,552	120,142	(81,324)	1,232,370

* Cost of removal of approximately $2.9 million was charged to expense as incurred in FY 2015 and is not included in accumulated depreciation.

		August 31, 2014			
		Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	$	5,595	—	—	5,595
Distribution and collection systems		1,481,218	61,971	(3,965)	1,539,224
Buildings and equipment		464,733	8,682	—	473,415
Total utility plant, at historical cost		1,951,546	70,653	(3,965)	2,018,234
Under construction		44,409	83,449	(70,652)	57,206
Less accumulated depreciation for:					
Distribution and collection systems		(701,621)	(32,274)*	3,847	(730,048)
Buildings and equipment		(139,347)	(12,493)*	—	(151,840)
Utility plant, net	$	1,154,987	109,335	(70,770)	1,193,552

* Cost of removal of approximately $2.7 million was charged to expense as incurred in FY 2014 and is not included in accumulated depreciation.

(h) Revenue Recognition

The Company is primarily a natural gas distribution company. Operating revenues include revenues from the sale of natural gas to residential, commercial, and industrial heating and nonheating customers. The Company also provides natural gas transportation service. Appliance and other revenues primarily consist of revenue from the Company's parts and labor repair program. Revenue from this program is recognized on a monthly basis for the life of the individual parts and labor plans. Additional revenue is generated from collection fees, reconnection charges, and bulk liquefied natural gas sales contracts. Other operating revenues primarily consist of finance charges assessed on delinquent accounts.

In early 2012, Act 11 was enacted by the Pennsylvania Legislature, which permitted public utilities to file a request with the PUC for the implementation of a Distribution System Improvement Charge (DSIC). A DSIC permits natural gas distribution companies to recover the costs related to main and service replacement not already recovered in base rates. This legislation provides utility companies with a supplemental recovery mechanism for costs related to incremental/accelerated distribution system repair, improvement, and replacement. Act 11 permits gas utilities to recover 5.0% of their nongas revenues via the recovery mechanism and permits greater percentage increases if the PUC approves. The Company started billing customers a DSIC surcharge as of July 1, 2013. In FY 2015, the Company billed customers $14.0 million for the DSIC surcharge. In FY 2014, the Company billed customers $19.4 million for the DSIC surcharge. The DSIC surcharge is fully reconcilable on a calendar-year basis and at the fiscal year end; the over billed or under billed amount is recorded as an adjustment to revenue.

The Company bills customers for the cost of natural gas and the related costs incurred through the processing, distribution, and delivery of natural gas to residential, commercial, and industrial heating and nonheating customers.

Revenue includes amounts related to gas that has been used by customers but has not yet been billed. Revenues are recognized as gas is distributed. Estimated revenues from gas distributed and unbilled, less estimated uncollectible amounts are accrued and included in operating revenues and were \$5.2 million and \$7.3 million for the years ended August 31, 2015 and 2014, respectively.

(i) Operating Expenses

The Company recognizes costs incurred as part of the Company's regular business activities on the statements of revenues and expenses and changes in net position as operating expenses. These costs include distribution, marketing, gas processing, and other similar costs.

Costs incurred that do not involve normal business operations are recognized as nonoperating expenses.

(j) Provision for Uncollectible Accounts

The Company estimates its accumulated provision for uncollectible accounts based on a financial analysis and a collectibility study performed as of the fiscal year end. The methodology used in performing the collectibility study has been reviewed by the PGC. For FY 2015 and FY 2014, management has provided an accumulated provision for uncollectible accounts in excess of the collectibility study results based on its analysis of historical aging data. The actual results of the Company's collection efforts could differ significantly from the Company's estimate.

Due to the seasonal nature of the business, the Company carries credit balances in accounts receivable primarily as a result of prepayment by budget customers. Credit balances of \$16.5 million in both FY 2015 and FY 2014, have been reclassified to accounts payable.

(k) Gas Inventories, Materials, and Supplies

Gas inventories, materials, and supplies, consisting primarily of fuel stock, gas stored to meet peak demand requirements, and spare parts, are stated at average cost at August 31, 2015 and 2014, as follows (thousands of U.S. dollars):

		2015	2014
Gas inventory	$	40,791	60,089
Material and supplies		10,117	9,900
Total	$	50,908	69,989

(l) Unamortized Bond Insurance Costs, Debt Discount, and Premium

Discounts or premiums and bond insurance costs arising from the sale of revenue bonds are amortized using the interest method over the term of the related bond issue. Other costs of bond issuance are expensed as incurred.

(m) Unamortized Losses on Reacquired Debt

Losses on reacquired debt are recorded as deferred outflows of resources and amortized, using the interest method, to interest expense over the shorter of the life of the refunding bond issue or the remaining original amortization period.

(n) Pensions and Postemployment Benefits

As described in note 10, the City sponsors a single employer defined-benefit pension plan, the Philadelphia Gas Works Pension Plan (the Pension Plan) to provide pension benefits for certain current and former PGW employees. In accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB 27* (GASB 68) as described in note 1(u), for purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Pension Plan and additions to/deductions from the Pension Plan's fiduciary net position are determined on the same basis as they are reported by the Pension Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value. With the exception of deferred outflows related to employer contributions made after the measurement date, deferred inflows and outflows related to pensions are amortized over a closed five-year period or the average remaining service life of employees in the pension plan. Deferred outflows of resources related to employer contributions made after the measurement date will be recognized as a reduction of the net pension liability in the next fiscal year.

As described in note 11, PGW sponsors a single employer defined-benefit healthcare plan that provides postemployment healthcare and life insurance benefits to substantially all current and former PGW employees. The change in the net OPEB obligation and OPEB expense are recorded based on the difference between the annual actuarially determined OPEB cost (AOC) and the Company's contributions.

(o) Cash and Cash Equivalents

For the purpose of reporting cash and cash equivalents, all highly liquid investments with original maturities of three months or less are considered cash equivalents, except those held for long-term purposes in the Sinking Fund, Workers' Compensation Escrow Fund, and Health Insurance Escrow Fund as described in note 3.

(p) Reserve for Injuries and Damages

The Company is principally insured through insurance carriers. However, the Company is required to cover settlement of claims, which are excluded under the provisions of such insurance policies. An estimated liability has been established, in accordance with PGC regulations, for settlements to be paid by the Company in the next fiscal year.

Estimated losses from claims for occurrences not covered by insurance, which will not be paid in the next fiscal year, have been accrued. Such liabilities have been established based upon Company history and consultation with counsel. Such expenses are expected to be recovered through future rates. Reductions to the reserve are made as claims are settled.

(q) Segment Information

All of the Company's assets and operations are employed in only one segment, local transportation, and distribution of natural gas in the City.

(r) Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in the Company's financial statements include the allowance for doubtful accounts, the fair value of interest rate swap agreements and the valuation of pension and OPEB liabilities.

(s) Pollution Remediation

Under Pennsylvania Act 2, *Land Recycling and Environmental Remediation Standards Act of 1995* (Act 2), the Notice of Intent to Remediate process was conducted by the Company in October 2004 and a total of four Public Involvement Plan meetings were conducted at multiple City Recreation Centers throughout Philadelphia during February and March 2005. In March 2005 (after the public meetings were conducted), the Company submitted a series of five Remedial Investigation Reports (RIRs) to the Act 2 for review. In July 2005, the Act 2 program approved all five RIRs submitted in March 2005.

The Company estimates its pollution remediation obligations using the effective cash flow method, in which measurement is based on the outlays expected to be incurred as a sum of probability-weighted amounts in a range of possible estimated amounts. The Company's liability is based on a combination of internal and external cost estimates for the specific remediation activities agreed to as part of Act 2 and Pennsylvania Act 32, *Storage Tank and Spill Prevention Act of 1989*.

Estimated site liabilities are determined based upon existing remediation laws and technologies, specific site consultants' engineering studies, or by extrapolating experience with environmental issues at comparable sites. Estimates may change substantially as additional information becomes available regarding the level of contamination at specific sites, available remediation methods, and changes in price, technology, proposed land use, or applicable regulations.

(t) Reclassifications

Certain prior-year amounts have been reclassified for comparative purposes.

(u) New Accounting Pronouncements

GASB 68 was effective for PGW's fiscal year beginning September 1, 2014 with restatement, to the extent practical, of all periods presented. This statement revises existing standards for measuring and reporting pension liabilities for pension plans. Under GASB 68, the balance sheet now includes PGW's net pension asset or liability related to its Pension Plan, which is measured as the total pension liability, less the amount of the Pension Plan's fiduciary net position. The total pension liability is actuarially determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the measurement date. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that Pension Plan assets are available to pay benefits.

The Pension Plan's fiscal year end and measurement date for the net pension liability is June 30. PGW's net pension liability in its fiscal year end 2015 audited financial statements reflects the net pension liability measured as of June 30, 2015, and PGW's 2014 audited financial statements have been restated to reflect the net pension liability as of the June 30, 2014 measurement date.

Effective concurrently with GASB 68, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date* (GASB 71) clarified that even if it is not practical to determine the amount of all deferred outflows and deferred inflows related to pensions at transition, pension contributions made by an employer between the measurement date and its fiscal year end should be reported as a deferred outflow of resources at transition to GASB 68.

As a result of the adoption of GASB 68 and GASB 71, the following adjustments were made to opening net position as of September 1, 2013 (thousands of U.S. dollars):

		Originally reported, August 31, 2013	Adjustments	As adjusted, September 1, 2013
Deferred outflows related to pension	$	—	1,411	1,411
Net pension liability		—	148,651	148,651
Unrestricted net position		134,827	(147,240)	(12,413)

The adjustment to deferred outflows related to pension represents the pension contributions made by PGW between June 30, 2013 (the measurement date for the August 31, 2013 net pension liability) and August 31, 2013.

As of and for the year ended August 31, 2014, as a result of the implementation of GASB 68 and GASB 71, previously reported amounts for pension expense, net pension liability, deferred outflows related to pension, deferred inflows related to pension, and unrestricted net position changed as follows (thousands of U.S. dollars):

		Originally reported	As adjusted,
Pension expense	$	24,521	27,214
Net pension liability		—	164,256
Deferred outflows related to pension		—	46,131
Deferred inflows related to pension		—	31,808
Unrestricted net position		136,630	(13,303)

(v) Accounting Standards with Future Effective Dates

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application* (GASB 72). This standard prescribes how state and local governments should define and measure fair value; which assets and liabilities should be measured at fair value; and required disclosures for fair value measurements. GASB 72 requires categorization of fair values based on the criteria of a fair value hierarchy that is based on the reliability of the information used to determine fair value, and requires the use of valuation techniques (market approach, cost approach, income approach, or a combination thereof) that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The statement is effective for periods beginning after June 15, 2015.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* (GASB 75). The statement establishes standards, similar to those established for defined benefit pension plans in GASB 68, for recognizing and measuring defined benefit OPEB liabilities, deferred outflows or resources, deferred inflows of resources, and expenses, and identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information are also addressed. GASB 75 is effective for fiscal years beginning after June 15, 2017.

(2) Ownership and Management and Related-Party Transactions and Balances

The Company is accounted for as a component unit of the City. As of January 1, 1973, under the terms of a two-year agreement automatically extended for successive two-year periods unless canceled upon 90 days' notice by the City, the Company is being managed by the Philadelphia Facilities Management Corporation (PFMC). The agreement, as amended, provides for reimbursement to PFMC of actual costs incurred in managing the Company, not to exceed a total of the prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance of the City on March 1 of each such fiscal year. In FY 2015 and FY 2014, the applicable maximum amount was calculated to be $1.2 million. The agreement requires the Company to make annual payments of $18.0 million to the City. In FY 2015 and FY 2014, the Company made the annual payment of $18.0 million to the City.

The Company engages in various other transactions with the City. The Company provides gas service to the City. Operating revenues include $7.7 million and $7.5 million in FY 2015 and FY 2014, respectively, relating to sales to the City. Net amounts receivable from the City were $0.0 million and $0.2 million at August 31, 2015 and 2014, respectively. Water and sewer services and licenses are purchased from the City. Such purchases totaled $1.2 million and $1.4 million in FY 2015 and FY 2014, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $0.9 million and $0.8 million in FY 2015 and FY 2014, respectively.

(3) Cash and Cash Equivalents, and Investments

(a) Cash, Cash Equivalents, and Short-Term Investments

Cash and cash equivalents consist primarily of bank deposits, money market accounts, and investments purchased through various brokerage relationships. Bank balances of such deposits, accounts, and investments at August 31, 2015 and 2014 were $114.0 million and $105.3 million, respectively. Book balances of such deposits and accounts at August 31, 2015 and 2014 were $114.3 million and $105.7 million, respectively. Federal depository insurance on these balances at August 31, 2015 and 2014 was $0.5 million. The remaining balances are not insured. Investments are primarily in money market accounts, U.S. Treasury bills, U.S. government agencies and instrumentalities, and corporate obligations (short-term investments).

The highest balance of short-term investments during FY 2015 and FY 2014 was $161.5 million and $102.6 million, respectively. Short-term investments with a carrying amount (at fair value) of $112.2 million and $102.6 million at August 31, 2015 and 2014, respectively, are included in the balances presented above.

(b) Sinking Fund Reserve, Workers' Compensation Escrow Fund, and Health Insurance Escrow Fund

The investments in the Company's Sinking Fund Reserve, Workers' Compensation Escrow Fund, and Health Insurance Escrow Fund consist primarily of U.S. Treasury and government agency obligations, corporate obligations, and money market accounts. These investments are maintained by the City or in the Company's name by its agent. Investments are recorded at fair value except for certain money market funds recorded at amortized cost. The adjustment to market value for the Sinking Fund Reserve resulted in a loss of $0.2 million in FY 2015 and a gain of $0.3 million in FY 2014.

The Sinking Fund Reserve is required by bond ordinance to hold an amount equal to the greatest amount of debt service required by bonds secured by the Sinking Fund Reserve in any fiscal year.

Pursuant to the Pennsylvania Department of Labor and Industry Bureau of Workers' Compensation Self-Insurance policy, the Company has established and maintained a restricted trust account. As of August 31, 2015 and 2014, the trust account balances were $2.6 million.

PGW is self-insured for the healthcare for active employees and retirees under the age of 65. Retirees over the age of 65 are insured on an experience rated basis. The self-insured model requires the Company to establish and maintain a restricted escrow account.

 (Continued)

The balance in the Health Insurance Escrow Fund was $3.2 million as of August 31, 2015 and 2014.

The Health Insurance Escrow Fund was closed in September 2015. PGW negotiated the closing of this account by providing an advance deposit of $0.8 million to the healthcare provider.

The following is a schedule that details the Company's investments in the Sinking Fund Reserve (thousands of U.S. dollars):

	August 31, 2015				
Investment type		**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government obligations:					
U.S. Treasury notes	$	21,039	2.9063	AAA/NA	Moody's/S&P
U.S. government agencies and instrumentalities:					
Federal National Mortgage Association medium term notes		675	0.4844	AAA/AA+	Moody's/S&P
Federal Home Loan Mortgage Corporation medium term notes		13,168	0.5950	AAA/AA+	Moody's/S&P
Federal Home Loan Bank bonds		16,497	1.2875	AAA/AA+	Moody's/S&P
Federal Farm Credit Bank bonds		5,025	0.0138	AAA/AA+	Moody's/S&P
Total U.S. government agencies and instrumentalities		35,365			
Total fair value of investments		56,404			
Corporate obligations:					
General Electric Capital Corporation		2,010	—	AA+/A1	Moody's/S&P
Total corporate obligations		2,010			
Foreign issues:					
Bank of Nova Scotia		2,051	—	A+/AA2	Moody's/S&P
Westpac Banking Corporation		981	—	AA-/AA2	Moody's/S&P
Total foreign issues		3,032			
Cash and cash equivalents:					
BNP Paribus Finance Inc commercial paper		2,000	—	*	*
Toyota Motor Credit Corporation commercial paper		1,997	—	*	*

(Continued)

	August 31, 2015			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
HSBC Americas Inc commercial paper	$ 1,994	—	*	*
JP Morgan Securities commercial paper	1,800	—	*	*
Money market:				
First American Government Obligations Fund Class Z	20,795	—	*	*
Total cash and cash equivalents	28,586	—		
Other	109	—	*	*
Total fair value of investments, including cash deposits	$ 90,141			
Portfolio weighted modified duration				

* The credit of this investment is unrated.

	August 31, 2014			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government obligations:				
U.S. Treasury notes	$ 26,837	7.1615	AAA/AA+	Moody's/S&P
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	9,390	0.6125	AAA/AA+	Moody's/S&P
Federal Home Loan Mortgage Corporation medium term notes	7,513	1.3230	AAA/AA+	Moody's/S&P
Federal Home Loan Bank bonds	5,770	0.1889	AAA/AA+	Moody's/S&P
Federal Home Loan Bank discounted notes	915	0.1763	AAA/AA+	Moody's/S&P
Federal Farm Credit Bank bonds	11,304	0.6389	AAA/AA+	Moody's/S&P

	August 31, 2014			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Federal National Mortgage Corporation Debt Securities	$ 7,525	1.6167	AAA/AA+	Moody's/S&P
Total U.S. government agencies and instrumentalities	42,417			
Total fair value of investments	69,254			
Corporate obligations:				
Walmart Stores	1,269	2.5036	AA2/AA	Moody's/S&P
National Australia Bank NY	2,598	3.3868	AA2/AA	Moody's/S&P
General Electric Capital Corporation	1,596	5.8879	A1/AA+	Moody's/S&P
Berkshire Hathaway Financial	537	1.4311	AA2/AA	Moody's/S&P
Total corporate obligations	6,000			
Foreign issues:				
Bank of Nova Scotia	2,961	1.9396	AA2+/A+	Moody's/S&P
Total Capital S.A.	3,070	5.7167	AA1+/AA-	Moody's/S&P
Westpac Banking Corporation	1,788	2.7128	AA2+/AA-	Moody's/S&P
Total foreign issues	7,819			
State Obligations:				
Pennsylvania ST Second Ser	762	—	AA3/AA	Moody's/S&P
Cash and cash equivalents:				
Credit Agricole N A commercial paper	2,250	—	*	*
BNP Paribus Finance Inc commercial paper	2,074	—	*	*
Rabobank USA Financial Corporation commercial paper	2,124	—	*	*
UBS Finance Delaware commercial paper	2,072	—	*	*
Toyota Motor Credit Corporation commercial paper	1,798	—	*	*
HSBC Americas Inc commercial paper	3,225	—	*	*
JP Morgan Securities commercial paper	2,748	—	*	*
Societe Generale NA C P	2,900	—	*	*
Deutsche Bank Financial LLC commercial paper	2,574	—	*	*

Investment type		Fair value	Weighted average maturity (years)	Credit rating	Rating agency
		August 31, 2014			
Money market:					
First American Government Obligations Fund Class Z	$	131	—	*	*
Total cash and cash equivalents		21,896			
Other		178	—	*	*
Total fair value of investments, including cash deposits	$	105,909			
Portfolio weighted modified duration			0.7673		

* The credit of this investment is unrated.

The following is a schedule that details the Company's investments in the Workers' Compensation Escrow Fund (thousands of U.S. dollars):

Investment type		Fair value	Weighted average maturity (years)	Credit rating	Rating agency
		August 31, 2015			
Money market:					
Fidelity Governmental Fund	$	2,597	—	*	*
Total fair value of investments, including cash deposits	$	2,597			

* The credit of this investment is unrated.

	August 31, 2014			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
Fidelity Governmental Fund	$ 2,597	—	*	*
Total fair value of investments, including cash deposits	$ 2,597			

* The credit of this investment is unrated.

The following is a schedule that details the Company's investments in the Health Insurance Escrow Fund (thousands of U.S. dollars):

	August 31, 2015			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
Fidelity Governmental Fund	$ 3,223	—	*	*
Total fair value of investments, including cash deposits	$ 3,223			

* The credit of this investment is unrated.

	August 31, 2014			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
Fidelity Governmental Fund	$ 3,223	—	*	*
Total fair value of investments, including cash deposits	$ 3,223			

* The credit of this investment is unrated.

(c) Interest Rate Risk

It is the policy of the City to diversify its investment portfolios. Portfolio diversification is employed as a way to control risk. Investments shall be diversified as to maturities, and as to kind of investments to minimize the risk of loss, which might result from over concentration of assets in a specific maturity, in a specific kind of a security, or from a specific issuer or industry.

(d) Credit Risk

The City has adopted an investment policy relating to the investments of the Company. Per the investment policy, the Company's allowable investments are: (1) bonds or notes of the U.S. government; (2) U.S. Treasury obligations, including separate trading of registered interest and principal securities; receipts indicating an undivided interest in such U.S. Treasury obligations; and stripped coupons held under book entry with the New York Federal Reserve Bank; (3) obligations of the following U.S. government-sponsored agencies; Government National Mortgage Association, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Farm Credit System, Federal Home Loan Bank, Resolution Funding Corporation, and Tennessee Valley Authority; (4) collateralized banker's acceptances and certificate of deposit denominated in U.S. dollars and issued by a city code authorized depository certificate of deposit that must be secured by acceptable collateral with a total market value equal to 102.0% of the deposit; (5) commercial paper with a stated maturity of 270 days or less, which is rated P1 by Moody's or A1+ by Standard & Poor's (S&P). The senior long-term debt of the commercial paper issuer, or the entity providing an explicit guarantee, must be rated not lower than A2 by Moody's or A by S&P; (6) asset-backed commercial paper (ABCP), which does not have a long-term rating, is an allowable investment if it meets the short-term rating requirements but is only allowed up to the ABCP sublimit; (7) general obligation bonds of corporations rated Aa2 or better by Moody's or AA or better by S&P with a final maturity of two years or less; (8) collateralized mortgage obligations and pass-through securities directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States and with a final maturity of two years or less, the rating must be no lower than Aa2 by Moody's or AA by S&P; (9) money market mutual funds, as defined by the Securities and Exchange Commission, such money markets funds must have assets over $15 billion, have the highest rating from Moody's, S&P, and Fitch, and contain only government securities; (10) repurchase agreements that are fully collateralized in bonds or notes of the U.S. government pledged to the City and held in the City's name and deposited at the time the investment is made with an entity or a third party selected and approved by the City the market value of the collateral shall be at least 102.0% of the funds being disbursed; and (11) obligations of the Commonwealth of Pennsylvania (the Commonwealth) or any municipality or other political subdivision of the Commonwealth with a final maturity of two years or less and a rating of at least AA by Moody's or S&P.

Authorized investments for Sinking Fund Portfolios are dictated by the First Class City Revenue Bond Act of the General Assembly of the Commonwealth of Pennsylvania, approved October 18, 1972. This also includes any investment vehicle permitted for any Commonwealth state agency.

The Company's investment policy provides for the following percentage limitations of authorized investments, valued at market:

	Percent of portfolio allowed	Percent of portfolio per issuer	Percent of outstanding securities per issuer
U.S. Government	100	100	N/A
U.S. Treasury	100	100	N/A
U.S. Agencies	100	33	N/A
Certificates of Deposit			
Banker's Acceptances, Eurodollar Deposits, and Euro Certificates of Deposit	15	3	3
Commercial Paper	25	3	3
Corporate Bonds	25	3	3
Collateralized Mortgage Obligation and Pass-throughs	5	3	3
Money Market Mutual Funds	25	10	3
Repurchase Agreements	25	10	N/A

More than 39.3% of the Company's investments as of August 31, 2015 are in the following: Federal Home Loan Mortgage Corporation medium term notes (15.4%), Federal Farm Credit Banks (5.6%), and Federal Home Loan Bank bonds (18.3%). These investments are in accordance with the City's investment policy.

(e) Custodial Credit Risk

The Company has selected, as custodial bank, a member of the Federal Reserve System to hold its investments. Delivery of the applicable investment documents to the Company's custodian is required for all investments. For secured transactions, such as repurchase agreements, either the title to or a perfected security interest in the securities, along with any necessary transfer documents, must be transferred to the custodian. Such transactions will always use delivery versus payment procedures.

(4) Recoverable Costs

In compliance with orders issued by the PGC, the cost of projects that produce benefits over an extended period is recorded on the balance sheet as a recoverable cost in other assets. There is no return on the asset being charged to the customers. The unamortized costs included in other assets and deferred debits were $0.4 million as of August 31, 2015. There were no unamortized costs included in other assets as of August 31, 2014. The unamortized costs included in other current assets and deferred debits were $0.1 million as of August 31, 2015. There were no unamortized costs in other current assets at August 31, 2014.

In accordance with U.S. GAAP for regulated entities, the Company has recognized the long-term portion of its environmental remediation liability as a regulatory asset because based on available evidence it is probable that the previously incurred costs will be recovered through rates. In FY 2015, settlements by the Company's insurance carriers provided less than $0.1 million associated with environmental remediation costs. Environmental remediation costs of approximately $0.7 million in FY 2015 were offset by these insurance settlements, and the remainder was recorded on the balance sheet as a recoverable cost in other assets. The Company estimates additional expenditures to be approximately $34.4 million.

(5) Deferred Compensation Plan

The Company offers its employees a deferred compensation plan (the Plan) created in accordance with Internal Revenue Code Section 457. The Plan, available to all Company employees with at least 30 days of service, permits them to defer a portion of their salary until future years. The Company provides an annual 10.0% matching contribution of applicable wages that immediately vests to the employee. The Company contributed $0.3 million in FY 2015 and $0.4 million in FY 2014.

(6) Notes Payable

Pursuant to the provisions of the City of Philadelphia Note Ordinances, PGW may sell short-term notes to either support working capital requirements or pay the costs of certain capital projects and other project costs. PGW may issue short-term notes in a principal amount, which, together with interest, may not exceed $150.0 million outstanding to support working capital requirements. PGW may also sell additional short-term notes in an aggregate principal amount, which may not exceed $120.0 million outstanding at any time to pay the costs of certain capital projects and other project costs. All notes are supported by two irrevocable letters of credit and a security interest in PGW's revenues. The letter of credit supporting PGW's combined commercial paper programs fixed the maximum level of outstanding notes plus interest at $120.0 million in FY 2015 and FY 2014. There was $30.0 million of tax-exempt capital project commercial paper outstanding at August 31, 2015. At the end of FY 2014, there was no tax-exempt commercial paper outstanding.

The commitment amount is $120.0 million under the current credit agreements. The expiration date of the credit agreements is August 14, 2017.

Commercial paper activity for the year ended August 31, 2015 was as follows (thousands of U.S. dollars):

	Year ended August 31, 2015			
	Beginning balance	Additions	Deletions	Ending balance
Commercial paper	$ —	30,000	—	30,000

(7) GCR Tariff Reconciliation

During the fiscal year ended August 31, 2015, the Company's actual gas costs were below its billed gas costs by approximately $8.4 million. This amount was netted with other costs and recorded in other current assets for FY 2015. Actual gas costs were $13.4 million higher than billed gas costs in FY 2014.

Natural Gas Pipeline Supplier Refund

The Company received no refunds in FY 2015 and $4.5 million in FY 2014, related to Federal Energy Regulatory Commission/Pipeline Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the applicable GCR.

(8) Long-Term Debt and Other Liabilities

The following summary of long-term debt consists primarily of bonds issued by the City under agreements whereby the Company must reimburse the City for the principal and interest payments required by the bond ordinances for the fiscal years ended August 31, 2015 and 2014 (thousands of U.S. dollars):

	August 31, 2015			August 31, 2014		
	Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$ 38,215	876,960	915,175	50,975	964,945	1,015,920
Unamortized discount	(63)	(723)	(786)	(234)	(1,926)	(2,160)
Unamortized premium	4,878	38,482	43,360	2,486	17,730	20,216
Total revenue bonds	$ 43,030	914,719	957,749	53,227	980,749	1,033,976

The following is a summary of activity related to revenue bonds and other liabilities and the respective balances for the fiscal years ended August 31, 2015 and 2014 (thousands of U.S. dollars):

	Year ended August 31, 2015				
	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Revenue bonds	$ 1,015,920	261,770	(362,515)	915,175	38,215
Other liabilities:					
Claims and judgments	5,216	1,285	—	6,501	5,011
Environmental cleanup	33,499	—	(1,025)	32,474	1,965
Other postemployment benefits	101,788	—	(11,774)	90,014	—
Interest rate swap liability	38,762	648	—	39,410	—
Total other liabilities	$ 179,265	1,933	(12,799)	168,399	6,976

	Year ended August 31, 2014				
	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Revenue bonds	$ 1,065,720	—	(49,800)	1,015,920	50,975
Other liabilities:					
Claims and judgments	5,486	—	(270)	5,216	4,728
Environmental cleanup	29,522	3,977	—	33,499	1,220
Other postemployment benefits	109,060	—	(7,272)	101,788	—
Interest rate swap liability	33,363	5,399	—	38,762	—
Total other liabilities	$ 177,431	9,376	(7,542)	179,265	5,948

(a) *Principal Maturities and Scheduled Interest and Swap Payments*

Principal maturities and scheduled interest payments for revenue bonds and estimated payments on the interest rate swaps are as follows (thousands of U.S. dollars):

	Revenue bonds			
	Principal	**Interest**	**Net swap amount**	**Total**
Fiscal year ending August 31:				
2016	$ 38,215	31,463	7,973	77,651
2017	49,130	30,418	7,973	87,521
2018	48,310	28,278	7,913	84,501
2019	48,855	26,732	7,436	83,023
2020	49,600	25,021	6,915	81,536
2021–2025	256,905	101,301	25,072	383,278
2026–2030	205,760	65,929	5,715	277,404
2031–2035	139,860	33,704	—	173,564
2036–2040	78,540	9,704	—	88,244
Total	$ 915,175	352,550	68,997	1,336,722

Future debt service is calculated using rates in effect at August 31, 2015 for variable rate bonds, which ranged from 0.1% to 0.2%. The variable rate received under the swaps is 70.0% of one-month LIBOR until maturity, which was 0.13899% at August 31, 2015.

(b) *Bond Issuances – Refunding of Bonds and Defeasance of Bonds*

1998 Ordinance Thirteenth Series Bonds

On August 18, 2015, the City issued Gas Works Revenue Bonds, Thirteenth Series (1998 General Ordinance) in the amount of $261.8 million for the purpose of redeeming, refunding, or defeasing all outstanding City of Philadelphia Gas Works Revenue Bonds under the 1975 Ordinance and to redeem all of the outstanding Fourth Series Bonds (1998 General Ordinance), Fifth Series A-1 Bonds (1998 General Ordinance), defease a portion of the Outstanding Seventh Series Bonds (1998 General Ordinance), and paying the costs of issuing the bonds. The Thirteenth Series Bonds, with fixed interest rates that range from 3.0% to 5.0%, have maturity dates through 2034. The loss on this refunding was $13.8 million, which will be amortized over the life of the Thirteenth Series Bonds. This transaction provided net present value debt service savings of $34.3 million utilizing an arbitrage yield of 2.91%. The savings as a percentage of refunded bonds was 11.02%.

As of August 31, 2015, the Company's Eighth Series variable rate debt was backed by letter of credit agreements, which either extend to August 1, 2016 (Eighth Series B, C, and D) or August 30, 2016 (Eighth Series E).

The Company's Fifth Series A-2 variable rate bonds are backed by an irrevocable letter of credit, which was extended on November 13, 2015 for a one-year term expiring on December 30, 2016.

Interest rates and maturities of the outstanding revenue bonds are detailed as follows (thousands of U.S. dollars):

	Interest rates	Maturity date (fiscal year)	Balance outstanding August 31, 2015	Balance outstanding August 31, 2014
4th Series	4.00% – 5.25%	2032	$ —	77,825
17th Series	4.00% – 5.38%	2026	—	101,160
5th Series	4.00% – 5.25%	2034	—	106,310
5th Series A-2	Variable**	2035	30,000	30,000
18th Series	5.00% – 5.25%	2021	—	27,050
19th Series	5.00%	2024	—	14,450
20th Series	2.00% – 5.00%	2015	—	2,725
7th Series	4.00% – 5.00%	2038	171,540	179,685
7th Series Refunding	—	2029	24,610	28,360
8th Series A	4.00% – 5.25%	2017	24,135	37,905
8th Series B	Variable *	2028	50,260	50,260
8th Series C	Variable *	2028	50,000	50,000
8th Series D	Variable **	2028	75,000	75,000
8th Series E	Variable *	2028	50,260	50,260
9th Series	2.00% – 5.25%	2040	135,835	138,895
10th Series	3.00% – 5.00%	2026	41,765	46,035
13th Series	3.00% – 5.00%	2026	261,770	—
			$ 915,175	1,015,920

* As of August 31, 2015, the interest rate was 0.02%.
** As of August 31, 2015, the interest rate was 0.01%.

(c) Debt Coverage and Sinking Fund Requirements

Under the terms of both general ordinances, the City is required to maintain rates to allow the Company to satisfy 1975 and 1998 revenue bond debt coverage ratio requirements. Upon issuance of the Thirteenth Series Bonds, no debt under the 1975 General Ordinance remains outstanding.

Also provided by both general ordinances is the establishment of a Sinking Fund Reserve into which deposits are made in an amount equal to the maximum annual debt service requirement on the bonds of each respective general ordinance in any fiscal year.

Funds in the Sinking Fund Reserve are to be applied to the payment of debt service if, for any reason, other funds in the Sinking Fund, which operates as a debt service payment fund into which debt service payments are deposited as they come due, should be insufficient.

The revenue bonds are, and will be, equally and ratably collateralized by a security interest in all of the Company's project revenues, as defined in the general ordinances, and moneys in the Sinking Fund, including the Sinking Fund Reserve.

Portions of certain revenue bonds were issued as zero coupon securities. Interest on these securities is accrued and compounded on the payment dates of the current interest bonds within the issue. The accrued interest in the amount of $6.4 million and $10.5 million in FY 2015 and FY 2014, respectively, is reported as a component of accrued accounts.

(d) Interest Rate Swap Agreements

Objective – In January 2006, the City entered into a fixed rate payor, floating rate receiver interest rate swap to create a synthetic fixed rate for the Sixth Series Bonds. The interest rate swap was used to hedge interest rate risk.

Terms – The swaps had an original termination date of August 1, 2031, which was amended to August 1, 2028. The swaps require the City to pay a fixed rate of 3.6745% and receive a variable rate equal to 70.0% of one-month LIBOR until maturity.

In August 2009, the City terminated approximately $54.8 million of the notional amount of the swap, issued fixed rate refunding bonds related to that portion and kept the remaining portion of the swap to hedge the Eighth Series variable rate refunding bonds backed with letters of credit. The Company paid a swap termination payment of $3.8 million to the counterparty to partially terminate the swap.

The original swap confirmation was amended and restated on August 12, 2009 to reflect the principal amount of the Eighth Series B Bonds, with all other terms remaining the same. The remainder of the notional amount was divided among separate trade confirmations with the same terms as the original swap that was executed with the counterparty for the Eighth Series C Bonds through the Eighth Series E Bonds.

In September 2011, the underlying variable rate bonds were remarketed with new letters of credit. During the remarketing, PGW redeemed the longest three maturities of the bonds, and reallocated remaining principal among the bond subseries. At the same time, the City terminated an aggregate notional amount of $29.5 million of the swaps, keeping the remaining portion of the swaps in place to hedge the remaining variable rate bonds backed with the letters of credit. The partial termination was competitively bid, with the winning swap counterparty providing the lowest cost of termination/assignment. PGW paid a swap termination payment of $7.0 million to partially terminate the swaps. The remaining notional amounts of each of the swaps were adjusted to match the reallocation of the underlying bonds.

In August 2013, two subseries of the underlying variable rate bonds (8th Series C and 8th Series D) were remarketed with new letters of credit. The letters of credit for the remaining two subseries (8th Series B and 8th Series E) were extended with the existing providers.

As of August 31, 2015, the swaps had a notional amount of $225.5 million and the associated variable rate debt had a $225.5 million principal amount, broken down by series as follows:

- The Series B swap had a notional amount of $50.3 million and the associated variable rate bonds had a $50.3 million principal amount.

- The Series C swap had a notional amount of $50.0 million and the associated variable rate bonds had a $50.0 million principal amount.
- The Series D swap had a notional amount of $75.0 million and the associated variable rate bonds had a $75.0 million principal amount.
- The Series E swap had a notional amount of $50.2 million and the associated variable rate bonds had a $50.2 million principal amount.

The final maturity date for all swaps is on August 1, 2028.

Fair Value – As of August 31, 2015, the swaps had a combined negative fair value of approximately $39.4 million. The fair values of the interest rate swaps were estimated using the zero coupon method. That method calculates the future net settlement payments required by the swap, assuming current forward rates are implied by the current yield curve for hypothetical zero coupon bonds due on the date of each future net settlement on the swaps.

Risks – As of August 31, 2015, the City is not exposed to credit risk because the swaps had a negative fair value. Should interest rates change and the fair value of the swaps become positive, the City would be exposed to credit risk in the amount of the swaps' fair value. The swaps include a termination event additional to those in the standard ISDA master agreement based on credit ratings. The swaps may be terminated by the City if the rating of the counterparty falls below A3 or A – (Moody's/S&P), unless the counterparty has (i) assigned or transferred the swap to a party acceptable to the City; (ii) provided a credit support provider acceptable to the City whose obligations are pursuant to a credit support document acceptable to the City; or (iii) executed a credit support annex, in form and substance acceptable to the City, providing for the collateralization by the counterparty of its obligations under the swaps.

The swaps may be terminated by the counterparty if the rating on the City of Philadelphia Gas Works Revenue bonds falls below Baa2 or BBB (Moody's/S&P). However, because the City's swap payments are insured by Assured Guaranty Municipal Corporation, as long as Assured Guaranty Municipal Corporation is rated at or above A2 or A (Moody's/S&P), the termination event based on the City's ratings is stayed. At the present time, the rating for Assured Guaranty Municipal Corporation is at A2/AA (Moody's/S&P).

The City is exposed to (i) basis risk, as reflected by the relationship between the rate payable on the bonds and 70.0% of one-month LIBOR received on the swap, and (ii) tax risk, a form of basis risk, where the City is exposed to a potential additional interest cost in the event that changes in the federal tax system or if marginal tax rates cause the rate paid on the outstanding bonds to be greater than the 70.0% of one-month LIBOR received on the swap.

The impact of the interest rate swaps on the financial statements for the years ended August 31, 2015 and 2014 is as follows (thousands of U.S. dollars):

		Interest rate swap liability	Deferred outflows of resources
Balance, August 31, 2014	$	38,762	18,879
Change in fair value through August 31, 2015		648	648
Amortization of terminated hedge		—	1,421
Balance, August 31, 2015	$	39,410	20,948

		Interest rate swap liability	Deferred outflows of resources
Balance, August 31, 2013	$	33,363	12,059
Change in fair value through August 31, 2014		5,399	5,399
Amortization of terminated hedge		—	1,421
Balance, August 31, 2014	$	38,762	18,879

Because the original hedging relationship was terminated when the Sixth Series Bonds were refunded by the Eighth Series Bonds in 2009, there is a difference between the interest rate swap liability and the related deferred outflows of resources. The difference is being amortized on a straight-line basis into expense over the life of the hedge.

The interest rate swap liability is included in other noncurrent liabilities on the balance sheet.

There are no collateral posting requirements associated with the swap agreements.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2015 was as follows (thousands of U.S. dollars):

	Latest date maturing to	Interest rate		Bonds outstanding
12th Series B	5/15/20	7.00%	$	24,735
17th Series	7/01/18	5.38		37,275
19th Series	10/01/23	5.00		14,450
Total			$	76,460

The assets pledged, primarily noncallable U.S. government securities, had a market value of $82.4 million at August 31, 2015, bearing interest on face value from 5.84% to 5.89%.

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2014 was as follows (thousands of U.S. dollars):

	Latest date maturing to	Interest rate	Bonds outstanding
12th Series B	5/15/20	7.00%	$ 28,755

The assets pledged, primarily noncallable U.S. government securities, had a market value of $30.3 million at August 31, 2014, bearing interest on face value from 0.00% to 5.89%.

The investments held by the trustee and the defeased bonds are not recognized on the Company's balance sheets in accordance with the terms of the Indentures of Defeasance. The investments pledged for the redemption of the defeased debt have maturities and interest payments scheduled to coincide with the trustee cash requirements for debt service.

(10) Pension Plan

(a) Plan Description

The Pension Plan provides pension benefits for all eligible employees of PGW and other eligible class employees of PFMC and PGC.

The Pension Plan provides for retirement payments for vested employees at age 65 or earlier under various options, which includes a disability pension provision, a preretirement spouse or domestic partner's death benefit, a reduced pension for early retirement, various reduced pension payments for the election of a survivor option, and a provision for retirement after 30 years of service without penalty for reduced age. In accordance with Resolutions of the PGC, Ordinances of City Council, and as prescribed by the City's Director of Finance, the Pension Plan is being funded with contributions by PGW to the Sinking Fund Commission of the City, which serves as the Trustee. Management believes that the Pension Plan is in compliance with all applicable laws.

(b) Benefits Provided

Normal Retirement Benefits: The Pension Plan provides retirement benefits as well as death and disability benefits. Retirement benefits vest after five years of credited service. Employees who retire at or after age 65 are entitled to receive an annual retirement benefit, payable monthly, in an amount equal to the greater of:

- 1.25% of the first $6,600 of Final Average Earnings plus 1.75% of the excess of Final Average Earnings over $6,600, times years of credited service, with a maximum of 60.0% of the highest annual earnings during the last 10 years of credited service or

- 2.0% of total earnings received during the period of credited service plus 22.5% of the first $1,200 annual amount, applicable only to participants who were employees on or prior to March 24, 1967.

Death Benefits: Before retirement, spouses of deceased active participates or of former participants are entitled to vested benefits provided such participants died after having attained age 45 and completed at least 15 years of Credited Service and whose age plus years of credited service equals at least 65 years of whom have completed at least 15 years of Credited Service regardless of age. The benefit payable is an amount for the spouse's remaining lifetime equal to the amount the beneficiary of the participant would have received had the participant retired due to a disability on the day preceding his/her death and elected the 100% contingent annuitant option.

Disability Benefits: Disability benefits are the same as the Normal Retirement Benefits and are based on Final Average Compensation and Credited Service as of the date of disability

Final Average Earnings are the employee's average pay, over the highest five years of the last 10 years of credited service. Employees with 15 years of credited service may retire at or after age 55 and receive a reduced retirement benefit. Employees with 30 years of service may retire without penalty for reduced age.

Except as noted in the following paragraph, covered employees are not required to contribute to the Pension Plan.

In December 2011, the Pension Plan was amended by Ordinance and a new deferred compensation plan was authorized by Ordinance as well. Newly hired employees have an irrevocable option to join either a new deferred compensation plan created in accordance with Internal Revenue Code Section 401 or the existing defined-benefit plan. The defined-contribution plan provides for an employer contribution equal to 5.5% of applicable wages. The defined-benefit plan provides for a newly hired employee contribution equal to 6.0% of applicable wages. The Ordinance did not affect the retirement benefits of active employees, current retirees and beneficiaries, or terminated employees entitled to benefits but not yet receiving them.

(Continued)

(c) Employees Covered by Benefit Terms

At June 30, 2015, the date of the most recent actuarial valuation, the Pension Plan membership consisted of:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	2,526
Participants:	
Vested	1,012
Nonvested	262
Total participants	1,274
Total membership	3,800

During the period September 1, 2014 through June 30, 2015, PGW experienced significant changes in its workforce. During this time, there were over 180 active Pension Plan participants who moved into retirement. This activity is more than double the number of retirements experienced by PGW in a normal year.

(d) Contributions

The Pension Plan funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due considering employee contributions required for new hires after December 2011 who elect to participate in the Pension Plan. Level percentages of payroll employer contribution rates are determined using the Projected Unit Credit actuarial funding method. For the Pension Plan years ending June 30, 2015 and 2014, PGW's average contribution rate was 22.6% and 23.6% of annual payroll, respectively. Employee contributions were approximately $0.4 million in each year. The actuarially determined contributions determined for FY 2015 and FY 2014 were $21.5 million and $24.4 million, respectively. PGW contributed $21.5 million and $24.4 million in FY 2015 and FY 2014, respectively.

(e) Net Pension Liability

The Company's net pension liability as of August 31, 2015 and 2014 were measured as of June 30, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015 and September 1, 2013, respectively. The September 1, 2013 actuarial valuation was rolled forward to the June 30, 2014 measurement date.

(Continued)

The total pension liability was determined using the entry age normal actuarial method and the following actuarial assumptions:

	2015	2014
Inflation	2.00%	2.00%
Salary increases	4.50	4.50
Investment rate of return	7.65	7.95

Mortality rates. Mortality rates for FY 2014 were based on the RP-2000 mortality tables for males and females projected to FY 2014. Mortality rates for FY 2015 were based on the RP-2014 mortality tables for males and females generationally projected with scale MP-2014.

Long-term rate of return. The long-term expected rate of return on Pension Plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of Pension Plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class for FY 2015 are summarized in the following table:

Asset class	Minimum	Maximum	Target	Expected annual return
Equity:				
Large-cap equity	36.9%	45.1%	41.0%	9.3%
Small cap equity	7.2	10.8	9.0	10.8
International equity	12.0	18.0	15.0	4.3
Fixed income:				
Core fixed income	13.2	19.8	16.5	6.4
Intermediate fixed income	14.8	22.2	18.5	6.4
Cash and cash equivalents	—	10.0	—	—
			100.0%	

Discount rate. The discount rate used to measure the total pension liability at June 30, 2015 and 2014 was 7.65% and 7.95%, respectively. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that Company contributions will be made at rates equal to the difference between actuarially determined contribution rates and the employee contributions. Based on those assumptions, the Pension Plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on Pension Plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Changes in Net Pension Liability

(Thousands of U.S. dollars)

		Increase (decrease)		
		Total pension liability (a)	**Plan fiduciary net position (b)**	**Net pension liability (a)-(b)**
Balances at September 1, 2013	$	604,966	456,314	148,652
Changes for the year:				
Service cost		8,924	—	8,924
Interest		47,098	—	47,098
Differences between expected and actual experience		59,326	—	59,326
Contributions-employer		—	24,934	(24,934)
Contributions-employee		—	239	(239)
Net investment income		—	75,303	(75,303)
Benefit payments, including refunds of employee contributions		(42,913)	(42,913)	—
Administrative expenses		—	(732)	732
Net changes		72,435	56,831	15,604
Balances at August 31, 2014	$	677,401	513,145	164,256
Balances at September 1, 2014	$	677,401	513,145	164,256
Changes for the year:				
Service cost		4,890	—	4,890
Interest		52,377	—	52,377
Differences between expected and actual experience		17,961	—	17,961
Contributions-employer		—	21,106	(21,106)
Contributions-employee		—	393	(393)
Net investment income		—	24,472	(24,472)
Benefit payments, including refunds of employee contributions		(46,917)	(46,917)	—
Administrative expenses		—	(1,480)	1,480
Change in assumptions		44,876	—	44,876
Net changes		73,187	(2,426)	75,613
Balances at August 31, 2015	$	750,588	510,719	239,869

Sensitivity of the net pension liability to changes in the discount rate. The following presents the net pension liability of the Company at June 30, 2015, calculated using the discount rate of 7.65%, as well as what the Company's net pension liability as of August 31, 2015 would be if it were calculated using a discount rate that is 1-percentage-point lower (6.65%) or 1-percentage point higher (8.65%) than the current rate:

		1% Decrease 6.65%	Current discount rate 7.65%	1% Increase 8.65%
Net pension liability (thousands of U.S. dollars)	$	326,719	239,869	167,415

The following presents the net pension liability of the Company at June 30, 2014, calculated using the discount rate of 7.95%, as well what the Company's net pension liability as of August 31, 2014 would have been if it were calculated using a discount rate that is 1-percentage-point lower (6.95%) or 1-percentage point higher (8.95%) than the current rate:

		1% Decrease 6.95%	Current discount rate 7.95%	1% Increase 8.95%
Net pension liability (thousands of U.S. dollars)	$	238,494	164,256	101,532

Pension Plan fiduciary net position. Detailed information about the Pension Plan's fiduciary net position is available in the separately issued Pension Plan financial report.

(f) Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the years ended August 31, 2015 and 2014, the Company recognized pension expense of $43.7 million and $27.2 million, respectively. At August 31, 2015 and 2014, the Company reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (thousands of U.S. dollars):

		August 31, 2015		August 31, 2014	
		Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Differences between expected and actual experience	$	44,377	—	45,133	—
Changes of assumptions		33,572	—	—	—
Net difference between projected and actual earnings on pension plan investments		—	(11,653)	—	(31,808)
Contributions made after measurement date		179	—	998	—
Total	$	78,128	(11,653)	46,131	(31,808)

The $179,000 reported as deferred outflows of resources related to employer contributions made after the measurement date as of August 31, 2015 will be recognized as a reduction of the net pension liability in FY 2016. Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows (thousands of U.S. dollars):

		Deferred outflows of resources	Deferred inflows of resources
Fiscal year:			
2016	$	30,200	(4,901)
2017		30,021	(4,901)
2018		17,907	(4,901)
2019		—	3,050
Total	$	78,128	(11,653)

(11) Other Postemployment Benefits

(a) Plan Description

The Company sponsors a single employer defined-benefit healthcare plan and provided postemployment healthcare and life insurance benefits to approximately 2,201 and 2,053 participating retirees and their beneficiaries and dependents in FY 2015 and FY 2014, respectively, in accordance with their retiree medical program. The annual covered payroll (which was substantially equal to total payroll) was $114.1 million and $115.2 million at August 31, 2015 and 2014, respectively.

The Company pays the full cost of medical, basic dental, and prescription coverage for employees who retired prior to December 1, 2001. Employees who retire after December 1, 2001 are provided a choice of three plans at the Company's expense and can elect to pay toward a more expensive plan. Retirees may also contribute toward enhanced dental plan and life insurance coverage. PGW pays 100% of the cost for the prescription drug plan after drug co-pays. Union employees hired on or after May 21, 2011 and Non Union employees hired on or after December 21, 2011 are entitled to receive postretirement medical, prescription, and dental benefits for five years only. Currently, the Company provides for the cost of healthcare and life insurance benefits for retirees and their beneficiaries on a pay-as-you-go basis.

Total expense incurred for healthcare and life insurance related to retirees amounted to $30.3 million and $25.9 million in FY 2015 and FY 2014, respectively. In addition, the Company expensed $0.3 million of funding for the OPEB Trust and retirees contributed $18.5 million towards their healthcare in both FY 2015 and FY 2014. These contributions represent the additional cost of healthcare plans chosen by retirees above the basic plan offered by the Company. Total premiums for group life insurance were $2.4 million and $2.2 million in FY 2015 and FY 2014, respectively, which included $1.9 million and $1.8 million for retirees. Retirees contributed $0.2 million towards their life insurance in both FY 2015 and FY 2014.

(b) Annual Postemployment Benefit Cost, Contributions Required, and Contributions Made

The amount paid by the Company for retiree benefits in FY 2015 was \$48.8 million, consisting of \$28.6 million of healthcare expenses, \$1.7 million of life insurance expenses, and \$18.5 million contributed to the OPEB Trust. The amount paid by the Company for retiree benefits in FY 2014 was \$44.4 million, consisting of \$24.3 million of healthcare expenses, \$1.6 million of life insurance expenses, and \$18.5 million contributed to the OPEB Trust. The difference between the AOC and the Company's contributions resulted in a decrease in the OPEB obligation of \$11.8 million and \$7.3 million in FY 2015 and FY 2014, respectively, which was recorded to other noncurrent liabilities and expensed.

Funded Status

The actuarial accrued liability for benefits at August 31, 2015 and 2014 was \$505.4 million and \$450.3 million, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 351.6% as of August 31, 2015 and 312.1% as of August 31, 2014.

Historical trend information reflecting funding progress and contributions made by the Company is presented in the Schedule of Other Postemployment Benefits Funding Progress (Required Supplementary Information).

Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and are subject to continual revision as actual amounts are compared to past expectations and new estimates are made about the future. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The assumptions used to determine the AOC for the current year and the funded status of the plan include:

Actuarial cost method	Projected unit credit
Method(s) used to determine the actuarial value of assets	Fair value of plan assets held in the OPEB trust
Investment return assumption (discount rate)	7.95%, which represents the long-term expected investment return on OPEB trust assets
Mortality	RP-2014 Mortality Tables with projection scale MP-2015
Amortization method	Level dollar amount
Amortization period	Open period of 30 years

Healthcare cost trend rates are as follows

	Healthcare cost trend rates			
Year	**Medical (pre-65)**	**Medical (post-65)**	**Prescription**	**Dental**
2015	8.0%	6.0%	10.5%	4.5%
2016	7.0	5.0	9.5	4.5
2017	6.5	4.5	8.5	4.5
2018	6.0	4.5	7.5	4.5
2019	5.5	4.5	6.5	4.5
2020	5.0	4.5	5.5	4.5
2021 and following	4.5	4.5	4.5	4.5

The following table shows the components of the Company's AOC for FY 2015 and FY 2014, the amount actually contributed to the plan, and the Company's net OPEB obligation (thousands of U.S. dollars):

		2015	**2014**
Annual required contribution	$	37,980	38,062
Interest on net OPEB obligation		8,092	8,670
Adjustment to the annual required contribution		(8,999)	(9,642)
Annual OPEB cost		37,073	37,090
Contributions made		(48,847)	(44,362)
Net OPEB obligation as of prior year		101,788	109,060
Net OPEB obligation as of August 31	$	90,014	101,788

The AOC is recorded in the statements of revenues and expenses and changes in net position. For the year ended August 31, 2015, approximately $6.7 million was recorded to other postemployment benefits expense and $30.3 million was allocated to administrative and general expense. For the year ended August 31, 2014, approximately $11.2 million was recorded as other postemployment benefits expense and $25.9 million was allocated to administrative and general expense.

The Company's AOC, the percentage of AOC contributed to the plan, and the net OPEB obligation for FY 2015 and the two preceding fiscal years were as follows (thousands of U.S. dollars):

		Annual OPEB cost	Percentage of annual OPEB cost contributed		Net OPEB obligation
Fiscal year ended August 31:					
2015	$	37,073	131.8%	$	90,014
2014		37,090	119.6		101,788
2013		40,235	105.0		109,060

(c) *Other Coverage Information*

PGW is self-insured for the healthcare of active employees and retirees under the age of 65. Retirees over the age of 65 are insured on an experience rated basis. At August 31, 2015, the Company has in place $200.9 million of group life insurance coverage for both active and retired employees, which is retrospectively rated on a monthly basis.

(12) Pollution Remediation Obligation

The Company recorded an additional liability for pollution remediation obligations of $1.0 million and $4.0 million for FY 2015 and FY 2014, respectively. The pollution remediation liability is reflected in other noncurrent are current liabilities. In accordance with U.S. GAAP for regulated entities, the Company has also recognized the long-term portion of its environmental remediation liability as a regulatory asset because based on available evidence it is probable that the previously incurred costs will be recovered through rates.

The pollution remediation obligations at August 31, 2015 and 2014 were $34.4 million and $34.7 million, respectively, which reflect the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

(13) Risk Management

The Company is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors, and omissions, injuries to employees, and natural disasters. While self-insured for many risks, the Company purchases insurance coverage where appropriate. The Company's real and personal property is insured against the risk of loss or damage in the amount of $250.0 million, subject to a $0.5 million per accident deductible at the Richmond and Passyunk Plants and a $0.1 million per accident deductible at all other locations. There are separate sublimits for flood and earth movement at select locations. The Company's Property Insurance includes coverage for damage incurred from a terrorist attack. In addition, the Company maintains Blanket Crime, which is a form of Property Insurance.

The Company maintains $210.0 million in liability (including terrorism) coverage, insuring against the risk of damage to property, or injury to the public with a $1.0 million per occurrence self-insured retention.

The Company maintains statutory limits for Workers' Compensation (including terrorism) with a $0.5 million per occurrence self-insured retention.

The Company maintains a $30.0 million Public Officials Liability (Directors and Officers Liability) policy with a $0.5 million retention as well as a $60.0 million Fiduciary Liability policy with a $0.2 million self-insured retention.

The Company maintains $5.0 million in Environmental Liability coverage for liability arising from nonowned Disposal Sites subject to an each incident deductible of $0.1 million, as well as a $5.0 million Cyber (Privacy) Liability policy with a $0.3 million retention covering costs arising from a data or security breach.

The Company maintains a medical stop-loss insurance program for its self-insured healthcare plans. The coverage provides for a $0.3 million deductible per covered participant.

The Company has evaluated all open claims as of August 31, 2015 and has appropriately accrued for these claims on the balance sheet.

Claims and settlement activity for occurrences excluded under the provisions of insurance policies for injuries and damages are as follows (thousands of U.S. dollars):

		Beginning of year reserve	Current year claims and adjustments	Claims settled	End of year reserve	Current liability amount
Fiscal year ended August 31:						
2015	$	9,944	3,610	(2,042)	11,512	5,011
2014		10,411	2,498	(2,965)	9,944	4,728
2013		11,102	2,616	(3,307)	10,411	4,925

(14) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately $25.3 million and $25.1 million, as of August 31, 2015 and 2014, respectively.

The Company is committed under various noncancelable operating lease agreements to pay minimum annual rentals as follows (thousands of U.S. dollars):

Fiscal year ending August 31:		
2016	$	843
2017		388
2018		258

Rent expense for the fiscal years ended August 31, 2015 and 2014 amounted to $1.5 million.

The Company, in the normal course of conducting business, has entered into long-term contracts for the supply of natural gas, firm transportation, and long-term firm gas storage service. The Company's cumulative obligations for demand charges for all of these services are approximately $5.0 million, per month.

The Company has entered into seasonal contracts with suppliers providing the Company the ability to fix the price of the purchase of natural gas during the period from November 1, 2014 through March 31, 2015.

The Company's amended FY 2016 Capital Budget was approved by City Council in the amount of $123.1 million. Within this approval, funding was provided to continue the implementation of an 18-mile CIMR Program. Main replacement cost for this program in FY 2016 is expected to be $22.4 million. The total six-year cost of the CIMR Program is forecasted to be $134.0 million. In addition to this program, the FY 2016 Capital Budget includes funding for an incremental CIMR Program for which PGW will request recovery through a DSIC. This incremental program in FY 2016 is expected to cost $25.3 million. The total six-year cost of this incremental program is forecasted to be $190.6 million. The FY 2016 Capital Budget also includes $2.3 million for the purchase of replacement Automatic Meter Reading (AMR) units. The total six-year cost of this program to replace AMR units is approximately $14.9 million.

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)
Required Supplementary Information (Unaudited)
Schedule of Changes in Net Pension Liability and Related Ratios
(Thousands of U.S. dollars)

		Fiscal Year Ending 2015	2014
Total pension liability:			
Service cost	$	4,890	8,924
Interest cost		52,377	47,098
Changes in benefit terms		—	—
Differences between expected and actual experience		17,961	59,326
Changes in assumptions		44,876	—
Benefit Payments		(46,917)	(42,913)
Net change in total pension liability		73,187	72,435
Total pension liability (beginning)		677,401	604,966
Total pension liability (ending)		750,588	677,401
Plan fiduciary net position:			
Contributions-employer		21,106	24,934
Contributions-employee		393	239
Net investment income		24,472	75,303
Benefit payments		(46,917)	(42,913)
Administrative expense		(1,480)	(732)
Net change in fiduciary net position		(2,426)	56,831
Plan fiduciary net position (beginning)		513,145	456,314
Plan fiduciary net position (ending)		510,719	513,145
Net pension liability (ending)	$	239,869	164,256
Net position as a percentage of pension liability		68.61%	75.75%
Covered employee payroll	$	95,187	103,530
Net pension liability as a percentage of payroll		252.00%	158.66%

Notes to Schedule:

Historical information:

The Company has presented the information noted above for those years for which information is available. Ten-year trend information will be presented prospectively.

Changes in assumptions:

In FY 2015, amounts reported as changes of assumptions resulted primarily from (i) adjustments to assumed life expectancies as a result of adopting the RP-2014 mortality table generationally projected with Scale MP-2014 to better reflect the actual and future mortality experience and (ii) changing the discount rate from 7.95% to 7.65%.

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Required Supplementary Information (Unaudited)

Schedule of Pension Contributions

(Thousands of U.S. dollars)

Fiscal Year Ending		**2015**	**2014**	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**
Actuarially determined contribution	$	21,526	24,385	23,673	23,802	22,936	23,099	15,437	15,453	15,608	15,056
Contributions made		21,526	24,385	23,673	23,802	22,936	23,099	15,437	15,453	15,608	15,056
Contribution deficiency/(excess)	$	—	—	—	—	—	—	—	—	—	—
Covered employee payroll	$	95,187	103,530	105,985	106,308	106,308	106,125	108,474	107,918	102,958	106,018
Contributions as a percent of covered employee payroll		22.61%	23.55%	22.34%	22.39%	21.58%	21.77%	14.23%	14.32%	15.16%	14.20%

Notes to schedule:

Methods and Assumptions used to determine contribution rates:

Actuarial Valuation Date: July 1 for 2015 and September 1 for prior periods
Actuarial Cost Method: Projected Unit Credit
Asset Valuation Method: Market Value
Amortization Method: 20 year level dollar open amortization method
Salary Increases: 4.50% for 2015, 3.0% for the current year and then 4.5% of salary for subsequent years for 2014; 3.0% for three years and then 4.25% of salary for the 4th and subsequent years for 2006-2013
General Inflation: 2.00%
Investment Rate of Return: 7.65% for 2015, 7.95% for 2013 and 2014, 8.15% for 2012, 8.25% for 2007-2011
Cost of Living: N/A
Mortality Rates: RP-2014 static mortality generationally projected with Scale MP-2014 for 2015, RP-2000 static mortality projected to year of valuation for prior periods

See accompanying independent auditors' report.

PHILADELPHIA GAS WORKS
(A Component Unit of the City of Philadelphia)

Required Supplementary Information (Unaudited)

Schedule of Other Postemployment Benefits Funding Progress

(Thousands of U.S. dollars)

Actuarial valuation date		(a) Actuarial value of assets	(b) Actuarial accrued liability (AAL)	(b)-(a) Unfunded AAL (UAAL)	(a/b) Funded ratio	Covered payroll	UAAL as a percent of covered payroll
August 31, 2015	$	104,318	505,434	401,116	20.6%	114,074	351.6%
August 31, 2014		90,838	450,289	359,451	20.2	115,174	312.1
August 31, 2013		61,796	436,527	374,731	14.2	110,120	340.3

See accompanying independent auditors' report.