PHILADELPHIA GAS WORKS

(A Component Unit of the City of Philadelphia)

Basic Financial Statements and Supplementary Information

August 31, 2016 and 2015

(With Independent Auditors' Reports 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:

We have audited the accompanying basic financial statements of the Philadelphia Gas Works (the Company), a component unit of the City of Philadelphia, as of and for the years ended August 31, 2016 and 2015, 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 opinions 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 respective financial position of Philadelphia Gas Works, as of August 31, 2016 and 2015, and the respective changes in financial position and cash flows thereof for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP is a Delaware limited liability partnership and the U.S. member
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KPMG International Cooperative ("KPMG International"), a Swiss entity.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3–15 and the schedules of changes in net pension liability and related ratios, pension contributions, and other post-employment benefits funding progress on pages 69-71 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 28, 2016

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2016 and 2015 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) 2016 reflected a 20.8% warmer than normal winter. The FY 2016 period was 24.5% warmer than the prior year and firm gas sales decreased by 10.7 billion Cubic Feet (Bcf). In addition, the Weather Normalization Adjustment (WNA) Clause, which was in effect from October 2015 through May 2016, resulted in heating customers receiving charges totaling $41.5 million as a result of the temperatures experienced during the period. The 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 Bcf. In addition, the WNA Clause, 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.
- PGW achieved a collection rate of 98.4% in the current period, 97.1% in FY 2015, and 95.0% in FY 2014. The increase in the collection rate of 1.3% between FY 2016 and FY 2015 was primarily driven by lower gas billings. Total gas billings are down primarily due to lower commodity prices for natural gas and significantly warmer than normal temperatures. Over the past 10 years, the cost of fuel has fallen approximately 72.8%. 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 2016 by the total gas billings that were applied to PGW customers' accounts from September 1, 2015 through August 31, 2016. The same methodology was utilized in FY 2015 and FY 2014.
- 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 2016 had $71.0 million of tax-exempt capital project commercial paper outstanding. At the end of FY 2015, there was $30.0 million of tax-exempt capital project commercial paper outstanding. There was no tax-exempt capital project commercial paper in FY 2014. The cash balances at the end of FY 2016 and FY 2015 were $91.7 million and $114.3 million, respectively. PGW had a cash balance of $105.7 million at the end of FY 2014.
- *Liquidity/Cash Flow* – At December 15, 2016, $49.0 million was available from the commercial paper program. The cash balance at December 15, 2016 was $68.9 million.
- The Company's FY 2017 Capital Budget was approved by the City Council of the City of Philadelphia in an amount not to exceed $118.3 million and funding was provided to continue the implementation of an 18-mile Cast Iron Main Replacement (CIMR) Program. Main replacement cost for this program in FY 2017 is expected to be $24.4 million. The total six-year cost of the CIMR Program is forecasted to be $154.9 million.
- On August 30, 2016, the City of Philadelphia (the City) issued Gas Works Revenue Bonds, Fourteenth Series (1998 General Ordinance) in the amount of $312.4 million for the purpose of redeeming, refunding, or defeasing City of Philadelphia Gas Works Revenue Bonds. The proceeds of the bonds were used to defease portions of the outstanding Seventh Series Bonds (1998 General Ordinance), Eighth Series A Bonds (1998 General Ordinance), and Ninth Series Bonds (1998 General Ordinance), and were used to

pay the costs of issuing the Fourteenth Series Bonds. The Fourteenth Series Bonds, with fixed interest rates that range from 2.0% to 5.0%, have maturity dates through 2038. The loss on this refunding of $33.5 million will be amortized over the life of the Fourteenth Series Bonds. This transaction provided net present value debt service savings of $38.2 million utilizing an arbitrage yield of 2.11%. The savings as a percentage of refunded bonds was 10.86%.

- 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, $239.9 million at August 31, 2015 and $296.1 million at August 31, 2016. 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 $0.0 million and $11.7 million in deferred inflows and $88.0 million and $78.1 million in deferred outflows at August 31, 2016 and 2015, 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 increase volatility in annual amounts recognized as pension expense compared to amounts recognized under prior accounting standards.
  - Pension expense was restated for the year ended August 31, 2014 resulting in an additional $2.7 million of expense to a total of $27.2 million.
  - Pension expense was $62.3 million for the year ended August 31, 2016 as compared to $43.7 in FY 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		
		2016	**2015**	**2014***
Total gas revenues	$	572,348	676,027	736,138
Other revenues		18,889	21,220	22,998
Total operating revenues		591,237	697,247	759,136
Fuel expense		146,524	252,169	304,051
All other operating expenses		370,433	354,357	336,892
Total operating expenses		516,957	606,526	640,943
Operating income		74,280	90,721	118,193
Interest and other income		1,393	3,784	3,597
Total interest expense		(47,619)	(56,523)	(57,135)
Distribution to the City of Philadelphia		(18,000)	(18,000)	(18,000)
Excess of revenues over expenses	$	10,054	19,982	46,655

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 10 to the basic financial statements.)

Operating Revenues

Operating revenues in FY 2016 were $591.2 million, a decrease of $106.0 million or 15.2% from FY 2015. The decrease was caused by lower natural gas sendout, which was approximately 17.2% lower in FY 2016 when compared to FY 2015. Operating revenues in FY 2015 were $697.2 million, a decrease of $61.9 million or 8.2% from FY 2014. The decrease in FY 2015 was due to a lower Gas Cost Rate (GCR). Please see the discussion of the cost of fuel in the *Operating Expenses* Section below.

Total sales volumes, including gas transportation deliveries, in FY 2016 decreased by 13.3 Bcf to 65.9 Bcf or 16.8% from FY 2015 sales volumes of 79.2 Bcf. 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. In FY 2016, firm gas sales of 37.7 Bcf were 10.7 Bcf or 22.1% lower than FY 2015. In FY 2015, firm gas sales of 48.4 Bcf were 0.1 Bcf or 0.2% lower than FY 2014. Interruptible customer sales decreased by 0.5 Bcf compared to FY 2015. The decrease in FY 2016 interruptible sales was caused by decreased opportunities for Liquefied Natural Gas (LNG) sales. Gas transportation sales in FY 2016 decreased by 2.1 Bcf to 28.2 Bcf from the 30.3 Bcf level experienced in FY 2015. 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.

In FY 2016, the number of customers served by PGW increased from the previous year and was approximately 502,000 customers. The number of customers served by PGW at the end of FY 2015 and FY 2014 was approximately 501,000 and 500,000, respectively. There were approximately 25,000 Commercial accounts, reflecting no change from the previous two fiscal years. Industrial accounts were unchanged from the previous two fiscal years at approximately 700 customers. The number of residential accounts in FY 2016 increased to approximately 476,300 customers, an increase of 1,000 customers from the FY 2015 level, and 2,000 higher from the 2014 level.

Operating Expenses

Total operating expenses, including fuel costs, in FY 2016 were $517.0 million, a decrease of $89.5 million or 14.8% from FY 2015. The decrease for FY 2016 was mainly caused by lower natural gas volumes and lower natural gas commodity prices, which was partially offset by higher costs associated with the pension. 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.

Cost of Fuel – The cost of natural gas utilized decreased by $105.7 million or 41.9% to $146.5 million in FY 2016 compared with $252.2 million in FY 2015. The average commodity price per Thousand Cubic Feet (Mcf) decreased by $1.64 or $66.2 million, while the volume of gas utilized decreased by 10.3 Bcf, 20.2% or $39.4 million. There were less than $0.1 million of pipeline supplier refunds in FY 2016 as compared to none in FY 2015 while demand charges increased by $0.1 million, compared to FY 2015. Cost of fuel includes all commodity charges and demand charges net of pipeline refunds.

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 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. In addition, 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.

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 2016, FY 2015, and FY 2014 were $2.20, $3.84, and $4.63 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2016 were $91.4 million, a $2.3 million or 2.5% decrease from the FY 2015 total of $93.7 million. The decrease in FY 2016 was mainly caused by lower labor costs associated with the Distribution department. The FY 2015 total of $93.7 million was $0.4 million lower than the FY 2014 total of $94.1 million as a result of lower labor costs associated with running the LNG plants.

Additionally, expenses of $126.7 million related to collection and account management, customer services, marketing, and the administrative area increased by $2.9 million or 2.3% in FY 2016 primarily due to higher administrative and healthcare expenses, offset by lower expenses associated with marketing. This category increased by $7.6 million or 6.5% in FY 2015 compared to FY 2014 primarily due to higher healthcare expenses, costs of customer programs, and an increase in customer services.

Pension costs increased in FY 2016 due to a number of factors including a decrease in the discount rate from 7.65% to 7.30%, and lower than anticipated earnings in FY 2016. Pension costs increased by $18.6 million or 42.6% to $62.3 million in FY 2016 as compared to FY 2015. Pension costs increased by $16.5 million or 60.7% to $43.7 million in FY 2015 as compared to FY 2014.

Other Postemployment Benefits (OPEB) costs increased $3.9 million in FY 2016 when compared to FY 2015. OPEB costs increased in FY 2016 due to increased normal costs and increased insurance expenses. OPEB costs remained the same in FY 2015 when compared to FY 2014. For FY 2016, FY 2015, and FY 2014, the Company utilized a discount rate of 7.95%. 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, 2016, approximately $9.9 million was recorded to other postemployment benefits expense and $31.1 million was allocated to administrative and general expense. 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.

The net OPEB obligation was $81.4 million for the fiscal year ended August 31, 2016, an $8.6 million decrease from the $90.0 million obligation at August 31, 2015. 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

(Continued)

August 31, 2014. 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 2016 totaled $27.1 million, a decrease of $7.7 million or 22.1% from FY 2015. 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 decrease in the provision for uncollectible accounts is mainly due to higher collection rates achieved in FY 2016 and FY 2015, and lower gas revenues. The accumulated provision for uncollectible accounts at August 31, 2016 reflects a balance of $74.3 million, compared to the $102.0 million balance in FY 2015 and $107.3 million in FY 2014. Net write-offs for FY 2016 were $54.9 million as compared to $40.2 million and $38.1 million in FY 2015 and FY 2014, respectively. 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 $1.6 million in FY 2016 compared with FY 2015. Net depreciation expense increased by $2.1 million in FY 2015 compared with FY 2014. The effective composite depreciation rates were 2.2% for FY 2016, FY 2015, and FY 2014. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income in FY 2016 was $2.4 million lower than FY 2015, primarily due to a change in accounting for revenue from pipeline capacity releases. In FY 2016, pipeline capacity release revenues are classified as other operating revenues. 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 Expense – Total interest expense was $47.6 million in FY 2016 a decrease of $8.9 million or 15.8% when compared with FY 2015. Interest expense was lower in FY 2016 primarily due to lower principal debt balances. 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. Other interest costs decreased in FY 2016 by $3.1 million or 27.0%, primarily due to the amortization of bond premium related to the Thirteenth Series bonds. 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.

(Continued)

Excess of Revenues over Expenses – In FY 2016, the Company's excess of revenues over expenses was $10.1 million, a decrease of $9.9 million from FY 2015. This decrease is primarily due to the items noted above. 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.

Condensed Balance Sheets

(Thousands of U.S. dollars)

		Years ended August 31		
Assets		**2016**	**2015**	**2014***
Current assets:				
Accounts receivable (net of accumulated provision for uncollectible accounts of $74,286, $102,029, and $107,349 for 2016, 2015, and 2014, respectively)	$	73,563	86,853	101,457
Restricted investment funds		2,603	5,820	5,820
Cash and cash equivalents, cash designated for capital expenditures, gas inventories, materials, and supplies and other current assets		170,651	178,831	204,944
Total current assets		246,817	271,504	312,221
Noncurrent assets:				
Utility plant, net		1,284,810	1,232,370	1,193,552
Unamortized bond insurance costs		512	3,473	14,136
Sinking fund, revenue bonds		86,652	90,141	105,909
Other assets		34,789	37,646	37,528
Total noncurrent assets		1,406,763	1,363,630	1,351,125
Total assets		1,653,580	1,635,134	1,663,346
Deferred Outflows of Resources				
Accumulated fair value of hedging derivatives		14,763	20,948	18,879
Unamortized losses on reacquired debt		57,175	37,471	37,051
Deferred outflows related to pension		88,043	78,128	46,131
Total deferred outflows		159,981	136,547	102,061
Total assets and deferred outflows of resources	$	1,813,561	1,771,681	1,765,407

Condensed Balance Sheets

(Thousands of U.S. dollars)

Net Position, Liabilities, and Deferred Inflows		Years ended August 31		
		2016	2015	2014*
Net position	$	288,038	277,984	258,002
Long-term revenue bonds		881,620	914,719	980,749
Other noncurrent liabilities		149,621	168,399	179,265
Net pension liability		296,093	239,869	164,256
Total noncurrent liabilities		1,327,334	1,322,987	1,324,270
Current liabilities:				
Current portion of revenue bonds		44,803	43,030	53,227
Notes payable		71,000	30,000	—
Other current liabilities		82,386	86,027	98,100
Total current liabilities		198,189	159,057	151,327
Deferred inflows related to pension		—	11,653	31,808
Total net position, liabilities, and deferred inflows	$	1,813,561	1,771,681	1,765,407

* FY 2014 has been restated as a result of the implementation of GASB 68 and GASB 71 (see note 10 to the basic financial statements)

Assets

Accounts Receivable – In FY 2016, accounts receivable (net) of $73.6 million decreased by $13.3 million or 15.3%, from FY 2015 due to lower gas billings during FY 2016, which resulted from lower volumes and lower commodity prices for natural gas. 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. The accumulated provision for uncollectible accounts, totaling $74.3 million decreased by $27.7 million in FY 2016 and totaled $102.0 million in FY 2015 and $107.3 million in FY 2014.

Cash and Cash Equivalents, Gas Inventories, Materials, and Supplies, and Other Current Assets – In FY 2016, cash and cash equivalents totaled $91.7 million, a decrease of $22.6 million from the FY 2015 total of $114.3 million and totaled $105.7 million in FY 2014. In FY 2016, gas inventories, materials, and supplies totaled $47.9 million, a decrease of $3.0 million from the FY 2015 total of $50.9 million. 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 2016, gas storage totaled $38.6 million, a decrease of $2.2 million or 5.5% when compared to FY 2015. The decrease in gas inventory reflects a decrease in the cost per Mcf of gas stored. Actual volumes in storage as of August 31, 2016 were 14.9 Bcf, an increase of 8.8% compared to the prior

year. 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. Other current assets totaled $31.0 million in FY 2016, an increase of $17.4 million from FY 2015, primarily as a result of an increase in the deferred GCR. 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.

Restricted Investment Funds – Restricted Investment Funds include the Workers Compensation Escrow Fund and the Health Insurance Escrow Fund. Interest income on all funds, to the extent not drawn, is reflected as an increase of $0.0 million in FY 2016, $0.5 million in FY 2015, and $0.4 million in FY 2014. 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, 2016, 2015, and 2014, 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. Prior to FY 2016, PGW had a Health Insurance Escrow Fund that, as of August 31, 2015 and 2014, 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 2016, noncurrent assets including utility plant, net, and unamortized bond insurance costs totaled $1,406.8 million, an increase of $43.2 million from FY 2015. 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. Utility plant, net, totaled $1,284.8 million in FY 2016, an increase of $52.4 million or 4.3% compared with the FY 2015 balance of $1,232.4 million. 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. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $97.9 million in FY 2016 compared to $82.6 million in FY 2015 and $80.2 million in FY 2014. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amount of $34.1 million in FY 2014. There were no Capital Improvement Fund drawdowns in FY 2016 or 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.

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 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 approved by the PUC. The Company started billing customers a DSIC surcharge as of July 1, 2013. In FY 2016, the Company billed customers $22.6 million for the DSIC surcharge. In FY 2015, the Company billed customers $14.0 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 will result in a reduction of net position in a subsequent period. Deferred outflows include the accumulated 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 $23.5 million or 17.2% from FY 2015 to FY 2016, and $34.5 million or 33.8% from FY 2014 to FY 2015 primarily due to increased unamortized losses on reacquired debt and 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 $926.4 million in FY 2016. This was $31.3 million less than the previous year primarily as a result of normal debt principal payments, refunding, and advanced payments. This represents 76.3% of total capitalization in FY 2016. 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. Long-term revenue bonds, including the current portion and unamortized discount and premium, totaled $1,034.0 million in FY 2014. Long-term debt represented 77.5% of total capitalization in FY 2015 and 80.0% of total capitalization in FY 2014. For additional information, see note 8, *Long-Term Debt and Other Liabilities* of the basic 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, 2016, only Senior 1998 Ordinance Bonds were outstanding. At August 31, 2016, debt service coverage on Senior 1998 Ordinance Bonds was 2.13 times, compared to 2.14 and 2.11 times at August 31, 2015 and 2014, respectively. At the time of the refunding in August 2015, debt service coverage on 1975 Ordinance Bonds was 6.57 times as compared to 6.15 times at August 31, 2014. 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 set the maximum level of outstanding notes plus interest at $120.0 million in FY 2016, FY 2015, and FY 2014. There was $71.0 million of tax-exempt capital project commercial paper outstanding at August 31, 2016. At the end of FY 2015, there was $30.0 million of tax-exempt capital project commercial paper outstanding and no tax-exempt capital project commercial paper outstanding in FY 2014.

Other Current Liabilities – In FY 2016, other current liabilities totaled $13.8 million, a decrease of $0.3 million from FY 2015, mainly due to a change in the value of natural gas deferred refunds. In FY 2015, the total was $14.1 million, and $19.3 million in FY 2014. In FY 2016, accounts payable totaled $55.9 million, a decrease of $0.1 million or 0.2% compared with FY 2015 primarily due to a decrease in natural gas payables of $0.2 million. 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.

Other Noncurrent Liabilities – In FY 2016, other noncurrent liabilities totaled $149.6 million, a decrease of $18.8 million compared to FY 2015. The decrease in FY 2016 is primarily due to the change in the value of the OPEB liability and a change in value of the interest rate swap. 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.

Net Pension Liability – The increase in the net pension liability of $56.2 million or 23.4% in FY 2016 as compared to FY 2015 was primarily driven by a decrease in the discount rate from 7.65% to 7.30%, and lower than anticipated earnings in FY 2016. The increase in the net pension liability of $75.6 million or 46.0% in FY 2015 as compared to FY 2014 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. Net pension liability totaled $164.3 million in FY 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 $11.7 million or 100.0% between FY 2015 and FY 2016 is related to changes in investment performance and an accounting reclassification. There was $31.8 million in deferred inflows of resources at August 31, 2014.

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 $20.0 million to $278.0 million at August 31, 2015 and $10.0 million to $288.0 million at August 31, 2016, primarily due to increases in the Company's net investment in capital assets. Unrestricted net position decreased $79.3 million or over 100.0% to negative $92.6 million at August 31, 2015 and $124.0 million or over 100.0% to negative $216.8 million at August 31, 2016, 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 was permitted to maintain virtually all of the extraordinary base rate relief, received an incremental rate increase of $16.0 million annually, and was 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). 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.

Additionally, on May 9, 2013, the PUC entered an order approving PGW's DSIC. The DSIC permitted PGW to recover reasonable and prudent costs incurred to repair, improve, or replace certain eligible distribution property that is part of the utility's distribution system, in an amount up to 5.0% of distribution revenues. On September 1, 2015, PGW proposed an increase in the DSIC from 5.0% to 7.5% of distribution revenues and to levelize and annualize the DSIC. The PUC issued an Opinion and Order granting PGW's request to increase its DSIC to 7.5% on January 28, 2016 (January 28 Order). The increase, from $22.0 million to $33.0 million per year, will generate approximately $11.0 million in additional revenue to fund PGW's accelerated pipeline replacement program. The January 28 Order also permits PGW to levelize and annualize DSIC recovery, which will provide PGW with more predictable cash flow and may help mitigate overcollections and undercollections. PGW's increased DSIC charge of 7.5% became effective on February 1, 2016.

On July 6, 2016, the PUC issued an Opinion and Order that permitted PGW to recover an additional $11.4 million in DSIC undercollections for the year ended December 31, 2015, over the course of two years. This results in a temporary increase in the DSIC of an additional $5.7 million a year for two years, for a total DSIC rate of 8.84%. PGW intends to implement the temporary increase on October 1, 2016, which will terminate on September 30, 2018. PGW is considering requesting future increases to the DSIC once the 7.5% DSIC has been in place for a period of two years and PGW has had the opportunity to evaluate the effect of such increase on risk and customers and PGW's ability to effectively implement the level of accelerated pipeline replacement associated with the 7.5% DSIC (or higher levels).

Refunding, Defeasance, and Redeeming of Debt

On August 30, 2016, the City issued Gas Works Revenue Bonds, Fourteenth Series (1998 General Ordinance) in the amount of $312.4 million for the purpose of redeeming, refunding, or defeasing City of Philadelphia Gas Works Revenue Bonds. The proceeds of the bonds were used to defease portions of the outstanding Seventh Series Bonds (1998 General Ordinance), Eighth Series A Bonds (1998 General Ordinance), and Ninth Series Bonds (1998 General Ordinance), and were used to pay the costs of issuing the Fourteenth Series Bonds. The Fourteenth Series Bonds, with fixed interest rates that range from 2.0% to 5.0%, have maturity dates through 2038.

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, 2016 and 2015

(Thousands of U.S. dollars)

Assets		**2016**	**2015**
Current assets:			
Cash and cash equivalents	$	91,743	114,327
Accounts receivable (net of provision for uncollectible accounts of $74,286 and $102,029 for 2016 and 2015, respectively)		73,563	86,853
Gas inventories, materials, and supplies		47,891	50,908
Workers' compensation escrow fund		2,603	2,597
Health insurance escrow fund		—	3,223
Other current assets		31,017	13,596
Total current assets		246,817	271,504
Noncurrent assets:			
Utility plant, at original cost:			
In service		2,178,632	2,093,112
Under construction		73,531	64,254
Total		2,252,163	2,157,366
Less accumulated depreciation		967,353	924,996
Utility plant, net		1,284,810	1,232,370
Unamortized bond insurance costs		512	3,473
Sinking fund, revenue bonds		86,652	90,141
Deferred environmental		28,425	29,609
Other noncurrent assets		6,364	8,037
Total noncurrent assets		1,406,763	1,363,630
Total assets		1,653,580	1,635,134
Deferred Outflows of Resources			
Accumulated fair value of hedging derivatives		14,763	20,948
Unamortized losses on reacquired debt		57,175	37,471
Deferred outflows related to pension		88,043	78,128
Total deferred outflows of resources		159,981	136,547
Total assets and deferred outflows of resources	$	1,813,561	1,771,681

(Continued)

PHILADELPHIA GAS WORKS

(A Component Unit of the City of Philadelphia)

Balance Sheets

August 31, 2016 and 2015

(Thousands of U.S. dollars)

Liabilities		**2016**	**2015**
Current liabilities:			
Current portion of revenue bonds	$	44,803	43,030
Notes payable		71,000	30,000
Accounts payable		55,870	56,027
Customer deposits		3,308	2,858
Other current liabilities		13,791	14,091
Accrued accounts:			
Interest, taxes, and wages		6,417	10,051
Distribution to the City		3,000	3,000
Total current liabilities		198,189	159,057
Noncurrent liabilities:			
Long-term revenue bonds		881,620	914,719
Other noncurrent liabilities		149,621	168,399
Net pension liability		296,093	239,869
Total noncurrent liabilities		1,327,334	1,322,987
Total liabilities		1,525,523	1,482,044
Deferred Inflows of Resources			
Deferred inflows related to pension		—	11,653
Total liabilities and deferred inflows of resources		1,525,523	1,493,697
Net Position			
Net investment in capital assets		415,561	274,621
Restricted (debt service)		89,255	95,962
Unrestricted		(216,778)	(92,599)
Total net position		288,038	277,984
Total liabilities, deferred inflows of resources, and net position	$	1,813,561	1,771,681

See accompanying notes to 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, 2016 and 2015

(Thousands of U.S. dollars)

		2016	2015
Operating revenues:			
Gas revenues:			
Nonheating	$	21,873	30,753
Gas transport service		41,008	39,588
Heating		509,467	605,686
Total gas revenues		572,348	676,027
Appliance and other revenues		7,961	8,727
Other operating revenues		10,928	12,493
Total operating revenues		591,237	697,247
Operating expenses:			
Natural gas		146,524	252,169
Gas processing		17,948	18,180
Field services		36,277	36,874
Distribution		37,173	38,629
Collection and account management		10,913	11,192
Provision for uncollectible accounts		27,133	34,833
Customer services		12,432	12,262
Marketing		3,671	6,956
Administrative and general		99,652	93,347
Pensions		62,336	43,748
Other postemployment benefits		9,929	6,726
Taxes		7,521	7,823
Total operating expenses before depreciation		471,509	562,739
Depreciation		51,679	49,371
Less depreciation expense included in operating expenses above		6,231	5,584
Net depreciation		45,448	43,787
Total operating expenses		516,957	606,526
Operating income		74,280	90,721
Interest and other income		1,393	3,784
Income before interest expense		75,673	94,505
Interest expense:			
Long-term debt		40,296	45,756
Other		8,443	11,548
Allowance for funds used during construction		(1,120)	(781)
Total interest expense		47,619	56,523
Distribution to the City of Philadelphia		(18,000)	(18,000)
Excess of revenues over expenses		10,054	19,982
Net position, beginning of year		277,984	258,002
Net position, end of year	$	288,038	277,984

See accompanying notes to basic financial statements.

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

Statements of Cash Flows

Years ended August 31, 2016 and 2015

(Thousands of U.S. dollars)

		2016	2015
Cash flows from operating activities:			
Receipts from customers	$	570,700	700,500
Payments to suppliers		(328,006)	(430,729)
Payments to employees		(112,068)	(113,275)
Claims paid		(3,041)	(2,042)
Other receipts		12,300	17,700
Net cash provided by operating activities		139,885	172,154
Cash flows from noncapital financing activities:			
Income from nonutility operations		3,844	3,177
Interest and fees		710	1,011
Distribution to the City of Philadelphia		(18,000)	(18,000)
Net cash used in noncapital financing activities		(13,446)	(13,812)
Cash flows from investment activities			
Sinking fund reserve deposits		—	(16,644)
Sinking fund reserve withdrawals		4,133	33,042
Interest income from short-term investments		117	96
Interest income on sinking fund		655	511
Net cash provided by investment activities		4,905	17,005
Cash flows from capital and related financing activities:			
Issuance of commercial paper		41,000	30,000
Redemption, refunding, or defeasance of long-term debt		(373,632)	(319,687)
Proceeds from long-term debt issued		369,613	294,267
Long-term debt issuance costs		(16,274)	(2,467)
Purchases of capital assets		(97,888)	(82,606)
Principal paid on long-term debt		(38,215)	(50,975)
Interest paid on long-term debt		(39,652)	(46,067)
Drawdowns on restricted capital expenditures		—	10,000
Allowance for funds used during construction		1,120	781
Net cash used in capital and related financing activities		(153,928)	(166,754)
Net (decrease) increase in cash and cash equivalents		(22,584)	8,593
Cash and cash equivalents at beginning of year		114,327	105,734
Cash and cash equivalents at end of year	$	91,743	114,327
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	74,280	90,721
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization expense		45,448	43,787
Provision for uncollectible accounts		27,133	34,833
Change in assets and liabilities:			
Receivables, net		(13,849)	(20,229)
Gas inventories, materials, and supplies		3,017	19,081
Other current assets		(17,422)	5,626
Other assets		2,857	(119)
Accounts payable		(157)	(2,861)
Customer deposits		450	614
Other current liabilities		(299)	(5,230)
Accrued accounts		(3,634)	(4,595)
Other liabilities		22,061	10,526
Net cash provided by operating activities	$	139,885	172,154

See accompanying notes to 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 27, 2016, PGW filed a proposed Fiscal Year (FY) 2017 Operating Budget with the PGC. The PGC Hearing Examiners conducted Informal Discovery (ID) sessions in June and July 2016. On July 25, 2016, a public hearing was convened by the Hearing Examiners to address PGW's Operating Budget. On August 18, 2016, a recommended decision was rendered by the Hearing Examiners, which proposed adjustments to the Operating Budget as filed. On September 20, 2016, the PGC approved, with adjustments, PGW's FY 2017 Operating Budget. PGW filed a Compliance Budget with the PGC on October 4, 2016.

On May 22, 2015, PGW filed a proposed FY 2016 Operating Budget. After appropriate discovery and hearings, the PGC approved the FY 2016 Operating Budget 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.

(c) Capital Budget

On January 4, 2016, PGW filed with the PGC its proposed FY 2017 Capital Budget in the amount of $139.4 million. After a due diligence review and related ID process in January and February 2016, a public hearing was held on February 23, 2016. The PGC's review culminated in deliberations taken at a public meeting held on April 26, 2016 whereby the PGC endorsed a FY 2017 Capital Budget in an amount not to exceed $118.3 million. The endorsed budget was approved by City Council on June 16, 2016 and signed by the Mayor on June 28, 2016.

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.

(d) Base Rates

In FY 2015, the PUC approved the Company's Gas Cost Rate (GCR) settlement petition, which included a provision allowing for the continued recovery of PGW's Other Postemployment Benefits (OPEB) Rider. The recovery shall remain at $16.0 million annually. PGW continues to deposit this $16.0 million plus an additional $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 was decided by the PUC in November 2016 and was revised and approved.

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 was permitted to maintain virtually all of the extraordinary base rate relief, received an incremental rate increase of $16.0 million annually, and was 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 (WNA) Clause was approved by PUC Order dated August 8, 2002. The purpose of the WNA Clause 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 Clause results in neither a rate increase nor a rate decrease, but acts as a billing adjustment. The main benefits of the WNA Clause are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA Clause 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, 2016 was an increase in billings of $41.5 million. The WNA Clause resulted in a decrease in billings of $10.7 million for the year ended August 31, 2015.

(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 they are passed through to the customer without markup. At August 31, 2016, approximately $20.7 million was recorded in other current assets for the GCR and surcharges under recovery. At August 31, 2015, approximately $2.5 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, 2016	$	4.1577	(0.0449)
September 1, 2016		4.2026	0.9847
June 1, 2016		3.2179	(0.2767)
March 1, 2016		3.4946	(0.1988)
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	—

* 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 $3.8 million and $2.9 million was charged to expense as incurred in FY 2016 and FY 2015, 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 2016 and FY 2015 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 2016 were as follows:

Production plant	1.95%
Transmission, distribution, and storage	2.02
General plant	2.99

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 4.84% and 4.87% in FY 2016 and FY 2015, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2016 and 2015 (thousands of U.S. dollars):

	August 31, 2016			
	Beginning balance	Additions and transfers	Retirements and transfers	Ending balance
Land	$ 5,595	—	—	5,595
Distribution and collection systems	1,599,184	70,226	(5,903)	1,663,507
Buildings and equipment	488,333	21,197	—	509,530
Total utility plant, at historical cost	2,093,112	91,423	(5,903)	2,178,632
Under construction	64,254	100,698	(91,421)	73,531
Less accumulated depreciation for:				
Distribution and collection systems	(761,495)	(34,456) *	4,855	(791,096)
Buildings and equipment	(163,501)	(11,917) *	(839)	(176,257)
Utility plant, net	$ 1,232,370	145,748	(93,308)	1,284,810

* Cost of removal of approximately $3.8 million was charged to expense as incurred in FY 2016 and is not included in accumulated depreciation.

	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.

(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 2016, the Company billed

customers $22.6 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.

Revenues include 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 $3.4 million and $5.2 million for the years ended August 31, 2016 and 2015, 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 2016 and FY 2015, 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 $17.1 million and $16.5 million in FY 2016 and FY 2015, respectively, 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, 2016 and 2015, as follows (thousands of U.S. dollars):

		2016	2015
Gas inventory	$	38,556	40,791
Material and supplies		9,335	10,117
Total	$	47,891	50,908

(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), 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) Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the financial statement measurement date. The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels as follows:

- Level 1 – quoted prices for identical assets or liabilities in active markets that a government can access at the measurement date.
- Level 2 – quoted prices other than those included within Level 1 and other inputs that are observable for an asset or liability, either directly or indirectly.

- Level 3 – pricing inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity or involvement.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3. When the fair value of an asset or a liability is measured using inputs from more than one level of the fair value hierarchy, the measurement is considered to be based on the lowest priority level that is significant to the entire measurement.

The categorization of a financial instrument within the hierarchy is based upon pricing transparency and is not necessarily an indication of the Company's perceived risk of that instrument.

The following is a description of the valuation methodologies used for investments measured at fair value:

- U.S. government obligations – The fair value of government obligations are based on institutional bond quotes and evaluations based on various market and industry inputs.
- U.S. government agencies and instrumentalities – The fair value of government agencies and instrumentalities are based on institutional bond quotes and evaluations based on various market and industry inputs.
- Corporate obligations – The fair value of corporate bonds are based on institutional bond quotes and evaluations based on various market and industry inputs.
- Foreign issues – The fair value of corporate bonds are based on institutional bond quotes and evaluations based on various market and industry inputs.

(p) 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 and Workers' Compensation Escrow Fund, and Health Insurance Escrow Fund as described in note 3.

(q) 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.

(r) 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.

(s) 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.

(t) Pollution Remediation

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 Pennsylvania Act 2, *Land Recycling and Environmental Remediation Standards Act of 1995* 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.

(u) Reclassifications

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

(v) New Accounting Pronouncements

The Company adopted GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72). GASB 72 addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. GASB 72 has been applied retrospectively to the investment disclosures in notes 3 and 10 and did not impact valuation of investments, net position, or changes in net position.

(w) Accounting Standards with Future Effective Dates

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. The Company is currently evaluating the impact of GASB 75 on its financial statements.

(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 2016 and FY 2015, 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 2016 and FY 2015, 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 $5.4 million and $7.7 million in FY 2016 and FY 2015, respectively, relating to sales to the City. There were no net amounts receivable from the City at August 31, 2016 and 2015. Water and sewer services and licenses are purchased from the City. Such purchases totaled $1.4 million and $1.2 million in FY 2016 and FY 2015, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $0.8 million and $0.9 million in FY 2016 and FY 2015, 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, 2016 and 2015 were $91.4 million and $114.0 million, respectively. Book balances of such deposits and accounts at August 31, 2016 and 2015 were $91.7 million and $114.3 million, respectively. Federal depository insurance on these balances at August 31, 2016 and 2015 was $0.8 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 2016 and FY 2015 was $136.6 million and $161.5 million, respectively. Short-term investments with a carrying amount (at fair value) of $84.4 million and $112.2 million at August 31, 2016 and 2015, 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 less than $0.1 million in FY 2016 and a loss of $0.2 million in FY 2015.

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, 2016 and 2015, 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 historically required the Company to establish and maintain a restricted escrow account.

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

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, 2016			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government obligations:				
U.S. Treasury notes	$ 10,618	4.3267	AAA/NA	Moody's/S&P
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	4,013	0.5208	AAA/AA+	Moody's/S&P
Federal Home Loan Mortgage Corporation medium term notes	25,382	11.1469	AAA/AA+	Moody's/S&P
Federal Home Loan Bank bonds	10,003	1.4988	AAA/AA+	Moody's/S&P
Federal Farm Credit Bank bonds	8,724	1.1200	AAA/AA+	Moody's/S&P
Tennessee Valley Authority	2,471	6.0698	AAA/AA+	Moody's/S&P
Total U.S. government agencies and instrumentalities	50,593			
Total fair value of U.S. government securities	61,211			
Corporate obligations:				
Chevron Corporation	2,408	1.5968	AA+/A1	Moody's/S&P
Total corporate obligations	2,408			
Foreign issues:				
Australia & New Zealand Banking Group, Ltd., New York	2,266	2.0460	A+/AA2	Moody's/S&P
Westpac Banking Corporation	2,007	2.1244	AA-/AA2	Moody's/S&P
Total foreign issues	4,273			

	August 31, 2016			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Cash and cash equivalents:				
Bank of Montreal commercial paper	$ 1,988	—	*	*
Bank of Tokyo Mitsubishi commercial paper	1,994	—	*	*
BNP Paribas Finance Inc. commercial paper	1,992	—	*	*
Canadian Imperial Hids commercial paper	1,989	—	*	*
Cooperatieve Centrale commercial paper	1,990	—	*	*
Credit Agricole Crpin commercial paper	1,990	—	*	*
ING US Funding LLC commercial paper	1,990	—	*	*
JP Morgan Securities commercial paper	1,994	—	*	*
Toyota Motor Credit Company commercial paper	1,995	—	*	*
Money market:				
First American Government Obligations Fund Class Z	626	—	*	*
Total cash and cash equivalents	18,548	—		
Other	212	—	*	*
Total fair value of investments, including cash deposits	$ 86,652			
Portfolio weighted modified duration				

* The credit of this investment is unrated.

Investment type	Fair value	Weighted average maturity (years)	Credit rating	Rating agency
	August 31, 2015			
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 U.S. government securities	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			

	August 31, 2015			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Cash and cash equivalents:				
BNP Paribas Finance Inc. commercial paper	$ 2,000	—	*	*
Toyota Motor Credit Corporation commercial paper	1,997	—	*	*
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.

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

	August 31, 2016			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
Fidelity Governmental Fund	$ 2,603	—	*	*
Total fair value of investments, including cash deposits	$ 2,603			

* The credit of this investment is unrated.

	August 31, 2015			
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.

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

	August 31, 2016			
Investment type	**Total Fair value**	**Level 1**	**Level 2**	**Level 3**
U.S. government obligations:				
U.S. Treasury notes	$ 10,618	10,618	—	—
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	4,013	—	4,013	—
Federal Home Loan Mortgage Corporation medium term notes	25,382	—	25,382	—
Federal Home Loan Bank bonds	10,003	—	10,003	—
Federal Farm Credit Bank bonds	8,724	—	8,724	—
Tennessee Valley Authority	2,471	—	2,471	—
Total U.S. government agencies and instrumentalities	50,593	—	50,593	—
Total fair value of U.S. government securities	61,211	10,618	50,593	—
Corporate obligations:				
Chevron Corporation	2,408	—	2,408	—
Total corporate obligations	2,408	—	2,408	—
Foreign issues:				
Australia & New Zealand Banking Group, Ltd., New York	2,266	—	2,266	—
Westpac Banking Corporation	2,007	—	2,007	—
Total foreign issues	4,273	—	4,273	—

(Continued)

Investment type		August 31, 2016			
		Total Fair value	Level 1	Level 2	Level 3
Cash and cash equivalents:					
Bank of Montreal commercial paper	$	1,988	—	1,988	—
Bank of Tokyo Mitsubishi commercial paper		1,994	—	1,994	—
BNP Paribas Finance Inc. commercial paper		1,992	—	1,992	—
Canadian Imperial Hids commercial paper		1,989	—	1,989	—
Cooperatieve Centrale commercial paper		1,990	—	1,990	—
Credit Agricole Crpin commercial paper		1,990	—	1,990	—
ING US Funding LLC commercial paper		1,990	—	1,990	—
JP Morgan Securities commercial paper		1,994	—	1,994	—
Toyota Motor Credit Company commercial paper		1,995	—	1,995	—
Money market:					
First American Government Obligations Fund Class Z		626	626	—	—
Total cash and cash equivalents		18,548	626	17,922	—
Other		212	—	212	—
Total fair value of investments, including cash deposits	$	86,652	11,244	75,408	—

(Continued)

	August 31, 2015			
Investment type	**Total Fair value**	**Level 1**	**Level 2**	**Level 3**
U.S. government obligations:				
U.S. Treasury notes	$ 21,039	21,039	—	—
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	675	—	675	—
Federal Home Loan Mortgage Corporation medium term notes	13,168	—	13,168	—
Federal Home Loan Bank bonds	16,497	—	16,497	—
Federal Farm Credit Bank bonds	5,025	—	5,025	—
Total U.S. government agencies and instrumentalities	35,365	—	35,365	—
Total fair value of U.S. government securities	56,404	21,039	35,365	—
General Electric Capital Corporation	2,010	—	2,010	—
Total corporate obligations	2,010	—	2,010	—
Foreign issues:				
Bank of Nova Scotia	2,051	—	2,051	—
Westpac Banking Corporation	981	—	981	—
Total foreign issues	3,032	—	3,032	—

Investment type		Total Fair value	Level 1	Level 2	Level 3
		August 31, 2015			
Cash and cash equivalents:					
BNP Paribas Finance Inc. commercial paper	$	2,000	—	2,000	—
Toyota Motor Credit Corporation commercial paper		1,997	—	1,997	—
HSBC Americas Inc. commercial paper		1,994	—	1,994	—
JP Morgan Securities commercial paper		1,800	—	1,800	—
Money market:					
First American Government Obligations Fund Class Z		20,795	20,795	—	—
Total cash and cash equivalents		28,586	20,795	7,791	—
Other		109	—	109	—
Total fair value of investments, including cash deposits	$	90,141	41,834	48,307	—

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

Investment type		Total Fair value	Level 1	Level 2	Level 3
		August 31, 2016			
Money market:					
Fidelity Governmental Fund	$	2,603	2,603	—	—
Total fair value of investments, including cash deposits	$	2,603	2,603	—	—

	August 31, 2015			
Investment type	**Total Fair value**	**Level 1**	**Level 2**	**Level 3**
Money market:				
Fidelity Governmental Fund	$ 2,597	2,597	—	—
Total fair value of investments, including cash deposits	$ 2,597	2,597	—	—

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

	August 31, 2015			
Investment type	**Total Fair value**	**Level 1**	**Level 2**	**Level 3**
Money market:				
Fidelity Governmental Fund	$ 3,223	3,223	—	—
Total fair value of investments, including cash deposits	$ 3,223	3,223	—	—

(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 as follows:

(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 $15.0 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 and instrumentalities	100	33	N/A
Banker's acceptances and certificates of deposit	15	3	3
Commercial paper	25	3	3
Corporate bonds	25	3	3
Collateralized mortgage obligations and pass-through securities	5	3	3
Money market mutual funds	25	10	3
Repurchase agreements	25	10	N/A

More than 58.4% of the Company's investments as of August 31, 2016 are in the following: Federal Home Loan Mortgage Corporation medium term notes (33.9%), Federal Farm Credit Banks (10.1%), Federal Home Loan Bank bonds (11.5%), and Tennessee Valley Authority (2.9%). 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 sheets 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 $0.3 million as of August 31, 2016. The unamortized costs included in other assets and deferred debits were $0.4 million as of August 31, 2015. The unamortized costs included in other current assets and deferred debits were $0.1 million as of August 31, 2016 and August 31, 2015.

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 2016, settlements by the Company's insurance carriers provided less than $0.1 million associated with environmental remediation

costs. Environmental remediation costs of approximately $0.6 million in FY 2016 were offset by these insurance settlements, and the remainder was recorded on the balance sheets as a recoverable cost in other assets. The Company estimates additional expenditures to be approximately $32.7 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 2016 and FY 2015. PGW's contributions are accounted for as part of administrative and general expense.

(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 (Capital Project Commercial Paper). All notes are supported by two irrevocable letters of credit and a security interest in PGW's revenues. The letters of credit supporting PGW's combined commercial paper programs fixed the maximum level of outstanding notes plus interest at $120.0 million in FY 2016 and FY 2015. There was $71.0 million of tax-exempt capital project commercial paper outstanding at August 31, 2016. At the end of FY 2015, there was $30.0 million of tax-exempt capital project 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.

Capital Project Commercial Paper activity for the year ended August 31, 2016 was as follows (thousands of U.S. dollars):

		Year ended August 31, 2016			
		Beginning balance	Additions	Deletions	Ending balance
Commercial paper	$	30,000	41,000	—	71,000

		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, 2016, the Company's actual gas costs were below its billed gas costs by approximately $2.2 million. This amount was netted with other costs and recorded in other current assets for FY 2016. Actual gas costs were $8.4 million higher than billed gas costs in FY 2015.

Natural Gas Pipeline Supplier Refund

The Company received less than $0.1 million in refunds in FY 2016 and no refunds in FY 2015, 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, 2016 and 2015 (thousands of U.S. dollars):

		August 31, 2016			August 31, 2015		
		Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$	34,790	803,040	837,830	38,215	876,960	915,175
Unamortized discount		(24)	(86)	(110)	(63)	(723)	(786)
Unamortized premium		10,037	78,666	88,703	4,878	38,482	43,360
Total revenue bonds	$	44,803	881,620	926,423	43,030	914,719	957,749

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, 2016 and 2015 (thousands of U.S. dollars):

		Year ended August 31, 2016				
		Beginning balance	Additions	Reductions	Ending balance	Due within one year
Revenue bonds	$	915,175	312,425	(389,770)	837,830	34,790
Other liabilities:						
Claims and judgments		6,501	—	(1,315)	5,186	5,307
Environmental cleanup		32,474	—	(1,288)	31,186	1,501
Other postemployment benefits		90,014	—	(8,571)	81,443	—
Interest rate swap liability		39,410	—	(7,604)	31,806	—
Total other liabilities	$	168,399	—	(18,778)	149,621	6,808

(Continued)

	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

(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:				
2017	$ 34,790	27,849	4,061	66,700
2018	47,770	32,157	4,061	83,988
2019	47,645	30,003	4,062	81,710
2020	48,425	27,637	4,062	80,124
2021	49,140	25,287	4,062	78,489
2022–2026	253,080	92,901	18,150	364,131
2027–2031	176,480	54,853	2,740	234,073
2032–2036	124,990	24,651	—	149,641
2037–2040	55,510	5,542	—	61,052
Total	$ 837,830	320,880	41,198	1,199,908

Future debt service is calculated using rates in effect at August 31, 2016 for variable rate bonds, which ranged from 0.55% to 0.60%. The variable rate received under the swaps is 70.0% of one-month London Interbank Offered Rate (LIBOR) until maturity, which was 0.35% at August 31, 2016.

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

1998 Ordinance Fourteenth Series Bonds

On August 30, 2016, the City issued Gas Works Revenue Bonds, Fourteenth Series (1998 General Ordinance) in the amount of $312.4 million for the purpose of advanced refunding of select maturities of the Seventh Series Bonds (1998 General Ordinance), Ninth Series Bonds (1998 General Ordinance), and Eighth Series A Bonds (1998 General Ordinance), and to make termination payments with respect to a portion of the swap agreements associated with certain maturities of the Eighth Series B, C, D, and E Bonds. The Fourteenth Series Bonds, with fixed interest rates that range

from 2.0% to 5.0%, have maturity dates through 2038. The loss on this refunding was $33.5 million, which will be amortized over the life of the Fourteenth Series Bonds. This transaction provided net present value debt service savings of $38.2 million utilizing an arbitrage yield of 2.11%. The savings as a percentage of refunded bonds was 10.86%.

As of August 31, 2016, the Company's Eighth Series variable rate debt was backed by letter-of-credit agreements, which either extend to August 1, 2018 (Eighth Series C and D) or August 30, 2019 (Eighth Series B and 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 2016	Balance outstanding August 31 2015
5th Series A-2	Variable *	2035	$ 30,000	30,000
7th Series	4.00%–5.00%	2038	4,615	171,540
7th Series Refunding	5.00%	2029	11,455	24,610
8th Series A	4.00%–5.25%	2017	7,840	24,135
8th Series B	Variable **	2028	27,370	50,260
8th Series C	Variable **	2028	27,225	50,000
8th Series D	Variable **	2028	40,845	75,000
8th Series E	Variable **	2028	27,370	50,260
9th Series	2.00%–5.25%	2040	67,860	135,835
10th Series	3.00%–5.00%	2026	35,355	41,765
13th Series	3.00%–5.00%	2034	245,470	261,770
14th Series	2.00%–5.00%	2038	312,425	—
			$ 837,830	915,175

* As of August 31, 2016, the interest rate was 0.58%.

** As of August 31, 2016, the interest rate ranged from 0.55% to 0.60%.

(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 $2.3 million and $6.4 million in FY 2016 and FY 2015, 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 2016, the underlying variable rate bonds maturing in FY 2017 through FY 2023 were refunded with fixed rate bonds and the related portions of the swaps, totaling $102.7 million in notional amount, were terminated. PGW made a termination payment of $13.9 million to partially terminate the swaps.

As of August 31, 2016, the swaps had a notional amount of $122.8 million and the associated variable rate debt had a $122.8 million principal amount, broken down by series as follows:

- The Series B swap had a notional amount of $27.4 million and the associated variable rate bonds had a $27.4 million principal amount.
- The Series C swap had a notional amount of $27.2 million and the associated variable rate bonds had a $27.2 million principal amount.
- The Series D swap had a notional amount of $40.8 million and the associated variable rate bonds had a $40.8 million principal amount.
- The Series E swap had a notional amount of $27.4 million and the associated variable rate bonds had a $27.4 million principal amount.

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

Fair Value – As of August 31, 2016, the swaps had a combined negative fair value of approximately $31.8 million. The fair values of the interest rate swaps were estimated using the zero-coupon method and are classified as Level 2 within the fair value hierarchy as described in note 1. 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, 2016, 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, 2016 and 2015 is as follows (thousands of U.S. dollars):

		Interest rate swap liability	Deferred outflows of resources
Balance, August 31, 2015	$	39,410	20,948
Change in fair value through August 31, 2016		(7,604)	(7,604)
Amortization of terminated hedge		—	1,419
Balance, August 31, 2016	$	31,806	14,763

		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

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, 2016 was as follows (thousands of U.S. dollars):

	Latest date maturing to	Interest rate		Bonds outstanding
7th Series	10/01/37	5.00%	$	180,080
8th Series A	08/01/17	5.25		4,000
8th Series B	08/01/23	3.68		22,890
8th Series C	08/01/23	3.68		22,775
8th Series D	08/01/23	3.68		34,155
8th Series E	08/01/23	3.68		22,890
9th Series	08/01/35	5.25		64,765
12th Series B	05/15/20	7.00		20,435
17th Series	07/01/18	5.38		23,995
19th Series	10/01/23	5.00		14,450
Total			$	410,435

The assets pledged, primarily noncallable U.S. government securities, had a market value of $436.2 million at August 31, 2016, bearing interest on face value from 0.00% to 5.89%.

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	05/15/20	7.00%	$	24,735
17th Series	07/01/18	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%.

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) Defined Benefit 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.

(c) Employees Covered by Benefit Terms

At June 30, 2016, 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	$	2,521
Participants:		
Vested	$	1,036
Nonvested		215
Total participants		1,251
Total membership	$	3,772

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 ended June 30, 2016 and 2015, PGW's average contribution rate was 29.1% and 22.6% of annual payroll, respectively. Employee contributions were approximately $0.6 million in the plan year ended June 30, 2016 and approximately $0.4 million in the plan year ended June 30, 2015. The actuarially determined contributions for FY 2016 and FY 2015 were $26.5 million and $21.5 million, respectively. PGW contributed $26.5 million and $21.5 million in its FY 2016 and FY 2015, respectively.

(e) Net Pension Liability

The Company's net pension liability as of August 31, 2016 and 2015 was measured as of June 30, 2016 and 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016, June 30, 2015.

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

	2016	**2015**
Inflation	2.00%	2.00%
Salary increases	4.50	4.50
Investment rate of return	7.30	7.65

Mortality rates. Mortality rates for FY 2015 were based on the RP-2014 mortality tables for males and females generationally projected with scale MP-2014. Mortality rates for FY 2016 were based on the RP-2014 mortality tables for males and females generationally projected with scale MP-2015.

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 2016 are summarized in the following table:

Asset class	**Minimum**	**Maximum**	**Target**	**Expected annual return**
Domestic equity	35.0%	55.0%	45.0%	9.0%
International equity	10.0	30.0	20.0	9.1
Fixed income	25.0	45.0	35.0	5.6
Cash equivalents	—	10.0	—	—
			100.0%	

Discount rate. The discount rate used to measure the total pension liability at June 30, 2016 and 2015 was 7.30% and 7.65%, 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, 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

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, 2015	$	750,588	510,719	239,869
Changes for the year:				
Service cost		5,399	—	5,399
Interest		55,903	—	55,903
Differences between expected and actual experience		(8,840)	—	(8,840)
Contributions – employer		—	21,123	(21,123)
Contributions – employee		—	602	(602)
Net investment income		—	2,872	(2,872)
Benefit payments, including refunds of employee contributions		(50,447)	(50,447)	—
Administrative expenses		—	(1,611)	1,611
Change in assumptions		26,748		26,748
Net changes		28,763	(27,461)	56,224
Balances at August 31, 2016	$	779,351	483,258	296,093

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, 2016, calculated using the discount rate of 7.30%, as well as what the Company's net pension liability as of August 31, 2016 would be if it were calculated using a discount rate that is one-percentage-point lower (6.30%) or one-percentage point higher (8.30%) than the current rate:

		1% Decrease 6.30%	**Current discount rate 7.30%**	**1% Increase 8.30%**
			(thousands of U.S. dollars)	
Net pension liability	$	387,060	296,093	220,296

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 one-percentage-point lower (6.65%) or one-percentage point higher (8.65%) than the current rate:

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

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, 2016 and 2015, the Company recognized pension expense of $62.3 million and $43.7 million, respectively. At August 31, 2016 and 2015, 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, 2016		August 31, 2015	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Differences between expected and actual experience	$ 61,232	—	44,377	—
Changes of assumptions	—	—	33,572	—
Net difference between projected and actual earnings on pension plan investments	21,278	—	—	(11,653)
Contributions made after measurement date	5,533	—	179	—
Total	$ 88,043	—	78,128	(11,653)

The $5.5 million reported as deferred outflows of resources related to employer contributions made after the measurement date as of June 30, 2016 will be recognized as a reduction of the net pension liability in FY 2017. 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:			
2017	$	36,730	—
2018		24,617	—
2019		14,155	—
2020		7,007	—
Total	$	82,509	—

(g) Fair Value Measurements

The following table sets forth by level, within the fair value hierarchy described in note 1, the Plan's assets at fair value as of June 30, 2016 (thousands of U.S. dollars):

		Level 1	Level 2	Level 3	Total
Corporate bonds	$	—	46,427	—	46,427
Common and preferred stock		298,387	17,274	1	315,662
U.S. government securities		35,964	19,659	—	55,623
Financial agreements		—	—	35	35
Collateralized mortgage obligations		—	42,851	—	42,851
Foreign entity's debt		—	5,595	221	5,816
Municipal obligations		—	4,038		4,038
	$	334,351	135,844	257	470,452

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2015 (thousands of U.S. dollars):

		Level 1	Level 2	Level 3	Total
Corporate bonds	$	—	43,599	—	43,599
Common and preferred stock		333,725	16,480	3	350,208
U.S. government securities		46,576	10,285	—	56,861
Financial agreements		—	—	64	64
Collateralized mortgage obligations		—	38,018	—	38,018
Foreign entity's debt		—	4,359	200	4,559
Municipal obligations		—	6,593		6,593
	$	380,301	119,334	267	499,902

(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 2,190 and 2,201 participating retirees and their beneficiaries and dependents in FY 2016 and FY 2015, respectively, in accordance with their retiree medical program. The annual covered payroll (which was substantially equal to total payroll) was $113.0 million and $114.1 million at August 31, 2016 and 2015, 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 $28.5 million and $30.3 million in FY 2016 and FY 2015, respectively. In addition, the Company expensed $18.5 million of funding for the OPEB Trust and retirees contributed $0.3 million toward their healthcare in both FY 2016 and FY 2015. 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 in both FY 2016 and FY 2015, which included $2.0 million and $1.9 million for retirees in FY 2016 and FY 2015, respectively. Retirees contributed $0.2 million toward their life insurance in both FY 2016 and FY 2015.

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

The amount paid by the Company for retiree benefits in FY 2016 was $49.6 million, consisting of $29.3 million of healthcare expenses, $1.8 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 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 difference between the AOC and the Company's contributions resulted in a decrease in the OPEB obligation of $8.6 million and $11.8 million in FY 2016 and FY 2015, respectively, which was recorded to other noncurrent liabilities and expensed.

(i) Funded Status

The actuarial accrued liability for benefits at August 31, 2016 and 2015 was $489.7 million and $505.4 million, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 316.8% as of August 31, 2016 and 351.6% as of August 31, 2015.

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).

(ii) 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	Market 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

(iii) Healthcare cost trend rates are as follows

	Healthcare cost trend rates			
Year	**Medical (pre-65)**	**Medical (post-65)**	**Prescription**	**Dental**
2016	7.0 %	5.0 %	9.5 %	4.0 %
2017	6.5	4.5	8.5	4.0
2018	6.0	4.5	7.5	4.0
2019	5.5	4.5	6.5	4.0
2020	5.0	4.5	5.5	4.0
2021 and following	4.5	4.5	4.5	4.0

The following table shows the components of the Company's AOC for FY 2016 and FY 2015, the amount actually contributed to the plan, and the Company's net OPEB obligation (thousands of U.S. dollars):

	2016	**2015**
Annual required contribution	$ 41,782	37,980
Interest on net OPEB obligation	7,156	8,092
Adjustment to the annual required contribution	(7,958)	(8,999)
Annual OPEB cost	40,980	37,073
Contributions made	(49,551)	(48,847)
Net OPEB obligation as of prior year	90,014	101,788
Net OPEB obligation as of August 31	$ 81,443	90,014

(Continued)

The AOC is recorded in the statements of revenues and expenses and changes in net position. For the year ended August 31, 2016, approximately $9.9 million was recorded to other postemployment benefits expense and $31.1 million was allocated to administrative and general expense. 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.

The Company's AOC, the percentage of AOC contributed to the plan, and the net OPEB obligation for FY 2016 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:			
2016	$ 40,980	120.9%	81,443
2015	37,073	131.8	90,014
2014	37,090	119.6	101,788

(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, 2016, the Company has in place $208.7 million of group life insurance coverage for both active and retired employees, which is retrospectively rated on a monthly basis.

(12) Defined Contribution Pension Plan

PGW contributes to a defined-contribution pension plan, for all employees hired after May 21, 2011 (Union) or December 8, 2011 (Nonunion) who elect not to contribute to the defined-benefit plan. The Defined Contribution Plan is administered by the PGW Investment Committee. Benefit terms, including contribution requirements, for the Defined Contribution Plan are established and may be amended by Ordinance of the City. For each employee in the Defined Contribution Plan, the Company is required to contribute annually 5.5% percent of applicable wages to an individual employee account. Employees are not required to make contributions to the plan. For the years ended August 31, 2016 and 2015, the Company recognized pension expense of $1.0 million and $0.7 million, respectively, for the Defined Contribution Plan.

Participants are immediately vested in Company contributions and earnings on Company contributions.

The Company had no accrued liabilities for contributions payable to the Defined Contribution Plan at August 31, 2016 and 2015.

(13) Pollution Remediation Obligation

The Company recorded an additional liability for pollution remediation obligations of $1.3 million and $1.0 million for FY 2016 and FY 2015, respectively. The pollution remediation liability is reflected in other noncurrent and 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, 2016 and 2015 were $32.7 million and $34.4 million, respectively, which reflect the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

(14) 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, 2016 and has appropriately accrued for these claims on the balance sheet.

(Continued)

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:						
2016	$	11,512	2,022	(3,041)	10,493	5,307
2015		9,944	3,610	(2,042)	11,512	5,011
2014		10,411	2,498	(2,965)	9,944	4,728

(15) Commitments and Contingencies

Commitments

Commitments for major construction and maintenance contracts were approximately $40.3 million and $25.3 million, as of August 31, 2016 and 2015, respectively.

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

2017	$	810
2018		373
2019		93

Rent expense for the fiscal years ended August 31, 2016 and 2015 amounted to $1.9 million and $1.5 million, respectively.

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 $4.5 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, 2016 through March 31, 2017.

The Company's amended FY 2017 Capital Budget was approved by City Council in the amount of $118.3 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 2017 is expected to be $24.4 million. The total six-year cost of the CIMR Program is forecasted to be $154.9 million. In addition to this program, the FY 2017 Capital Budget includes funding for an incremental CIMR Program for which PGW will request recovery through a DSIC. This incremental program in FY 2017 is expected to cost $33.5 million. The total six-year cost of this incremental program is forecasted to be $212.1 million. The FY 2017 Capital Budget

also includes $2.4 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 $15.2 million.

Contingencies

The Company's material legal proceeding is described below. The Company believes that it has valid defenses to these legal proceedings and intends to defend them vigorously. PGW records reserves for estimated losses from contingencies when information available indicates that a loss is probable and the amount of the loss, or range of loss, can be reasonably estimated. Management has assessed the following matter based on current information and made a judgment concerning its potential outcome, considering the nature of the claim, the amount and nature of damages sought, and the probability of success. The Company is unable to predict the outcome of this legal proceedings nor reasonably estimate the scope or amount of any associated costs and potential liabilities.

Augustin, et al. v. City of Philadelphia - This is a federal action brought against the City (PGW) on behalf of plaintiffs and similarly situated property owners, whose property the City (PGW) filed liens for unpaid gas charges incurred by another party (i.e., a tenant). The plaintiffs represent a class of non-owner-occupied residential and commercial property owners, seeking to enjoin the City (PGW) from imposing or enforcing gas liens on their properties for unpaid charges incurred by their tenants or others living in or utilizing the properties. Plaintiffs allege that the City (PGW) imposes such liens on their properties without meaningful and timely notice to them or opportunity to be heard beforehand, in alleged violation of their federal due process rights.

In February 2016, the Court denied the City’s summary judgment motion, identifying certain purported issues of material fact. In March 2016, the Court granted the plaintiffs’ summary judgment motion, finding that the process employed by the City to impose liens on non-owner occupied properties violates owners’ due process rights. In May 2016, following a hearing, the Court entered a preliminary injunction against the City and PGW restraining them, pending further order of the Court, from filing any new liens against such properties and from collecting upon existing liens. However, the Court permitted the City and PGW to continue to issue payoff statements to facilitate real estate transactions on such properties, and to accept the payoffs, but directed it to segregate such money. A hearing on permanent injunction and relief, and other outstanding issues was held July 26, 2016. On December 1, 2016, the Court issued an Order and Opinion certifying the class. An order addressing the request for a permanent injunction and relief has not yet issued. Upon receipt of a final order in this matter, the City will evaluate its legal options, including, if necessary, pursuing an appeal.

In addition to the legal proceeding noted above, PGW is party to other litigation or legal proceedings arising in the ordinary course of business. In management's opinion, the disposition of these ordinary course matters will not materially adversely affect PGW’s financial statements.

(16) Subsequent Events

The Company has evaluated events and transactions that occurred between the balance sheet date and December 28, 2016, which is the date the financial statements were available to be issued, and determined that there are no other items to disclose.

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	
		2016	**2015**
Total pension liability:			
Service cost	$	5,399	4,890
Interest cost		55,903	52,377
Changes in benefit terms		—	—
Differences between expected and actual experience		(8,840)	17,961
Changes in assumptions		26,748	44,876
Benefit payments		(50,447)	(46,917)
Net change in total pension liability		28,763	73,187
Total pension liability (beginning)		750,588	677,401
Total pension liability (ending)		779,351	750,588
Plan fiduciary net position:			
Contributions – employer		21,123	21,106
Contributions – employee		602	393
Net investment income		2,872	24,472
Benefit payments		(50,447)	(46,917)
Administrative expense		(1,611)	(1,480)
Net change in fiduciary net position		(27,461)	(2,426)
Plan fiduciary net position (beginning)		510,719	513,145
Plan fiduciary net position (ending)		483,258	510,719
Net pension liability (ending)	$	296,093	239,869
Net position as a percentage of pension liability		62.01%	68.04%
Covered employee payroll	$	90,860	95,187
Net pension liability as a percentage of payroll		325.88%	252.00%

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 2016, 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-2015 to better reflect the actual and future mortality experience and (ii) changing the discount rate from 7.65% to 7.30%.

See paragraph on Required Supplementary Information included in independent auditor’s 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		2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Actuarially determined contribution	$	26,476	21,526	24,385	23,673	23,802	22,936	23,099	15,437	15,453	15,608
Contributions made		26,476	21,526	24,385	23,673	23,802	22,936	23,099	15,437	15,453	15,608
Contribution deficiency/(excess)	$	—	—	—	—	—	—	—	—	—	—
Covered employee payroll	$	90,860	95,187	103,530	105,985	106,308	106,308	106,125	108,474	107,918	102,958
Contributions as a percent of covered employee payroll		29.14%	22.61%	23.55%	22.34%	22.39%	21.58%	21.77%	14.23%	14.32%	15.16%

Notes to schedule:
Methods and assumptions used to determine contribution rates:
Actuarial Valuation Date: July 1 for 2016 and 2015 and September 1 for prior periods
Actuarial Cost Method: Projected Unit Credit
Asset Valuation Method: Assets smoothed over a five-year period beginning in 2015 and Market Value in 2014
Amortization Method: Contributions based on greater of 20-year level dollar open amortization method or 30-year level dollar closed amortization method
Salary Increases: 4.50%
General Inflation: 2.00%
Investment Rate of Return: 7.30% in 2016, 7.65% in 2015, and 7.95% in 2014 and prior
Cost of Living: N/A
Mortality Rates: RP-2014 static Mortality generationally projected with Scale MP-2015 in 2016

See paragraph on Required Supplementary Information included in independent auditor's 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, 2016	$	131,868	489,725	357,857	26.9%	112,956	316.8%
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

See paragraph on Required Supplementary Information included in independent auditor’s report.