PHILADELPHIA GAS WORKS

(A Component Unit of the City of Philadelphia)

Basic Financial Statements and Supplementary Information

August 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

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

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KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

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

We have audited the accompanying balance sheets of Philadelphia Gas Works (the Company), a component unit of the City of Philadelphia, as of August 31, 2011 and 2010, and the related statements of revenues and expenses, cash flows, and changes in fund equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Philadelphia Gas Works as of August 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The required supplementary information of management's discussion and analysis on pages 2 to 11 and the schedules of pension funding progress and other postemployment benefits funding progress on pages 61 and 62 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. This supplementary information is the responsibility of the Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and express no opinion on it.

KPMG LLP

December 22, 2011

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2011 and 2010 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) 2011 reflected an 8.8% warmer than normal winter. The FY 2011 period was 7.4% colder than the prior year and firm gas sales increased by 3.2 billion cubic feet (Bcf). In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2010 through May 2011, resulted in heating customers receiving charges totaling $1.8 million as a result of the temperatures experienced during the period. The FY 2010 reflected a 15.5% warmer than normal winter. The FY 2010 period was 10.8% warmer than the prior year and firm gas sales decreased by 3.2 Bcf. In addition, the WNA, which was in effect from October 2009 through May 2010, resulted in heating customers receiving charges totaling $13.4 million as a result of the temperatures experienced during the period.
- PGW achieved a collection rate of 95.1% in the current period, 98.7% in FY 2010, and 93.8% in FY 2009. The collection rate is calculated by dividing the total gas receipts collected in FY 2011 by the total gas billings that were applied to PGW customers' accounts from September 1 through August 31. The same methodology was utilized in FY 2010 and FY 2009.
- On July 29, 2010, the Pennsylvania Public Utility Commission (PUC) approved the settlement of the base rate filing filed by the Company in December 2009, under which PGW will be permitted to maintain virtually all of the $60.0 million extraordinary rate increase granted by the PUC in 2008 that was effective as of January 1, 2009, as well as receiving an incremental rate increase of $16.0 million annually to fund Other Postemployment Benefits (OPEB). PGW is required under the settlement to fund annually, $15.0 million of its Unfunded Actuarial Accrued Liability (UAAL) in each of the fiscal years 2011 through 2015. Additionally, PGW must fund $3.5 million a year, which represents a 30-year amortization of the Net OPEB obligation of $109.5 million as of August 31, 2011. The Company established an OPEB Trust in July 2010 and began funding the trust in September 2010. The settlement also permitted the implementation of the Demand Side Management Program, which is an energy efficiency and conservation plan.
- In addition to the rate increases noted above, various business initiatives were implemented to improve collections, productivity, and operational efficiencies throughout the Company, and achieved positive results. PGW, at the end of FY 2011 and FY 2010, had no tax exempt commercial paper outstanding and a cash balance of $105.4 million and $79.1 million, respectively. This reflects an overall improvement of $26.3 million in PGW's liquidity.
- On August 26, 2010, the City of Philadelphia (the City) issued Gas Works Revenue Bonds, Ninth Series in the amount of $150.0 million for the purpose of financing capital projects, and paying the costs of issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Ninth Series Bonds consist of $53.0 million of serial bonds with interest rates that range from 2.0% to 5.0% and have maturity dates through 2025. The bonds also included $97.0 million of term bonds with interest rates of 5.0% and 5.25% and have maturities through 2040.

- The Company's only derivative instruments within the scope of Governmental Accounting Standards Board (GASB), Statement 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53), are four interest rate swaps entered into to hedge the interest payments on its variable rate debt. These swaps originate from an interest rate swap used as a hedge of the Sixth Series Bonds. Because the hedges were effective at August 31 2011, the change in fair value of the swaps of $0.5 million for FY 2011 has been recorded as a decrease in the interest rate swap liability and the related deferred outflow of resources. The balance of the interest rate swap liability at August 31, 2011 is $51.7 million, and the related deferred outflow of resources balance is $25.4 million. The difference between the balances is due to the impact of refunding the Sixth Series Bonds, which the original swap previously hedged, during FY 2009, and establishing a hedging relationship between the portion of the original swap remaining after the refunding (divided into four swaps) and the refunding Eighth Series Bonds. Because the hedges were determined effective for both periods presented, there was no impact on the Statements of Revenues and Expenses for either year other than swap settlement payments.

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 are comprised of:

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 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 four statements presented are:

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

The balance sheet includes all of PGW's assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in fund equity are indicators of whether PGW's financial position is improving or deteriorating.

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

The statement of changes in fund equity provides a rollforward of the fund equity balance of PGW based upon the results from the statement of revenues and expenses.

Condensed Statements of Revenues and Expenses

(Thousands of dollars)

		Years ended August 31		
		2011	2010	2009
Total gas revenues	$	749,268	742,342	910,457
Other revenues		17,011	16,890	18,984
Total operating revenues		766,279	759,232	929,441
Total operating expenses		641,640	662,594	845,558
Operating income		124,639	96,638	83,883
Interest and other income		4,348	5,301	12,240
Total interest expense		(75,682)	(71,123)	(78,912)
Excess of revenues over expenses	$	53,305	30,816	17,211

Operating Revenues

Operating revenues in FY 2011 were $766.3 million, an increase of $7.0 million or 0.9% from the FY 2010 level. The increase in FY 2011 was due to increased heating demand and higher natural gas sales. Operating revenues in FY 2010 were $759.2 million, a decrease of $170.2 million or 18.3% from the FY 2009 level. The decrease in FY 2010 was due to significantly lower natural gas costs. Please see the discussion of the cost of fuel in the Operating Expenses section below.

Total sales volumes, including gas transportation deliveries, in FY 2011 increased by 5.2 Bcf to 74.5 Bcf or 7.5% from FY 2010 sales volumes of 69.3 Bcf. In FY 2010, total sales volumes, including gas transportation deliveries, decreased by 2.5 Bcf to 69.3 Bcf or 3.5% from FY 2009 sales volumes of 71.8 Bcf. In FY 2011, firm gas sales of 48.0 Bcf were 3.2 Bcf or 7.2% higher than FY 2010 firm gas sales of 44.8 Bcf, which were 3.2 Bcf, or 6.7% lower than FY 2009. Interruptible customer sales decreased by less than 0.1 Bcf compared to FY 2010 which decreased by 0.1 Bcf compared to FY 2009. Gas transportation sales in FY 2011 increased by 2.2 Bcf to 25.3 Bcf from the 23.1 Bcf level experienced in FY 2010. In FY 2010, the volume increased by 0.5 Bcf to 23.1 Bcf from the 22.6 Bcf level experienced in FY 2009.

In FY 2011, customers served by PGW increased by 0.2% from the previous year to approximately 503,000 customers. The number of customers served by PGW at the end of FY 2010 and FY 2009 were approximately 502,000 and 504,000, respectively. Commercial accounts were approximately 25,000 customers, reflecting no change from the previous two fiscal years. Industrial accounts decreased by 12.5% from the previous year to 700 customers, a decrease of 100 customers from the prior two fiscal year's level of 800 customers. Residential accounts increased to 477,000 customers, an increase of 1,000 customers from the prior year. The number of residential accounts in FY 2010 decreased to approximately 476,000 customers, a decrease of 2,000 customers from the FY 2009 level.

Operating Expenses

Total operating expenses, including fuel costs, in FY 2011 were $641.6 million, a decrease of $21.0 million or 3.2% from FY 2010. The decrease for FY 2011 reflects lower natural gas prices. Total operating expenses, including fuel costs, in FY 2010 were $662.6 million, a decrease of $183.0 million or 21.6% from FY 2009. The decrease for FY 2010 reflects substantially lower natural gas prices and a decrease in natural gas volumes.

Cost of Fuel – The cost of natural gas utilized decreased by $23.1 million or 6.5% to $330.9 million in FY 2011 compared with $354.0 million in FY 2010. The average commodity price per Thousand cubic feet (Mcf) decreased by $0.75 or $41.1 million, while the volume of gas utilized increased by 3.2 Bcf, 6.2% or $17.5 million. In addition, pipeline supplier refunds in FY 2011 decreased by $0.1 million while demand charges increased by $0.4 million, compared to FY 2010.

The cost of natural gas utilized decreased by $191.9 million or 35.1% to $354.0 million in FY 2010 compared with $545.9 million in FY 2009. The average commodity price per Mcf decreased by $3.09 or $160.3 million, while the volume of gas utilized decreased by 3.7 Bcf, 6.6% or $31.2 million. In addition, pipeline supplier refunds in FY 2010 increased by $0.1 million while demand charges decreased by $0.3 million, compared to FY 2009.

Variations in the cost of purchased gas are passed through to customers under the gas cost rate (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 and deferred debits or other current liabilities and deferred credits, 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 2011, FY 2010, and FY 2009 were $4.71, $5.45, and $8.55 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2011 were $78.0 million, an increase from the FY 2010 total of $72.4 million as a result of higher costs associated with maintenance of mains and gas operations. The FY 2010 total of $72.4 million was $3.2 million lower than the FY 2009 total of $75.6 million.

Additionally, expenses related to customer services, collection and account management, marketing, and the administrative area increased by $1.7 million or 1.6% in FY 2011 primarily due to costs related to the higher cost of healthcare and other administrative costs. This category increased by $7.4 million or 7.7% in FY 2010 primarily due to costs related to the higher cost of healthcare.

Pension costs decreased due to a larger offset from the Sinking Fund. Pension costs decreased by $2.0 million to $22.6 million in FY 2011 as compared to FY 2010. Pension costs increased by $9.2 million to $24.6 million in FY 2010 as compared to FY 2009.

OPEB costs decreased by $4.8 million to $22.5 million in FY 2011 as compared to FY 2010, and increased by $1.3 million in FY 2010 as compared to FY 2009. OPEB costs decreased due to funding of the OPEB Trust.

The net OPEB obligation was $109.4 million for the fiscal year ended August 31, 2011. The net OPEB obligation was $105.5 million for the fiscal year ended August 31, 2010.

Provision for Uncollectible Accounts – The provision for uncollectible accounts in FY 2011 totaled $36.0 million, an increase of $1.0 million or 2.9% higher than FY 2010. The provision for uncollectible accounts in FY 2010 totaled $35.0 million, a decrease of $7.0 million or 16.7% lower than FY 2009. The accumulated provision for uncollectible accounts at August 31, 2011 reflects a balance of $99.9 million, compared to the $103.6 million balance in FY 2010 and $123.0 million in FY 2009. 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.

Depreciation Expense – Depreciation expense increased by $0.4 million in FY 2011 compared with FY 2010. Depreciation expense increased by $0.7 million in FY 2010 compared with FY 2009. The effective composite depreciation rates for FY 2011, FY 2010, and FY 2009 were 2.5%, 2.3%, and 2.3%, respectively. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income in FY 2011 was $1.0 million lower than FY 2010. Interest and other income in FY 2010 was $6.9 million lower than FY 2009. The year-to-year decrease is the result of a continual decline in interest rates coupled with lower restricted fund balances for most of the fiscal year.

Interest Expense – Total interest expense increased by $4.6 million or 6.4% in FY 2011 compared with FY 2010 and decreased by $7.8 million or 9.9% in FY 2010 compared with FY 2009. Interest on long-term debt was $4.7 million higher in FY 2011 as a result of the full year effect of the issuance of the Ninth Series Bonds in August 2010. Interest on long-term debt was $11.1 million lower in FY 2010 due to both the reduction in long-term debt for the majority of the fiscal year and declining interest costs associated with PGW's variable rate demand notes. Other interest costs decreased by $0.1 million or 0.5% due to a decrease in the cost associated with the letters of credit that support PGW's variable rate demand notes. Other interest costs increased by $3.4 million or 22.0% in FY 2010 due to a $7.0 million increase in the cost associated with the letters of credit that support PGW's variable rate demand notes and commercial paper program in FY 2010. This increase was partially offset by a $3.6 million decrease in interest expense associated with both PGW's variable rate demand notes and commercial paper program.

Excess of Revenues over Expenses – In FY 2011, the Company's excess of revenues over expenses was $53.3 million, an increase of $22.5 million from FY 2010. The Company had an excess of revenues over expenses of $30.8 million in FY 2010, an increase of $13.6 million from FY 2009.

Condensed Balance Sheets

(Thousands of dollars)

		Years ended August 31		
Assets		**2011**	**2010**	**2009**
Utility plant, net	$	1,111,078	1,094,009	1,076,467
Restricted investment funds		236,966	284,813	175,534
Current assets:				
Accounts receivable (net of accumulated provision for uncollectible accounts of $99,932, $103,600, and $123,009 for 2011, 2010, and 2009, respectively)		98,925	92,173	105,496
Other current assets and deferred debits, cash and cash equivalents, gas inventories, materials, and supplies		226,902	209,397	143,668
Total current assets		325,827	301,570	249,164
Other assets and deferred debits		142,624	146,770	130,926
Total assets	$	1,816,495	1,827,162	1,632,091
Fund Equity and Liabilities				
Fund equity	$	309,740	274,435	243,619
Total long-term debt		1,166,992	1,224,987	1,114,488
Current liabilities:				
Current portion of long-term debt		50,549	42,537	48,175
Other current liabilities and deferred credits		91,336	95,229	85,580
Total current liabilities		141,885	137,766	133,755
Other liabilities and deferred credits		197,878	189,974	140,229
Total fund equity and liabilities	$	1,816,495	1,827,162	1,632,091

(Continued)

Assets

Utility Plant – Utility plant, net of depreciation, totaled $1,111.1 million in FY 2011, an increase of $17.1 million or 1.6% compared with the FY 2010 balance of $1,094.0 million. The FY 2010 balance increased by $17.5 million or 1.6% compared with the FY 2009 balance of $1,076.5 million. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $58.8 million in FY 2011 compared to $59.1 million in FY 2010 and $52.2 million in FY 2009. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amounts of $48.1 million, $41.0 million, and $48.5 million in FY 2011, FY 2010, and FY 2009, respectively. The major capital expenditures are associated with PGW's gas supply infrastructure, namely, gas mains, and customer service lines.

Restricted Investment Funds – Restricted investment funds decreased by $47.8 million in FY 2011 primarily due to proceeds being drawn from the Capital Improvement Fund to fund capital expenditures. Interest income on these funds, to the extent not drawn, is reflected as an increase of $1.2 million in FY 2011, $1.7 million in FY 2010, and $4.8 million in FY 2009. A drawdown from the accrued interest in the Capital Improvement Fund in the amount of $5.0 million was utilized for working capital purposes in FY 2009. There was no drawdown of interest from the Capital Improvement Fund in FY 2010. A drawdown from the accrued interest in the Capital Improvement Fund in the amount of $9.4 million was utilized for working capital purposes in FY 2011.

Accounts Receivable – In FY 2011, accounts receivable (net) of $98.9 million increased by $6.7 million, or 7.3%, from FY 2010 due to higher gas billings during FY 2011. In FY 2010, accounts receivable (net) of $92.2 million decreased by $13.3 million, or 12.6%, from FY 2009 due to lower gas billings during FY 2010 and an increase in the collection rate experienced during FY 2010 as compared to FY 2009. The accumulated provision for uncollectible accounts, totaling $99.9 million decreased by $3.7 million in FY 2011 and totaled $103.6 million in FY 2010 and $123.0 million in FY 2009.

Other Current Assets and Deferred Debits, Cash and Cash Equivalents, Gas Inventories, Materials, and Supplies – In FY 2011, cash and cash equivalents were $105.4 million, an increase of $26.3 million from $79.1 million in FY 2010, and totaled $13.8 million in FY 2009. In FY 2011, gas storage decreased by $17.5 million or 18.2% compared to FY 2010. The decrease in gas inventory reflects a decrease in the gas cost per Mcf. In FY 2010, gas storage decreased by $21.8 million or 18.5% compared to FY 2009. The decrease in gas inventory reflects a decrease in the gas cost per Mcf plus a decrease in the amount of storage at year-end. Materials and supplies of $86.0 million, which principally include gas inventory, maintenance spare parts, and material, decreased by $17.1 million and were $103.1 million in FY 2010 and $125.0 million in FY 2009. Other current assets and deferred debits totaled $35.5 million in FY 2011, an increase of $8.3 million from FY 2010 primarily as a result of an increase in the deferred GCR of $7.8 million. Other current assets and deferred debits totaled $27.2 million in FY 2010, up $22.3 million from FY 2009.

Other Assets and Deferred Debits – In FY 2011, other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled $142.6 million, a decrease of $4.2 million from FY 2010, mainly due to the decrease in unamortized loss on reacquired debt. In FY 2010, the total was $146.8 million, an increase of $15.8 million from FY 2009.

Liabilities

Long-Term Debt – Long-term debt, including the current portion and unamortized discount and premium, totaled $1,217.5 million in FY 2011, $50.0 million less than the previous year primarily as a result of normal debt principal payments. This represents 79.7% of total capitalization in FY 2011. Long-term debt, including the current portion and unamortized discount and premium, totaled $1,267.5 million in FY 2010, $104.9 million more than the previous year primarily as a result of the issuance of the Ninth Series Bonds. Long-term debt, including the current portion and unamortized discount and premium, totaled $1,162.7 million in FY 2009. Long-term debt represented 82.2% of total capitalization in FY 2010 and 82.7% of total capitalization in FY 2009.

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. In FY 2011, the debt service coverage was at 6.06 times debt service on the outstanding 1975 Ordinance Bonds and 2.15 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 6.28 and 2.44 times, respectively, in FY 2010 and 2.13 times, respectively, in FY 2009. PGW's current bond ratings are "Baa2" from Moody's Investors Service (Moody's), "BBB+" from Standard & Poor's Ratings Service (S&P), and "BBB" from Fitch Ratings (Fitch).

Short-Term Debt – Due to the highly seasonal nature of PGW's business, short-term debt is utilized to meet working capital requirements. PGW, pursuant to the provisions of the City of Philadelphia Note Ordinance, may sell short-term notes in a principal amount, which together with interest, may not exceed $150.0 million outstanding at any one time. These notes are supported by irrevocable letters of credit and a security interest in PGW's revenues. The letters of credit supporting PGW's commercial paper program fixed the maximum level of outstanding notes plus interest at $90.0 million in FY 2011 and $120.0 million in FY 2010, the maximum level of outstanding notes FY 2010. In June 2010, PGW renewed the letters of credit supporting the commercial paper program at $120.0 million.

Effective September 2011, PGW requested that each of the three banks reduce the stated amounts of their respective letters of credit for the commercial paper Series F-1, F-2, and F-3 from $30.0 million to $20.0 million. As a result of the reduction of each of the letters of credit, PGW's commercial paper program was reduced from $90.0 million to $60.0 million.

There were no notes outstanding at August 31, 2011 and 2010. The Company has not utilized commercial paper for working capital since May 2009.

Other Current Liabilities and Deferred Credits – In FY 2011, other current liabilities and deferred credits totaled $12.1 million, a decrease of $0.1 million from FY 2010, mainly due to the decrease in the injuries and damages reserve. In FY 2010, the total was $12.2 million a decrease of $4.0 million from FY 2009.

Liquidity/Cash Flow – At December 1, 2011, $60.0 million was available from the commercial paper program. Additionally, PGW had $121.0 million available in its Capital Improvement Fund to be utilized for construction expenditures. These funding sources may be utilized during the fall and early winter period to provide liquidity until billings from the winter heating season are collected. The cash balance at December 1, 2011 was $22.9 million.

Accounts Payable – In FY 2011, accounts payable totaled $55.9 million, a decrease of $3.4 million or 5.8% compared with FY 2010 primarily due to a decrease in trade payables of $2.6 million and a decrease of natural gas payables of $1.6 million. In FY 2010, accounts payables totaled $59.3 million, an increase of $13.1 million or 28.3% compared with FY 2009 primarily due to an increase in credit balances in accounts receivable, which have been reclassified to accounts payable.

Other Liabilities and Deferred Credits – In FY 2011, other liabilities and deferred credits totaling $197.9 million increased $7.9 million compared to FY 2010. The increase in FY 2011 is primarily due to the effect of recording the increased liability for OPEB in the amount of $3.9 million and the increase in deferred environmental liability in the amount of $3.0 million. In FY 2010, other liabilities and deferred credits totaling $190.0 million increased $49.7 million compared to FY 2009. The increase in FY 2010 is primarily due to the effect of recording the liability for OPEB in the amount of $27.3 million and the net increase in the interest rate swap liability in the amount of $24.7 million.

Other Financial Factors

The City granted back PGW's annual $18.0 million payment in FY 2010 and FY 2009. The City did not grant back the $18.0 million payment in FY 2011.

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 Plan, an energy efficiency and conservation plan, into the base rate filing. On May 19, 2010, PGW, along with all active parties to the proceeding, submitted a Petition for Proposed Settlement of the proceeding (the Settlement) and the PUC approved the Settlement on July 29, 2010. Under the Settlement, PGW will be permitted to maintain virtually all of the extraordinary base rate relief, will receive an incremental rate increase of $16.0 million annually, and will be required to fund $18.5 million of the OPEB liability in each of the years 2011 through 2015. The Settlement also permitted the implementation of the Demand Side Management Program.

Establishment of OPEB Trust Fund

As part of the July 29, 2010, rate case settlement, which provided for the establishment of an irrevocable trust for the deposit of funds derived through a rider from all customer classes to fund OPEB liabilities, PGW established the trust in July 2010 and began funding the trust in accordance with the settlement agreement in September 2010. The settlement provides that PGW shall deposit $15.0 million annually towards the ARC and an additional $3.5 million annually, which represents a 30-year amortization of the OPEB liability of $109.5 million at August 31, 2011. These deposits will be funded primarily through increased rates of $16.0 million granted in the settlement.

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excesses) over a period of 30 years.

The actuarial accrued liability as of August 31, 2011 was $485.7 million and assumes that the Company will continue to fund its OPEB obligations of $18.5 million per year on an ongoing basis.

Bond Transactions Subsequent to Year-End

Defeasance and Remarketing of Debt

On September 1, 2011, the City issued Gas Works Revenue Bonds, Eighth Series in the amount of $225.5 million for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the cost of terminating a portion of the interest rate swap agreement, paying the costs of issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. Approximately $29.5 million of the Sixth Series Bonds was defeased utilizing internally generated funds.

As a result of this defeasance, a portion of the interest rate swap agreement was terminated. The termination payment was approximately $7.0 million. The interest rate swap agreement was amended to reflect new notional amounts related to the respective Eighth Series Bonds. The Eighth Series B Bonds have a $50.3 million notional amount. The Eighth Series C Bonds have a $50.0 million notional amount. The Eighth Series D Bonds have a $75.0 million notional amount. The Eighth Series E Bonds have a $50.3 million notional amount.

Refunding of Bonds

On September 28, 2011, the City issued Gas Works Revenue Bonds, Twentieth Series (1975 General Ordinance) in the amount of $16.2 million for the purpose of refunding the entire Sixteenth Series Bond (1975 General Ordinance), and paying the costs of issuing the bonds. The Twentieth Series Bonds, with fixed interest rates that range from 2.0% to 5.0%, have maturity dates through 2015.

On September 28, 2011, the City issued Gas Works Revenue Bonds, Tenth Series (1998 General Ordinance) in the amount of $72.6 million for the purpose of refunding the entire First Series A, First Series C, Second Series, and Third Series Bonds (1998 General Ordinance), and paying the costs of issuing the bonds. The Tenth Series Bonds, with fixed interest rates that range from 3.0% to 5.0%, have maturity dates through 2026.

Notes Payable

Effective September 2011, PGW requested that each of the three banks reduce the stated amounts of their respective letters of credit for the commercial paper Series F-1, F-2, and F-3 from $30.0 million to $20.0 million. As a result of the reduction of each of the letters of credit, PGW's commercial paper program was reduced from $90 .0 million to $60.0 million.

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, 2011 and 2010

(Thousands of dollars)

Assets		**2011**	**2010**
Utility plant, at original cost:			
In service	$	1,856,303	1,794,277
Under construction		40,555	46,339
Total		1,896,858	1,840,616
Less accumulated depreciation		785,780	746,607
Utility plant, net		1,111,078	1,094,009
Restricted investment funds:			
Sinking fund, revenue bonds		112,038	111,409
Capital improvement fund		122,332	170,809
Workers' compensation escrow fund		2,596	2,595
Total restricted investment funds		236,966	284,813
Current assets:			
Cash and cash equivalents		105,386	79,052
Accounts receivable (net of provision for uncollectible accounts of $99,932 and $103,600 for 2011 and 2010, respectively)		98,925	92,173
Gas inventories, materials, and supplies		85,993	103,133
Other current assets and deferred debits		35,523	27,212
Total current assets		325,827	301,570
Unamortized bond issuance costs		24,585	27,066
Unamortized losses on reacquired debt		62,039	70,873
Other assets and deferred debits		56,000	48,831
Total assets	$	1,816,495	1,827,162

See accompanying notes to financial statements.

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

Balance Sheets

August 31, 2011 and 2010

(Thousands of dollars)

Fund Equity and Liabilities		**2011**	**2010**
Fund equity:			
Excess (deficiency) of capital assets, net of related debt	$	15,869	(2,706)
Restricted		114,634	114,004
Unrestricted		179,237	163,137
Total fund equity		309,740	274,435
Long-term debt:			
Revenue bonds		1,166,992	1,224,987
Current liabilities:			
Current portion of revenue bonds		50,549	42,537
Accounts payable		55,893	59,303
Customer deposits		2,869	3,998
Other current liabilities and deferred credits		12,098	12,185
Accrued accounts:			
Interest, taxes, and wages		17,476	16,743
Distribution to the City		3,000	3,000
Total current liabilities		141,885	137,766
Other liabilities and deferred credits		197,878	189,974
Total fund equity and liabilities	$	1,816,495	1,827,162

See accompanying notes to financial statements.

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

Statements of Revenues and Expenses

Years ended August 31, 2011 and 2010

(Thousands of dollars)

	2011	2010
Operating revenues:		
Gas revenues:		
Nonheating	$ 51,437	51,343
Gas transport service	28,700	26,860
Heating	669,131	664,139
Total gas revenues	749,268	742,342
Appliance and other revenues	8,400	8,959
Other operating revenues	8,611	7,931
Total operating revenues	766,279	759,232
Operating expenses:		
Natural gas	330,932	354,004
Gas processing	16,097	14,952
Field services	33,950	34,026
Distribution	27,990	23,426
Collection and account management	11,765	15,266
Provision for uncollectible accounts	36,027	35,000
Customer services	12,532	13,030
Marketing	4,378	3,900
Administrative and general	76,850	71,620
Pensions	22,597	24,633
Other postemployment benefits	22,472	27,269
Taxes	7,135	6,990
Total operating expenses before depreciation	602,725	624,116
Depreciation	43,629	43,168
Less depreciation expense included in operating expenses above	4,714	4,690
Total depreciation	38,915	38,478
Total operating expenses	641,640	662,594
Operating income	124,639	96,638
Interest and other income	4,348	5,301
Income before interest expense	128,987	101,939
Interest expense:		
Long-term debt	57,225	52,527
Other	18,884	18,986
Allowance for funds used during construction	(427)	(390)
Total interest expense	75,682	71,123
Excess of revenues over expenses	$ 53,305	30,816

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended August 31, 2011 and 2010

(Thousands of dollars)

	2011	2010
Cash flows from operating activities:		
Receipts from customers	$ 731,500	741,000
Payments to suppliers	(466,394)	(457,406)
Payments to employees	(106,125)	(106,003)
Claims paid	(3,468)	(3,252)
Other receipts	9,800	10,944
Net cash provided by operating activities	165,313	185,283
Cash flows from noncapital financing activities:		
Interest and fees	(6,337)	(5,787)
Distribution to the City of Philadelphia	(18,000)	(18,000)
Grant back of distribution from the City of Philadelphia	—	18,000
Net cash used in noncapital financing activities	(24,337)	(5,787)
Cash flows from capital and related financing activities:		
Proceeds from long-term debt issued	—	150,000
Premium from long-term debt issues	—	1,420
Long-term debt issuance costs	—	(2,167)
Purchases of capital assets	(58,825)	(59,063)
Principal paid on long-term debt	(40,459)	(46,045)
Interest paid on long-term debt	(64,493)	(51,136)
Capital improvement fund deposits	—	(149,058)
Drawdowns on capital improvement fund	48,130	40,963
Interest income on capital improvement fund	617	322
Interest income on sinking fund	564	1,362
Sinking fund withdrawals (deposits)	(603)	(1,182)
Other investment income	427	390
Net cash used in capital and related financing activities	(114,642)	(114,194)
Net increase in cash and cash equivalents	26,334	65,302
Cash and cash equivalents, beginning of year	79,052	13,750
Cash and cash equivalents, end of year	$ 105,386	79,052
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 124,639	96,638
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	41,756	41,521
Provision for uncollectible accounts	36,027	35,000
Change in assets and liabilities:		
Accounts receivable	(42,779)	(21,677)
Gas inventories, materials, and supplies	17,140	21,890
Other current assets and deferred debits	(8,311)	(22,317)
Other assets and deferred debits	(7,169)	(25,366)
Accounts payable	(3,410)	13,098
Customer deposits	(1,129)	(226)
Other current liabilities and deferred credits	(88)	(3,818)
Accrued accounts	733	795
Other liabilities and deferred credits	7,904	49,745
Net cash provided by operating activities	$ 165,313	185,283

See accompanying notes to financial statements.

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

Statements of Changes in Fund Equity

Years ended August 31, 2011 and 2010

(Thousands of dollars)

		2011	2010
Fund equity balance, beginning of year	$	274,435	243,619
Excess of revenues over expenses		53,305	30,816
Distribution to the City of Philadelphia		(18,000)	(18,000)
Grant back of distribution from the City of Philadelphia		—	18,000
Fund equity balance, end of year	$	309,740	274,435

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

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

As described in note 2, the Company is a component unit of the City, and consequently follows accounting principles promulgated by the Governmental Accounting Standards Board (GASB) as they apply to proprietary fund-type activities. In accordance with GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), the Company has not elected to apply accounting standards promulgated by the Financial Accounting Standards Board (FASB) issued after November 30, 1989 that do not conflict with or contradict GASB literature. Under the Regulated Operations guidance within 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 June 15, 2011, PGW filed a proposed fiscal year (FY) 2012 Operating Budget. The PGC conducted informal discovery sessions beginning on June 28, 2011, with follow-up sessions on July 8 and 19, 2011. On July 28, 2011, a public hearing was convened. On August 25, 2011, the PGC hearing examiners rendered a Recommended Decision with interim operating spending authority for FY 2012 pending final budget action by the PGC. At the PGC meeting on September 20, 2011, PGW was granted interim spending authority for operating and maintenance expenses for the first two months of FY 2012. The PGC at its October 11, 2011 meeting adopted an Order and Resolution approving PGW's FY 2012 Operating Budget.

On June 23, 2010, PGW filed a proposed FY 2011 Operating Budget. The PGC conducted informal discovery concerning the budget in July and August, with a formal hearing held on August 12, 2010. At the PGC meeting on September 21, 2010, PGW was granted interim spending authority for operating and maintenance expenses for the first three months of FY 2011. On September 29, 2010, the PGC staff filed a recommended decision on PGW's proposed FY 2011 Operating Budget. Exceptions to the decision were filed on October 8, 2010. The PGC approved the FY 2011 Operating Budget on November 16, 2010.

On December 2, 2009, PGW filed its FY 2010 Compliance Budget reflecting the adjustment incorporated into the PGC's Motion dated November 17, 2009. These adjustments reduced total operating expenses by $1,970,000 from PGW's original budget request.

(c) Capital Budget

On January 4, 2011, PGW filed a proposed FY 2012 Capital Budget in the amount of $80,915,000. On April 27, 2011, the PGC, after review and evaluation, approved a recommendation to City Council for a budget of $80,837,000. City Council approved the FY 2012 Capital Budget on June 2, 2011. The Mayor signed the ordinance on June 15, 2011.

On January 4, 2010, PGW filed a proposed FY 2011 Capital Budget in the amount of $67,723,000. On January 26, 2010, the PGC, after review and evaluation, approved a recommendation to City Council for a budget of $67,689,000. City Council approved the FY 2011 Capital Budget on June 17, 2010. The Mayor signed the ordinance on March 23, 2011.

On January 6, 2010, PGW submitted a request to the PGC to amend the FY 2010 Capital Budget to "Install 200kW Microturbine and 40 Ton Chiller at 800 W. Montgomery." On March 16, 2010, the PGC issued a Resolution and Order approving this project in the amount of $1,240,000 with a reimbursement grant of up to $465,000 from the Pennsylvania Department of Environmental Protection for Green Energy Works program. City Council approved the amendment of the FY 2010 Capital Budget on April 22, 2010, with the Mayor signing the ordinance on April 29, 2010.

On June 10, 2009, PGW requested that the PGC endorse a proposal to amend the FY 2010 Capital Budget in the amount of $2,552,000 for a project "Consolidate Fire Protection System – Richmond Plant." On September 9, 2009, the PGC staff issued a recommended decision approving PGW's request. The PGC approved the staff recommendation on September 22, 2009. City Council approved an ordinance amending the FY 2010 Capital Budget on October 29, 2009, with the Mayor signing the ordinance on November 6, 2009.

(d) Base Rates

On December 18, 2009, PGW submitted a base rate filing with the PUC (1) to maintain the $60,000,000 base rate increase that the PUC granted in 2008 and (2) to fund PGW's Other Postemployment Benefits (OPEB) liability in the amount of $42,500,000. PGW also moved to consolidate the Company's Demand Side Management Plan, an energy efficiency and conservation plan, into the base rate filing. On May 19, 2010, PGW, along with all active parties to the proceeding, submitted a Petition for Proposed Settlement of the proceeding (the Settlement) and the PUC approved the Settlement on July 29, 2010. Under the Settlement, PGW will be permitted to maintain virtually all of the extraordinary base rate relief, will receive an incremental rate increase of $16,000,000 annually, and will be required to fund $18,500,000 of the OPEB liability in each of the years 2011 through 2015. The new rates were effective September 1, 2010. The Settlement also permitted the implementation of the Demand Side Management Program.

On November 14, 2008, the Company filed for an extraordinary base rate increase of approximately $60,000,000 or 5.2% and simultaneously requested an $85,000,000 or 7.4% decrease in the gas cost rate (GCR) for a net 2.2% overall rate decrease of approximately $25,000,000. The base rate increase served several purposes. First, the increase covered the additional financing costs that the Company incurred. Second, the increase improved the Company's financial position so as to enhance its ability to access the financial markets and maintain its bond rating. Third, the increase provided additional liquidity and financial flexibility in this tight credit market. On December 18, 2008, the PUC issued its decision approving a base rate increase of $60,000,000 or 5.2% and a decrease in the GCR of $107,000,000 for a net decrease in rates of $47,000,000, or 4.2%. These rates were effective as of January 1, 2009.

The previous increase in base rates of $25,000,000 was approved by the PUC on September 28, 2007.

(e) Weather Normalization Adjustment Clause

The Weather Normalization Adjustment Clause (WNA) was approved by PUC Order dated August 8, 2002. The purpose of the WNA is to neutralize the impact of weather on the Company's revenues. This allows the Company to achieve the recovery of appropriate costs as authorized by the PUC. The WNA results in neither a rate increase nor a rate decrease, but acts as a billing adjustment. The main benefits of the WNA are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA is applied to customer invoices rendered during the period of October 1 through May 31 of each year for each billing cycle. The WNA will continue in place unless the PUC issues an order directing that it be discontinued. The Company cannot predict when the PUC will complete its review of the WNA, and the review was not completed as of August 31, 2011. The adjustments for the years ended August 31, 2011 and 2010 were an increase in billings of $1,824,000 and $13,425,000, respectively.

(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 factor. The GCR reflects the increases or decreases in natural gas costs and the cost of other raw materials. 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 are compared to the actual cost of fuel and other specific costs. Customers are then credited or charged for over–recovery or under–recovery of costs. The GCR may be adjusted 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 and operating expenses, but do not affect operating income or net income. The Company at August 31, 2011 deferred approximately $17,365,000 for GCR under–recovery in other current assets and deferred debits. At August 31, 2010, the Company deferred approximately $11,778,000 for GCR under–recovery.

GCR effective dates and rates

Effective date		GCR rate per Mcf*	Change
September 1, 2011	$	6.0594	(0.0336)
June 1, 2011		6.0930	(0.4470)
March 1, 2011		6.5400	0.2647
December 1, 2010		6.2753	(0.6297)
September 1, 2010		6.9050	0.3911
June 1, 2010		6.5139	(0.8316)
March 1, 2010		7.3455	0.0958
December 1, 2009		7.2497	0.1597
September 1, 2009		7.0900	(0.0915)

(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 $1,873,000 and $1,647,000 was charged to expense as incurred in FY 2011 and FY 2010, respectively, and is included in depreciation expense in the statements of revenues and expenses. 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 2011 and FY 2010 was 2.5% and 2.3%, respectively. The composite rates are supported by a depreciation study of utility plant as of August 2010. The effective composite depreciation rates, as a percentage of cost, for FY 2011 were as follows:

Production plant	2.35%
Transmission, distribution, and storage	2.10%
General plant	3.23%

The next depreciation study is scheduled to be completed in 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 5.41% and 5.69% in FY 2011 and FY 2010, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2011 and 2010 (thousands of dollars):

	August 31, 2011			
	Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$ 5,595	—	—	5,595
Distribution and collection systems	1,355,984	46,119	(1,533)	1,400,570
Buildings and equipment	432,698	18,602	(1,162)	450,138
Total utility plant, at historical cost	1,794,277	64,721	(2,695)	1,856,303
Under construction	46,339	58,937	(64,721)	40,555
Less accumulated depreciation for:				
Distribution and collection systems	(635,269)	(29,833)*	1,834	(663,268)
Buildings and equipment	(111,338)	(11,923)*	749	(122,512)
Utility plant, net	$ 1,094,009	81,902	(64,833)	1,111,078

* Cost of removal in the amount of $1,873 was charged to expense as incurred in FY 2011 and is not included in accumulated depreciation.

(Continued)

	August 31, 2010			
	Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$ 5,595	—	—	5,595
Distribution and collection systems	1,322,205	36,911	(3,132)	1,355,984
Buildings and equipment	426,497	6,802	(601)	432,698
Total utility plant, at historical cost	1,754,297	43,713	(3,733)	1,794,277
Under construction	30,953	58,994	(43,608)	46,339
Less accumulated depreciation for:				
Distribution and collection systems	(609,376)	(29,025)*	3,132	(635,269)
Buildings and equipment	(99,407)	(12,495)*	564	(111,338)
Utility plant, net	$ 1,076,467	61,187	(43,645)	1,094,009

* Cost of removal in the amount of $1,647 was charged to expense as incurred in FY 2010 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 and reconnection charges. Other operating revenues primarily consist of finance charges assessed on delinquent accounts.

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

Revenue includes amounts related to gas that has been used by customers but has not yet been billed. Revenues are recognized as gas is distributed. Estimated revenues from gas distributed and unbilled, less estimated uncollectible amounts, are accrued and included in operating revenues.

(i) Customers (Unaudited)

The Company's service territory encompasses the City. Of the Company's approximately 503,000 and 502,000 customers at August 31, 2011 and 2010, respectively, nearly 95.0% were residential.

(Continued)

The Company offers a discounted payment plan for current receivables with a possible forgiveness of arrearages in three years. The total number of customers with discounted payment plans as of both August 31, 2011 and 2010 was approximately 84,000 and 82,000 respectively.

The Senior Citizen Discount also provides customers with a discounted payment plan. The total number of customers receiving the discount as of August 31, 2011 and 2010 was approximately 31,000 and 33,000, respectively.

(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 with the PGC. For FY 2011 and FY 2010, 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 $23,270,000 and $22,760,000 for FY 2011 and FY 2010, respectively, have been reclassified to accounts payable.

(k) Gas Inventories, Materials, and Supplies

Gas inventories, materials, and supplies, consisting primarily of fuel stock, gases stored to meet peak demand requirements, and spare parts, are stated at average cost at August 31, 2011 and 2010, as follows (thousands of dollars):

		2011	2010
Gas inventory	$	78,579	96,097
Material and supplies		7,414	7,036
Total	$	85,993	103,133

(l) Bond Issuance Costs, Debt Discount, and Premium

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

(m) Losses on Reacquired Debt

Losses on reacquired debt are deferred 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.

(Continued)

(n) Pensions and Postemployment Benefits

The City sponsors a public employee retirement system (PERS), Philadelphia Gas Works Pension Plan (the Pension Plan), a single-employer defined-benefit plan, to provide pension benefits for all of its employees. The Pension Plan is noncontributory, covering all employees and providing 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 the Company to the Sinking Fund Commission of the City. Management believes that the Pension Plan is in compliance with all applicable laws.

The Company sponsors a single employer defined benefit healthcare plan and provides postemployment healthcare and life insurance benefits to approximately 2,002 and 1,963 participating retirees and their beneficiaries and dependents for FY 2011 and FY 2010, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,671 and 1,669 active employees and their dependents for FY 2011 and FY 2010, respectively, by charging the annual insurance premiums to expense.

The difference between the annual OPEB expense and the amounts paid by the Company, net of the Company contributions to the OPEB Trust, results in an increase in the liability, which is recorded in other liabilities and deferred credits.

(o) Cash Equivalents

For the purpose of reporting 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, Capital Improvement Fund, and Workers' Compensation Escrow Fund as described in Note 3.

(p) Reserve for Injuries and Damages

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

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

(q) Segment Information

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

(r) Estimates

In preparing the financial statements in conformity with U.S. GAAP, management uses estimates. The Company has disclosed in the financial statements all estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

(s) Pollution Remediation

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

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

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.

The Company recorded an additional liability for pollution remediation obligations of $3,508,000 and $1,624,000 for FY 2011 and FY 2010, respectively. The pollution remediation liability is reflected in other liabilities and deferred credits and in other current liabilities and deferred credits. 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.

(t) New Accounting Pronouncements

The Company early adopted the provisions of GASB 62, which are required to be adopted for periods beginning after December 15, 2011, for the year ended August 31, 2011. The objective of the

(Continued)

statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in pronouncements of the Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) prior to November 30, 1989, which does not conflict with or contradict GASB pronouncements. Such guidance had previously been referenced in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* which is superseded by GASB 62. The adoption of GASB 62 did not have a significant impact on the financial statements as the underlying accounting and financial reporting guidance has not changed.

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

The Company is 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 Public Financial 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 2011, the applicable maximum amount was calculated to be $1,108,000. In FY 2010, the applicable maximum amount was calculated to be $1,066,000. The agreement requires the Company to make annual payments of $18,000,000 to the City. In FY 2011 and FY 2010, the Company made the annual payment of $18,000,000 to the City. The City did not grant back the payment in FY 2011. The City did grant the $18,000,000 back to the Company in FY 2010.

The Company engages in various other transactions with the City. The Company provides gas service to the City. Operating revenues include $7,684,000 and $10,298,000 in FY 2011 and FY 2010, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled $734,000 and $402,000 in FY 2011 and FY 2010, respectively. Net amounts receivable from the City were $119,000 and $145,000 at August 31, 2011 and 2010, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $761,000 and $750,000 in FY 2011 and FY 2010, respectively.

(3) Cash, Cash Equivalents, and Investments

(a) Cash and Cash Equivalents

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, 2011 and 2010 were $110,108,000 and $83,281,000, respectively. Book balances of such deposits and accounts at August 31, 2011 and 2010 were $105,386,000 and $79,052,000, respectively. Federal depository insurance on these balances at August 31, 2011 and 2010 was $428,000 and $528,000, respectively. The remaining balances are not insured. Excess cash balances are invested 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 the fiscal years ended August 31, 2011 and 2010 was $159,400,000 and $148,000,000, respectively. Short term investments with a carrying amount (at fair value) of $108,100,000 and $75,900,000 at August 31, 2011 and 2010, respectively, are included in the balances presented above.

(b) Restricted Investment Funds

The investments in the Company's Sinking Fund, Capital Improvement Fund, and Workers' Compensation Escrow Fund consist primarily of a Guaranteed Investment Contract (GIC), 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. The balance of the Capital Improvement Fund at August 31, 2011 and 2010 was $122,332,000 and $170,809,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2011 and FY 2010, the Company utilized the Capital Improvement Fund to provide liquidity for the additions to utility plant.

Investments are recorded at fair value except for certain money market funds recorded at amortized cost and guaranteed investment contracts recorded at contract value. The adjustment to market value for the Capital Improvement Fund resulted in a loss of $364,000 at August 31, 2011 and a loss of $275,000 at August 31, 2010. The adjustment to market value for the Sinking Fund resulted in a gain of $25,000 at August 31, 2011 and a loss of $292,000 at August 31, 2010.

Pursuant to the Pennsylvania Department of Labor and Industry Bureau of Workers' Compensation Self-Insurance policy, the Company has to establish and maintain a restricted trust account. As of August 31, 2011 and 2010, the trust account balances were $2,596,000 and $2,595,000, respectively.

The following is a schedule that details the Company's investments in the Capital Improvement Fund (thousands of dollars):

	August 31, 2011			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government obligations:				
U.S. Treasury notes	$ 18,979	0.4747	AAA/N/A	Moody's/S&P
U.S. government agencies and instrumentalities:				
Federal Home Loan Mortgage Corporation medium term notes	42,444	0.9733	AAA/AA+	Moody's/S&P
Federal National Mortgage Association medium term notes	17,645	0.8156	AAA/AA+	Moody's/S&P
Federal Home Loan Bank bonds	8,233	0.9115	AAA/AA+	Moody's/S&P
Federal National Mortgage Association debentures	1,486	0.5417	AAA/AA+	Moody's/S&P
Federal Home Loan Mortgage Corporation golden partner certificate	68	0.2528	AAA/AA+	Moody's/S&P
Federal Home Loan Mortgage Corporation partner certificate	667	0.2528	AAA/AA+	Moody's/S&P
Federal National Mortgage Association gtd REMIC pass through	745	0.6528	AAA/AA+	Moody's/S&P
Total U.S. government agencies and instrumentalities	71,288			

Investment type		Fair value	Weighted average maturity (years)	Credit rating	Rating agency
		August 31, 2011			
Corporate obligations:					
Johnson & Johnson	$	2,027	0.4696	AAA/AAA	Moody's/S&P
XTO Energy Inc.		291	0.0440	AAA/AAA	Moody's/S&P
XTO Energy Inc.		1,538	0.2323	AAA/AAA	Moody's/S&P
XTO Energy Inc.		281	0.0425	AAA/AAA	Moody's/S&P
Total		4,137			
General Electric Capital Corp		287	0.0274	AA2/AA+	Moody's/S&P
General Electric Capital Corp		1,832	0.4341	AA2/AA+	Moody's/S&P
General Electric Capital Corp		282	0.0132	AA2/AA+	Moody's/S&P
Berkshire Hathaway Financial		250	0.0193	AA2/AA+	Moody's/S&P
Berkshire Hathaway Financial		296	0.0386	AA2/AA+	Moody's/S&P
Berkshire Hathaway Financial		1,563	0.3393	AA2/AA+	Moody's/S&P
Berkshire Hathaway Financial		286	0.0373	AA2/AA+	Moody's/S&P
Total		4,796			
Shell International Financial		290	0.0068	AA1/AA	Moody's/S&P
Shell International Financial		290	0.0068	AA1/AA	Moody's/S&P
Chevron Corporation		294	0.0571	AA1/AA	Moody's/S&P
Chevron Corporation		1,463	0.2837	AA1/AA	Moody's/S&P
Chevron Corporation		285	0.0551	AA1/AA	Moody's/S&P
Total		2,622			
Pfizer		296	0.2756	A1/AA	Moody's/S&P
Pfizer		286	0.2661	A1/AA	Moody's/S&P
Total		582			
Total Corporate Obligations		12,137			
Total fair value of investments	$	102,404			

Investment type		Fair value	Weighted average maturity (years)	Credit rating	Rating agency
		August 31, 2011			
Cash and cash equivalents:					
HSBC Finance Corporation Commercial Paper	$	300	0.0233	P-1/A-1	Moody's/S&P
HSBC Finance Corporation Commercial Paper		290	0.0225	P-1/A-1	Moody's/S&P
UBS Finance (Delaware) Commercial Paper		299	0.0776	P-1/A-1	Moody's/S&P
John Deere Credit Inc. Commercial Paper		290	0.0348	P-1/A-1	Moody's/S&P
Total cash and Cash equivalents		1,179			
Money market:					
Fidelity Governmental Fund 57		13,927	N/A	N/A	
First American Prime Obligations Class Z		3,176	N/A	N/A	
Morgan Stanley Prime Portfolio Institutional Class		100	N/A	N/A	
Total money market		17,203			
Other		1,546			
Total fair value of investments, including cash deposits	$	122,332			
Portfolio weighted modified duration			0.7973		

	August 31, 2010			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	$ 2,230	0.2917	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	2,230			
Corporate obligations:				
General Electric Capital Corporation	1,009	0.2528	Aa2/AA+	Moody's/S&P
Total corporate obligations	1,009			
Total fair value of investments	3,239			

(Continued)

	August 31, 2010			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Cash and cash equivalents:				
UBS Finance (Delaware) commercial paper	999	0.2278	FDIC Insured	
Total cash and Cash equivalents	999			
Money market:				
Fidelity Governmental Fund	149,057		N/A	N/A
First American Government Obligations Class II	6,653		N/A	N/A
Morgan Stanley Governmental Institutional Class	10,861		N/A	N/A
Total money market	166,571			
Total fair value of investments, including cash deposits	$ 170,809			
Portfolio weighted modified duration		0.2673		

(Continued)

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

	August 31, 2011			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Guaranteed investment contracts	44,257	9.5028		
U.S. government obligations:				
U.S. Treasury notes	32,405	0.8664	AAA/N/A	Moody's/S&P
Total U.S. government obligations	32,405			
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	11,166	1.3140	AAA/A+	Moody's/S&P
Federal Home Loan Bank bonds	6,887	1.5100	AAA/A+	
Federal Farm Credit Banks bonds	7,807	0.7306	AAA/A+	Moody's/S&P
Total U.S. government agencies and instrumentalities	25,860			
Corporate obligations:				
General Electric Capital Corporation	4,586	0.8403	AA2/AA+	Moody's/S&P
Total corporate obligations	4,586			
Total fair value of investments	107,108			

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	August 31, 2011			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Cash and cash equivalents:				
Bnp Paribas Financial Corporation Inc. commercial paper	1,000	0.4353	P-1/A-1+	Moody's/S&P
Credit Agicole N.A. commerical paper	1,310	0.5703	P-1/A-1+	
Total cash and Cash equivalents	2,310			
Money market:				
Fidelity Governmental Fund	2,620			
Total money market	2,620		N/A	N/A
Total fair value of investments, including cash deposits	$ 112,038			
Portfolio weighted modified duration		0.9804		

	August 31, 2010			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Guaranteed investment contracts (at contract value)	$ 45,734	10.5000	*	*
U.S. government obligations:				
U.S. Treasury notes	18,413	1.0441	Aaa/AAA	Moody's/S&P
U.S. government agencies and instrumentalities:				
Federal National Mortgage Association medium term notes	4,470	1.8725	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association discount notes	4,594	0.6722	Aaa/AAA	Moody's/S&P
Federal Home Loan Bank discount notes	7,679	0.6833	Aaa/AAA	Moody's/S&P
Federal Home Loan Bank bonds	8,480	0.7882	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage Corporation medium term notes	12,558	1.2439	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	37,781			

	August 31, 2010			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Corporate obligations:				
General Electric Capital Corp (Floating) Global corporate note	1,500	1.6111	Aa2/AA+	Moody's/S&P
General Electric Capital Corp (FDIC) Global corporate note	2,219	0.5306	Aaa/AAA FDIC Insured	Moody's/S&P
Total corporate obligations	3,719			
Total fair value of investments	105,647			
Cash and cash equivalents:				
Credit Agicole N.A. Commercial Paper	230	0.0095	P-1/A-1+	Moody's/S&P
Credit Agicole N.A. Commercial Paper	2,782	0.1257	P-1/A-1+	Moody's/S&P
Total cash and Cash equivalents	3,012			
Fidelity Institutional Government Portfolio Class I	2,750		N/A	N/A
Total fair value of investments, including cash deposits	$ 111,409			
Portfolio weighted modified duration**		0.9891		

* The credit rating of this investment is unrated.
** The portfolio weighted modified duration excludes the fair value of the guaranteed investment contracts.

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

		August 31, 2011			
Investment type		**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:					
Fidelity Governmental Fund	$	2,596	N/A	N/A	N/A
Total fair value of investments, including cash deposits	$	2,596			

		August 31, 2010			
Investment type		**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:					
Fidelity Governmental Fund	$	2,595	N/A	N/A	N/A
Total fair value of investments, including cash deposits	$	2,595			

(c) Interest Rate Risk

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

(d) Credit Risk

The City has adopted an investment policy relating to the investments of the Company. Per the investment policy, the Company's allowable investments are: (1) bonds or notes of the U.S. government; (2) U.S. Treasury obligations, including STRIPs; receipts indicating an undivided interest in such U.S. Treasury obligations; and stripped coupons held under book-entry with the New

(Continued)

York Federal Reserve Bank; (3) obligations of the following U.S. government-sponsored agencies; Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), 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 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 and 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 money markets funds must have assets over $15 billion, have the highest rating from Moody's, S&P, and Fitch, and contain only government securities; (10) repurchase agreements that are fully collateralized in bonds or notes of the U.S. government pledged to the City and held in the City's name and deposited at the time the investment is made with an entity or a third party selected and approved by the City the market value of the collateral shall be at least 102.0% of the funds being disbursed; and (11) obligations of the Commonwealth of Pennsylvania (the Commonwealth) or any municipality or other political subdivision of the Commonwealth with a final maturity of two years or less and a rating of at least AA by Moody's or S&P.

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

(e) Custodial Credit Risk

The Company has selected custodian banks that are members 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.

(f) Concentration of Credit Risk

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

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

More than 5.0% of the Company's investments are in Federal Home Loan Corporation Medium Term notes, a GIC with Assured Guaranty Ltd., Fidelity Governmental Fund, Federal National Mortgage Association Medium Term notes, and Federal Home Loan Bank bonds. These investments represent 22.77%, 21.83%, 18.80%, 8.13%, 7.50%, and 6.42%, respectively, of the Company's total investments, which is in accordance with the City's investment policy. In addition, the GIC with Assured Guaranty Ltd. is collateralized in amounts that meet the City's investment policy.

(4) Deferred Costs

In compliance with orders issued by the PGC, the cost of projects that produce benefits over an extended period is deferred. Such costs are being amortized to expense over a period matching their useful lives, which range from two to ten years. There is no return on the asset being charged to the customers. The unamortized costs included in other assets, and deferred debits were \$454,000 and \$704,000 as of August 31, 2011 and 2010, respectively. The unamortized costs included in other current assets and deferred debits were \$250,000 and \$398,000 as of August 31, 2011 and 2010, respectively.

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. The Company received $12,000 from the Company's insurance carriers as a result of settlements related to environmental remediation costs. Environmental remediation costs of approximately $576,000 in FY 2011 were offset by these insurance settlements, and the remainder was deferred. The Company estimates additional expenditures to be approximately $28,122,000.

(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 six months of service, permits them to defer a portion of their salary until future years. The Company provides an annual 10.0% matching contribution up to $500 that immediately vests to the employee. The Company contributed $320,000 and $322,000 for the years ended August 31, 2011 and 2010, respectively.

(6) Notes Payable

Pursuant to the provisions of certain ordinances and resolutions of the City, the Company may sell short-term notes in a principal amount that, together with interest, may not exceed $150,000,000 outstanding at any one time. These notes are intended to provide additional working capital. They are supported by irrevocable letters of credit and a subordinated security interest in the Company's revenues.

The commitment amount is $90,000,000 under the current credit agreement, which was reduced to $60,000,000 subsequent to year-end (see note 15). The expiration of the credit agreement is June 1, 2012.

There were no outstanding notes payable at August 31, 2011 and 2010.

Commercial paper activity for the years ended August 31, 2011 and 2010 was as follows (thousands of dollars):

	Year ended August 31, 2011			
	Beginning balance	**Additions**	**Deletions**	**Ending balance**
Commercial paper	$ —	—	—	—

	Year ended August 31, 2010			
	Beginning balance	**Additions**	**Deletions**	**Ending balance**
Commercial paper	$ —	300	300	—

(7) GCR Tariff Reconciliation

During the fiscal years ended August 31, 2011, 2010, and 2009, the Company's actual gas costs were below its billed gas costs by approximately $120,000, $8,939,000, and $24,638,000, respectively.

Natural Gas Pipeline Supplier Refund

The Company received refunds including interest in FY 2011 in the amount of $123,000 related to Federal Energy Regulatory Commission (FERC)/Pipeline Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2011.

The Company received refunds including interest in FY 2010 in the amount of $264,000 related to FERC/ Pipeline Rate Cases. This amount was utilized as a reduction in the cost of gas for reconciliation purposes in the calculation of the GCR for FY 2010.

(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, 2011 and 2010 (thousands of dollars):

		August 31, 2011			August 31, 2010		
		Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$	48,513	1,147,260	1,195,773	40,459	1,203,274	1,243,733
Unamortized discount		(322)	(2,653)	(2,975)	(364)	(2,961)	(3,325)
Unamortized premium		2,358	22,385	24,743	2,442	24,674	27,116
Total revenue bonds	$	50,549	1,166,992	1,217,541	42,537	1,224,987	1,267,524

(Continued)

The following is a summary of activity related to revenue bonds and other liabilities and deferred credits and the respective balances for the fiscal years ended August 31, 2011 and 2010 (thousands of dollars):

	Year ended August 31, 2011			
	Beginning balance	**Additions**	**Reductions**	**Ending balance**
Revenue bonds	$ 1,243,733	—	(47,960)	1,195,773
Other liabilities and deferred credits:				
Unamortized balance of Guaranteed Investment Contract in Sinking Fund	$ 6,558	—	(625)	5,933
Claims and judgments	4,486	2,071	—	6,557
Environmental clean-up	21,237	3,032	—	24,269
Other postemployment benefits	105,476	3,972	—	109,448
Interest rate swap liability	52,217	—	(546)	51,671
Total other liabilities and deferred credits	$ 189,974	9,075	(1,171)	197,878

	Year ended August 31, 2010			
	Beginning balance	**Additions**	**Reductions**	**Ending balance**
Revenue bonds	$ 1,138,162	150,000	(44,429)	1,243,733
Other liabilities and deferred credits:				
Unamortized balance in Guaranteed Investment Contract in Sinking Fund	$ 7,183	—	(625)	6,558
Claims and judgments	6,645	—	(2,159)	4,486
Environmental clean-up	20,639	598	—	21,237
Other postemployment benefits	78,207	27,269	—	105,476
Interest rate swap liability	27,555	24,662	—	52,217
Total other liabilities and deferred credits	$ 140,229	52,529	(2,784)	189,974

(Continued)

Liability amounts due within one year are reflected in the other current liabilities and deferred credits line of the balance sheet, and are not included in the tables above.

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

	Revenue bonds			
	Principal	**Interest**	**Net swap amount**	**Total**
Fiscal year ending August 31:				
2012*	48,513	55,022	8,975	112,510
2013	47,990	53,283	8,975	110,248
2014	50,035	50,923	8,975	109,933
2015	51,340	48,345	8,975	108,660
2016	49,240	45,604	8,975	103,819
2017 – 2021	253,670	191,331	41,604	486,605
2022 – 2026	270,125	130,629	26,602	427,356
2027 – 2031	223,900	72,925	6,862	303,687
2032 – 2036	141,465	30,306	—	171,771
2037 – 2040	59,495	5,953	—	65,448
Total	1,195,773	684,321	119,943	2,000,037

* Tax Exempt Capital Accumulator (TECA) accretions for the 11 "C" Series in the amount of $327,000 are not included in the principal amount in FY 2012.

Future debt service is calculated using rates in effect at August 31, 2011 for variable rate bonds. As described in Note 8(c), the variable rate received under the swaps is the lesser of the actual bond rate and the SIFMA Municipal Swap Index until September 1, 2011, when the variable rate received changes to 70% of LIBOR until maturity. Therefore, through August 31, 2011, the net swap amounts were calculated by subtracting swap receipts payments based on the lesser of the bond rate or SIFMA rate from the payments related to the fixed rate of the swaps. Subsequent to August 31, 2011, swap receipts payments will be based on 70% of LIBOR.

(a) Bond Issuances

1998 Ordinance Ninth Series Bonds

On August 26, 2010, the City issued Gas Works Revenue Bonds, Ninth Series in the amount of $150,000,000 for the purpose of financing capital projects, and paying the costs of issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Ninth Series Bonds consisted of $53,015,000 of serial bonds with interest rates that range from 2.0% to 5.0% and have maturity dates through 2025. The Bonds also included $96,985,000 of term bonds with interest rates of 5.0% and 5.25% and have maturities through 2040.

1998 Ordinance Eighth Series Bonds

On August 20, 2009, the City issued Gas Works Revenue Refunding Bonds, Eighth Series in the amount of $313,285,000 for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the costs of terminating a portion of the interest rate swap agreement, and issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Eighth Series Bonds consist of $58,285,000 of serial bonds with interest rates ranging from 4.0% to 5.25% and have maturity dates through 2017. The Eighth Series Bonds also consist of four serial bonds totaling $255,000,000 that have variable rates set through a weekly reset mode. Interest is paid monthly and the bonds are secured with letters of credit that expired August 19, 2011, were extended through September 1, 2011, and were replaced on September 1, 2011 with new letters of credit expiring August 30, 2013 (see note 15). These bonds mature at various dates from 2017 to 2031. The loss on refunding the Sixth Series Bonds and issuing the Eighth Series Bonds of $55,344,000, including $26,311,000 related to the elimination of the deferred outflow of resources upon termination of the Sixth Series hedging relationship, was deferred and will be amortized over the life of the Eighth Series Bonds.

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

	Interest rates	Maturity date (fiscal year)	Balance outstanding August 31, 2011	Balance outstanding August 31, 2010
Series 11C	6.80%	2012	$ 13,679	23,498
1st Series A	4.50% – 5.50%	2026	65,350	74,315
1st Series C	3.85% – 5.00%	2014	5,410	7,050
16th Series	4.00% – 5.50%	2015	16,915	16,915
2nd Series	4.63% – 5.38%	2012	2,925	5,715
3rd Series	4.25% – 5.50%	2012	2,980	5,815
4th Series	4.00% – 5.25%	2032	87,110	89,915
17th Series	4.00% – 5.38%	2026	126,560	132,675
5th Series	4.00% – 5.25%	2034	114,915	117,520
5th Series A-2	Variable	2035	30,000	30,000
18th Series	5.00% – 5.25%	2021	36,575	39,490
19th Series	5.00%	2024	14,450	14,450
7th Series	4.00% – 5.00%	2038	190,484	193,785
7th Series Refunding	5.00%	2029	30,900	30,900
8th Series A	4.00% – 5.25%	2017	55,055	56,690
8th Series B	Variable	2031	105,000	105,000
8th Series C	Variable	2031	50,000	50,000
8th Series D	Variable	2031	50,000	50,000
8th Series E	Variable	2031	50,000	50,000
9th Series	2.00% – 5.25%	2040	147,465	150,000
			$ 1,195,773	1,243,733

(b) 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.

Also provided by both general ordinances is the establishment of a sinking fund into which deposits are made sufficient to meet all principal and interest requirements of the bonds as they become due. Both general ordinances also provide that sinking fund reserves be maintained as part of the Sinking Fund Reserve, which have previously been funded from the proceeds of each series of bonds 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 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 monies in the Sinking Fund.

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 is reported as long-term debt.

(c) Interest Rate Swap Agreements

Objective – In January 2006, the City entered into a fixed rate payer, floating rate receiver swap to create a synthetic fixed rate for the Sixth Series Bonds. The variable rate/swap structure was used as a means to increase the City's savings, when compared with fixed-rate refunding bonds at the time of issuance. The swaps are hedging interest rate risk.

Terms – The swap was originally executed with the counterparty on January 26, 2006 and will mature on August 1, 2031. Under the swap, the City pays a fixed rate of 3.6745% and receives a variable rate computed as the lesser of (i) the actual bond rate and (ii) the SIFMA Municipal Swap Index until September 1, 2011 on which date the variable interest rate received will switch to 70.0% of one month LIBOR until maturity.

In August 2009, the City terminated approximately $54,800,000 of the notional amount of the swap, issued fixed rate refunding bonds related to that portion and kept the remaining portion of the swap to hedge the Eight Series variable rate refunding bonds backed with letters of credit. The Company paid a swap termination payment of $3,791,000 to the counterparty to partially terminate the swap.

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

As of August 31, 2011, the swaps had a notional amount of $255,000,000 and the associated variable rate debt had a $255,000,000 principal amount, broken down by series as follows:

- The Series B swap had a notional amount of $105,000,000 and the associated variable rate bonds had a $105,000,000 principal amount.
- The Series C swap had a notional amount of $50,000,000 and the associated variable rate bonds had a $50,000,000 principal amount.
- The Series D swap had a notional amount of $50,000,000 and the associated variable rate bonds had a $50,000,000 principal amount.
- The Series E swap had a notional amount of $50,000,000 and the associated variable rate bonds had a $50,000,000 principal amount.

The final maturity date for all swaps is on August 1, 2031.

Fair value – As of August 31, 2011, the swaps had a combined negative fair value for all series of $51,671,000. The fair values of the interest rate swaps were estimated using the zero coupon method. That method calculates the future net settlement payments required by the swap, assuming current forward rates are implied by the current yield curve for hypothetical zero coupon bonds due on the date of each future net settlement on the swaps.

Risks – As of August 31, 2011, 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 Company's 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 Aa3/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 in 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 year ended August 31, 2011 and 2010 is as follows (thousands of dollars):

		Interest rate swap liability	Deferred outflow of resources
Balance August 31, 2010	$	52,217	25,906
Change in fair value through August 31, 2011		(546)	(546)
Balance August 31, 2011	$	51,671	25,360

		Interest rate swap liability	Deferred outflow of resources
Balance August 31, 2009	$	27,555	1,244
Change in fair value through August 20, 2010		24,662	24,662
Balance August 31, 2010	$	52,217	25,906

The interest rate swap liability is included in other liabilities and deferred credits and deferred outflow of resources is included in other assets and deferred debits on the balance sheet.

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

(d) Guaranteed Investment Contracts in Sinking Fund

On August 23, 2002, the City entered into GICs in connection with a portion of its 1975 and 1998 Ordinance Sinking Fund Reserves for the Company. At settlement, approximately 65.0% of the Sinking Fund Reserves, from the two ordinances, totaling $61,396,000 were invested in the GICs. In exchange for this investment, the Company received an up-front payment of $21,800,000 in lieu of receiving interest payments over the life of the GICs. The life of the GIC is 18 1/2 years, with 9 1/2 years remaining at August 31, 2011.

The GICs are recorded at contract value in the Sinking Fund and had contract values of $44,257,000 and $45,734,000 at August 31, 2011 and 2010, respectively.

The Company also paid $1,650,000 to terminate an existing agreement as part of this transaction. Of the remaining net proceeds of $20,150,000, $8,596,000 was allocated to the 1975 Sinking Fund Reserve and $11,554,000 was allocated to the 1998 Sinking Fund Reserve. For debt service coverage purposes, the $20,150,000 was considered "project revenues" in FY 2002. For financial statement purposes, the $8,596,000 was recorded as revenue in FY 2002 in the category of interest and other income. This amount is nonrefundable and was granted to the Company by the City.

Under the 1998 General Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 General Ordinance. Therefore, the $11,554,000 received under the 1998 ordinance was deferred and is being amortized on a straight-line basis over the life of the agreement. The unamortized balance of the proceeds was $5,933,000 and $6,558,000 at August 31, 2011 and 2010, respectively.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2011 was as follows (thousands of dollars):

	Latest date maturing to	Interest rate	Bonds outstanding
7th Series	3/15/13	6.00%	$ 10,675,000
12th Series B	5/15/20	7.00	39,300,000
4th Series	8/1/20	5.25	20,005,000

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.

The assets pledged, primarily noncallable U.S. government securities, had a market value of $74,865,000 at August 31, 2011, bearing interest on face value from 0.0% to 6.7%.

(10) Pension Costs

(a) Plan Description

The Pension Plan sponsored by the City provides pension benefits for all eligible employees of the Company and other eligible class employees of PFMC and the PGC. The Company's annual covered payroll (which was substantially equal to total payroll) was $106,125,000 and $106,003,000 at August 31, 2011 and 2010, respectively.

At September 1, 2009, the beginning of the plan year of the last 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	2,232
Current employees:	
Vested	1,347
Nonvested	306
Total current employees	1,653
Total membership	3,885

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.

Final Average Earnings are the employee’s average pay, over the highest five years of the last ten 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.

Covered employees are not required to contribute to the Pension Plan. The Company is required by statute to contribute the amounts necessary to fund the Pension Plan. Benefit and contribution provisions are established by City Ordinance and may be amended only as allowed by City Ordinance.

The City issues a publicly available financial report that includes financial statements and required supplementary information for the Pension Plan. The report may be obtained by writing to the Director of Finance of the City.

(b) Annual Pension Cost, Contributions Required, and Contributions Made

The normal cost, amortization of the unfunded balance, and annual required and actual contributions for FY 2011 and the two preceding fiscal years were as follows (thousands of dollars):

		Normal cost	Amortization of the underfunded balance	Annual required and actual contributions
Fiscal year ended August 31:				
2011	$	8,499	14,098	22,597
2010		8,292	16,341	24,633
2009		8,125	7,300	15,425

Beneficiary payments in FY 2011 were made from operating funds. Instead, the Company set up a receivable to draw the FY 2010 funds of $11,139,000 in FY 2011, which is recorded in other current assets and deferred debits on the balance sheet. The withdrawals from the pension assets in FY 2010 of $15,365,000 were utilized to meet beneficiary payment obligations.

The Company's annual pension cost is equal to its annual required contribution (ARC). The ARCs were determined based on an actuarial study, or updates thereto, using the projected unit credit method. Significant actuarial assumptions used for the above valuation include a rate of return on the investment of present and future assets of 8.25% per year compounded annually; projected salary increases of 3.0% of the salary at the beginning of the next three years, then 4.25% of the salary at the beginning of the fourth and subsequent year; and retirements that are assumed to occur prior to age 62, at a rate of 10.0% at ages 55 to 61 and 100.0% at age 62. The assumptions did not include postretirement benefit increases. These actuarial assumptions are consistent with the prior fiscal year.

The actuarial asset value is equal to the value of the fund assets as reported by the City with no adjustments. The unfunded actuarial accrued liability is being amortized over 10 years.

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. Level percentages of payroll employer contribution rates are determined using the Projected Unit Credit actuarial funding method. The actuarial value of assets, actuarial accrued liability, unfunded actuarial accrued liability, funded ratio, covered payroll and the unfunded actuarial accrued liability of covered payroll for FY 2011, and the two preceding fiscal years were as follows (thousands of 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
September 1, 2010	$	381,975	533,630	151,655	71.58%	106,125	142.90%
September 1, 2009		355,499	519,773	164,274	68.40%	106,003	154.97
September 1, 2008		430,390	495,155	64,765	86.92%	107,918	60.01

The ARCs, contributions made, and net pension obligation for FY 2011 and the two preceding fiscal years were as follows (thousands of dollars):

		2011	2010	2009
Annual required contribution	$	22,597	24,633	15,425
Contributions made		(22,597)	(24,633)	(15,425)
Net pension obligation	$	—	—	—

(c) Historical Trend Information (Unaudited)

Historical trend information reflecting funding progress and contributions made by the Company is presented in the supplemental schedule of pension funding progress (unaudited).

(11) Other Postemployment Benefits

(a) Plan Description

The Company sponsors a single employer defined benefit healthcare plan and provides postemployment healthcare and life insurance benefits to approximately 2,002 and 1,963 participating retirees and their beneficiaries and dependents for FY 2011 and FY 2010, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,671 and 1,669 active employees and their dependents for FY 2011 and FY 2010, respectively, by charging the annual insurance premiums to expense. The annual covered payroll (which was substantially equal to total payroll) was $106,125,000 and $106,003,000 at August 31, 2011 and 2010, respectively.

The Company pays 100.0% of premiums for basic medical, hospitalization, and prescription drugs incurred by retirees and their dependents. The Company also pays a portion of the premium for life insurance for each eligible retiree. 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. Additionally, in FY 2011, the Company began funding an OPEB Trust.

Total expense incurred for healthcare amounted to $46,250,000 and $42,083,000 in FY 2011 and FY 2010, respectively, of which approximately 47.2% and 48.9%, respectively, represents payments on behalf of retired employees and their dependents. Employees and retirees contributed $1,174,000 and $1,029,000 in FY 2011 and FY 2010, respectively, towards their healthcare. These contributions represent the additional cost of healthcare plans chosen by employees and retirees above the basic plan offered by the Company. Total premiums for group life insurance were $1,977,000 and $1,874,000 in FY 2011 and FY 2010, respectively. The amount attributed to retirees was approximately 77.8% and 76.5% in FY 2011 and FY 2010, respectively. The contribution requirements of nonunion plan members are established by management and may be amended. The contribution requirements for union plan members are subject to collective bargaining.

The Plan does not issue a stand-alone report.

(b) Actuarial Valuation and Assumptions

The Company engaged an actuarial consulting firm to provide an actuarial valuation of the Company’s OPEB obligations as of August 31, 2011. The actuarial valuations involve estimates of the value of reported amounts and the assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision, as actual results are compared to past expectations, and new estimates are made about the future. The calculations were based on the types of benefits provided under the terms of the substantive plan at the time of the valuation.

The projected unit cost method was utilized in the valuation to develop the actuarial accrued liability and normal cost. Under the projected unit cost method, the present value of benefits is allocated uniformly over the employee’s expected working lifetime. The actuarial accrued liability is that portion of the present value of projected benefits, which has been accrued during the employee’s working lifetime from hire to valuation date. The normal cost represents the amount charged for services earned during the current reporting period. The normal cost is calculated by dividing the present value of projected benefits for an employee by the total service.

The valuation was prepared utilizing certain assumptions, including the following:

- Economic assumptions – the discount rate and healthcare cost trend rates

The report utilized an 8.0% discount rate for purposes of developing the liabilities and ARC on the Plan for FY 2011. This rate is based on the expected return of the investments of the OPEB Trust.

	Healthcare cost trend rates			
	Medical (pre-65)	**Medical (post-65)**	**Prescription**	**Dental**
Year:				
1	11.0%	9.0%	9.0%	4.5%
2	10.0	8.0	8.0	4.5
3	9.0	7.0	7.0	4.5
4	8.0	6.0	6.0	4.5
5	7.0	5.0	5.0	4.5
6	6.5	4.5	4.5	4.5
7	6.0	4.5	4.5	4.5
8	5.5	4.5	4.5	4.5
9	5.0	4.5	4.5	4.5
10 and beyond	4.5	4.5	4.5	4.5

- Benefit assumptions – the initial per capita cost rates for medical coverage, and the face amount of Company-paid life insurance
- Demographic assumptions – including the probabilities of retiring, dying, terminating (without a benefit), becoming disabled, recovery from disability, election (participation rates), and coverage levels

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

The amount paid by the Company for retiree benefits in FY 2011 was $41,719,000, consisting of $21,819,000 of healthcare expenses $1,400,000 of life insurance expenses and $18,500,000 contributed to the OPEB trust. The difference between the ARC and the expenses paid resulted in an increase in the OPEB liability of $3,972,000 and $27,269,000 recorded in other liabilities and deferred credits and expensed in FY 2011 and FY 2010, respectively. As of August 31, 2011, the actuarial accrued liability for benefits was $485,722,000, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 457.7%. Historical trend information reflecting funding progress and contributions made by the Company is presented in the Schedule of Other Postemployment Benefits Funding Progress (unaudited).

(Continued)

The following table shows the components of the Company's annual OPEB cost for FY 2011, the amount actually contributed to the plan, and the Company's net OPEB obligation (thousands of dollars):

		2011	2010
Annual required contribution	$	46,622	50,152
Interest on net OPEB obligation		8,438	3,910
Adjustment to the annual required contribution		(9,369)	(5,087)
Annual OPEB cost		45,691	48,975
Contributions made		(41,719)	(21,706)
Net OPEB obligation as of prior year		105,476	78,207
Net OPEB obligation as of August 31,	$	109,448	105,476

The difference between the annual OPEB cost and contributions made is recorded as other postemployment benefits expense on the statement of revenues and expenses. Contributions made are allocated to operating expense line items along with salaries and other employee benefit costs.

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for FY 2011 and the two preceding fiscal years were as follows (thousands of dollars):

		Annual OPEB cost	Percentage of annual OPEB cost contributed	Net OPEB obligation
Fiscal year ended August 31:				
2011	$	45,691	91.31	109,448
2010		48,975	44.32	105,476
2009		46,009	43.59	78,207

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.

(Continued)

(d) Other Coverage Information

The Company has entered into several one-year contracts to provide healthcare for both active and retired employees that are experience rated, and premiums are adjusted annually. In addition, the Company has in place approximately $176,985,000 of group life insurance coverage for both active and retired employees, which is retrospectively rated on a monthly basis. The Company also has in place approximately $140,327,000 of accidental death and dismemberment insurance coverage for active employees.

(12) Pollution Remediation

The pollution remediation obligations at August 31, 2011 and 2010 are $28,122,000 and $24,614,000 respectively, which reflect the impact of GASB 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

(13) Risk Management

The Company is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disasters. While self-insured for many risks, the Company purchases insurance coverage where appropriate. The Company's real and personal property is insured against the risk of loss or damage in the amount of $250,000,000, subject to a $500,000 per accident deductible at the Richmond and Passyunk Plants and a $100,000 deductible per accident 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 maintained $210,000,000 in liability (including terrorism) coverage, insuring against the risk of damage to property or injury to the public with a per occurrence self-insured retention of $1,000,000.

The Company maintains statutory limits for Workers' Compensation (including terrorism) with a $500,000 per occurrence self-insured retention.

The Company maintains a $10,000,000 Public Officials Liability (Directors and Officers Liability) policy with a $500,000 retention as well as a $60,000,000 Fiduciary Liability policy with a $500,000 self-insured retention.

The Company has evaluated all open claims as of August 31, 2011 and has appropriately accrued for these claims on the balance sheet.

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

		Beginning of year reserve	Current year claims and adjustments	Claims settled	End of year reserve	Current liability amount
Fiscal year ended August 31:						
2011	$	9,866	4,299	(3,468)	10,697	4,141
2010		11,881	1,237	(3,252)	9,866	5,380
2009		13,534	1,938	(3,591)	11,881	5,236

(14) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately $10,605,000 as of August 31, 2011.

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

Fiscal year ending August 31:		
2012	$	606
2013		321
2014		103
2015		16

Rent expense for the fiscal years ended August 31, 2011 and 2010 amounted to $1,126,000 and $1,225,000, 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 $6,501,000 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, 2011 through March 31, 2012.

The Company's FY 2011 Capital Budget was approved by City Council in the amount of $67,689,000. Within this approval, funding was provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program. Main replacement cost for this program in FY 2011 is expected to be $17,982,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately $113,044,000.

The FY 2011 Capital Budget also includes $1,862,000 for the purchase of replacement Automatic Meter Reading (AMR) units. The total six-year cost of this program to replace AMR units is approximately $4,006,000.

(15) Subsequent Events

Bond Transactions

Defeasance and Remarketing of Debt

On September 1, 2011, the City of Philadelphia issued Gas Works Revenue Bonds, Eighth Series in the amount of $225,520,000 for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the cost of terminating a portion of the interest rate swap agreement, paying the costs of issuing the bonds, and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. Approximately $29,500,000 of the Sixth Series Bonds were defeased utilizing internally generated funds. The cost of issuance related to this transaction was approximately $411,000.

As a result of this defeasance a portion of the interest rate swap agreement was terminated. The termination payment was approximately $6,970,000. The interest rate swap agreement was amended to reflect new notional amounts related to the respective Eighth Series Bonds. The Eighth Series B Bonds have a $50,260,000 notional amount. The Eighth Series C Bonds have a $50,000,000 notional amount. The Eighth Series D Bonds have a $75,000,000 notional amount. The Eighth Series E Bonds have a $50,260,000 notional amount.

Refunding of Bonds

On September 28, 2011, the City issued Gas Works Revenue Bonds, Twentieth Series (1975 General Ordinance) in the amount of $16,245,000 for the purpose of refunding the entire Sixteenth Series Bond (1975 General Ordinance), and paying the costs of issuing the bonds. The Twentieth Series Bonds, with fixed interest rates that range from 2.0% to 5.0%, have maturity dates through 2015. The cost of issuance related to this transaction was approximately $222,000.

On September 28, 2011, the City issued Gas Works Revenue Bonds, Tenth Series (1998 General Ordinance) in the amount of $72,610,000 for the purpose of refunding the entire First Series A, First Series C, Second Series, and Third Series Bonds (1998 General Ordinance), and paying the costs of issuing the bonds. The Tenth Series Bonds, with fixed interest rates that range from 3.0% to 5.0%, have maturity dates through 2026. The cost of issuance related to this transaction was approximately $1,299,000.

Notes Payable

Effective September 2011, PGW requested that each of the three banks reduce the stated amounts of their respective letters of credit for the commercial paper Series F-1, F-2, and F-3 from $30,000,000 to $20,000,000. As a result of the reduction of each of the letters of credit, PGW's commercial paper program was reduced from $90,000,000 to $60,000,000.

Pension Plan

In December 2011, the Pension Plan sponsored by the City was amended by Ordinance and a new deferred compensation plan was authorized by Ordinance as well. Newly hired employees will 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 deferred compensation 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.

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

Required Supplementary Information (Unaudited)

Schedule of Pension Funding Progress

(Thousands of 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
September 1, 2010*	$	381,975	533,630	151,655	71.58%	$	106,125	142.90%
September 1, 2009**		355,499	519,773	164,274	68.40		106,003	154.97
September 1, 2008***		430,390	495,155	64,765	86.92		107,918	60.01
September 1, 2007+		416,183	482,380	66,197	86.28		105,596	62.69
September 1, 2006++		411,886	474,250	62,364	86.85		106,018	58.82
September 1, 2005+++		383,517	450,866	67,349	85.06		102,544	65.68

* The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2009 through August 31, 2010, updated for contributions and additional accrued benefits in the subsequent fiscal year.

** The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2009 through August 31, 2010.

*** The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2007 through August 31, 2008, updated for contributions and additional accrued benefits in the subsequent fiscal year.

\+ The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2007 through August 31, 2008.

++ The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2005 through August 31, 2006, updated for contributions and additional accrued benefits in the subsequent fiscal year.

+++ The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2005 through August 31, 2006.

See accompanying independent auditors' report.

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

Required Supplementary Information (Unaudited)

Schedule of Other Postemployment Benefits Funding Progress

(Thousands of 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, 2011*	$	17,886	485,722	467,836	3.68%	$	106,125	440.83%
August 31, 2010**		—	654,126	654,126	—		106,003	617.08
August 31, 2009***		—	635,792	635,792	—		107,918	589.14
August 31, 2008****		—	591,599	591,599	—		105,596	560.25

* The required supplementary information is based on a biennial actuarial valuation of the OPEB fund for the plan year September 1, 2010 through August 31, 2011.

** The required supplementary information is based on a biennial actuarial valuation of the OPEB fund for the plan year September 1, 2009 through August 31, 2010 updated for contributions and additional accrued benefits in the subsequent fiscal year.

*** The required supplementary information is based on a biennial actuarial valuation of the OPEB fund for the plan year September 1, 2008 through August 31, 2009.

**** The required supplementary information is based on a biennial actuarial valuation of the OPEB fund for the plan year September 1, 2007 through August 31, 2008 updated for contributions and additional accrued benefits in the subsequent fiscal year.

See accompanying independent auditors' report.