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

Basic Financial Statements and Supplementary Information

August 31, 2008 and 2007

(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, 2008 and 2007, and the related statements of revenues and expenses, cash flows, and changes in fund equity, as of and 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, 2008 and 2007, 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 3 to 12 and the schedules of pension funding progress, other postemployment benefits funding progress, and other postemployment benefit employer contributions on pages 52 to 54 is not a required part of the basic financial statements but is 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.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included on pages 55 to 58 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP, a U.S. limited liability partnership, is the U.S.
member firm of KPMG International, a Swiss cooperative.

As discussed in note 1(n), the Company adopted the provisions of Governmental Accounting Standards Board Statement (GASB) No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and GASB Statement No. 50, *Pension Disclosures*, as of September 1, 2006.

KPMG LLP

December 29, 2008

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2008 and 2007 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) 2008 reflected a 16.9% warmer than normal winter. The FY 2008 period was 0.7% warmer than the prior year and firm gas sales decreased by 2.4 Billion cubic feet (Bcf). In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2007 through May 2008, resulted in heating customers receiving charges totaling $12.2 million as a result of the temperatures experienced during the period. FY 2007 reflected a 16.6% warmer than normal winter. The FY 2007 period was 1.2% warmer than the prior year; however, firm gas sales increased by 2.0 Bcf. In addition, the WNA, which was in effect from October 2006 through May 2007, resulted in heating customers receiving charges totaling $6.5 million as a result of the temperatures experienced during the period.
- PGW achieved a collection rate of 95.5% in the current period, 95.8% in FY 2007 and 96.6% in FY 2006. The collection rate of 95.5% is calculated by dividing the total gas receipts collected in FY 2008 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 2007 and FY 2006, respectively.
- The Company adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 45 (GASB 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of September 1, 2006 and had a zero net Other Postemployment Benefits (OPEB) obligation at transition. PGW adopted the provisions of GASB 45 a year earlier than required by GASB because the Company is a component unit of the City of Philadelphia (the City) for financial reporting purposes and the Company's FY 2007 financial statements will be consolidated into the City's financial statements for the fiscal year ended June 30, 2008. The difference between the FY 2008 Annual Required Contribution (ARC) of $44.1 million and the expenses paid by the Company of $18.3 million resulted in a liability of $25.8 million which has been recorded in other liabilities and deferred credits and expensed in FY 2008. The difference between the FY 2007 ARC of $45.2 million and the expenses paid by the Company of $18.8 million resulted in a liability of $26.4 million which was recorded in other liabilities and deferred credits and expensed in FY 2007.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), is effective for the Company's fiscal year beginning September 1, 2008; however, the Company has chosen to implement the provisions of GASB 49 a year earlier than required by GASB because the Company is a component unit of the City for financial reporting purposes and the Company's FY 2008 financial statements will be consolidated into the City's financial statements for the fiscal year ended June 30, 2009. This statement establishes a framework for the recognition and measurement of pollution remediation liabilities. A pollution remediation obligation addresses the current or potential detrimental effects of existing pollution by participation in pollution remediation activities.

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Prior to the implementation of GASB 49, the Company recognized liabilities related to its voluntary participation in remediation activities under Pennsylvania Act 2, *Land Recycling and Environmental Remediation Standards Act of 1995*, which established the land recycling program, and its mandatory participation in activities under Pennsylvania Act 32, *Storage Tank and Spill Prevention Act of 1989*, which established a comprehensive program to prevent leaks and spills from underground and above ground tanks in accordance with existing U.S. generally accepted accounting principles (U.S. GAAP) related to the accrual of liabilities.

The Company revised its methodology for estimating its pollution remediation obligations to conform with GASB 49 in the current year, which resulted in an additional $8.3 million liability which is reflected in other liabilities and deferred credits at August 31, 2008. GASB 49 requires pollution remediation liabilities to be measured at the beginning of the first period presented in the financial statements. The Company has not restated prior periods and instead recognized the effect of GASB 49 implementation in the current year, because the increase in the liability related to the implementation of GASB 49 is not material.

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.

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.

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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		
		2008	**2007**	**2006**
Total gas revenues	$	831,428	840,105	929,961
Other revenues		18,199	19,246	24,007
Total operating revenues		849,627	859,351	953,968
Total operating expenses		794,246	819,748	880,040
Operating income		55,381	39,603	73,928
Interest and other income		15,732	13,073	8,518
Total interest expense		(68,006)	(68,780)	(65,687)
Excess (deficiency) of revenues over (under) expenses	$	3,107	(16,104)	16,759

Operating Revenues

Operating revenues in FY 2008 were $849.6 million, a decrease of $9.8 million or 1.1% from the FY 2007 level. The decrease in FY 2008 was due to a milder winter. Operating revenues in FY 2007 were $859.4 million, a decrease of $94.6 million or 9.9% from the FY 2006 level. The decrease in FY 2007 was principally due to lower fuel costs which are a component of operating revenues through the gas cost rate (GCR). Please see the discussion of the cost of fuel in the Operating Expenses section below.

Total sales volumes, including gas transportation deliveries, in FY 2008 increased by 2.5 Bcf to 66.3 Bcf or 3.9% from FY 2007 sales volumes of 63.8 Bcf. In FY 2007 total sales volumes increased by 4.4 Bcf to 63.8 Bcf or 7.4% from FY 2006 sales volumes of 59.4 Bcf. Firm gas sales of 45.5 Bcf were 2.4 Bcf or 5.0% lower than FY 2007 firm gas sales of 47.9 Bcf were 1.7 Bcf or 3.7% higher than FY 2007. Interruptible customer sales decreased by 0.9 Bcf compared to FY 2007 and increased by 0.3 Bcf compared to FY 2006. Gas transportation sales in FY 2008 increased by 5.9 Bcf to 19.0 Bcf from the 13.1 Bcf level experienced in FY 2007. In FY 2007, the volume increased by 2.4 Bcf to 13.1 Bcf from the 10.7 Bcf level experienced in FY 2006.

The number of customers served by PGW at the end of FY 2008 decreased by 0.2% from the previous year to approximately 505,000 customers. The number of customers served by PGW at the end of FY 2007 and FY 2006 were approximately 506,000 and 486,000, respectively. Commercial accounts were approximately 25,000, reflecting no change from the previous two fiscal years. Industrial accounts decreased by 11.1% from the prior year's level to 800. Industrial accounts were 900 and 1,000 customers in FY 2007 and FY 2006, respectively.

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Residential customers decreased to 479,000 customers, a decrease of 1,000 from the prior year. The number of residential customers in FY 2007 increased to approximately 480,000 customers, an increase of 20,000 over the FY 2006 level.

Operating Expenses

Total operating and maintenance expenses, including fuel costs, in FY 2008 were $794.2 million, a decrease of $25.5 million or 3.1% from FY 2007. Total expenses decreased by $60.3 million or 6.9% from FY 2007 compared to FY 2006. The decrease for FY 2008 reflects substantially lower natural gas utilization and an increase in refunds received from pipeline suppliers. The decrease for FY 2007 reflects substantially higher natural gas prices from FY 2006.

Cost of Fuel – The cost of natural gas utilized decreased by $27.3 million or 5.1% to $512.0 million in FY 2008 compared with $539.3 million in FY 2007. The average commodity price per Thousand cubic feet (Mcf) increased by $0.25 or $13.5 million, while the volume of gas utilized decreased by 4.6 Bcf, 7.9% or $37.6 million. In addition, pipeline supplier refunds in FY 2008 increased by $10.0 million while demand charges increased by $6.8 million, compared to FY 2007.

The cost of natural gas utilized decreased by $85.8 million or 13.7% to $539.3 million in FY 2007 compared with $625.1 million in FY 2006. The average commodity price per Mcf decreased by nearly $2.02 or $117.2 million, while the volume of gas utilized increased by 3.0 Bcf, 5.4% or $30.6 million, in FY 2007 despite a 1.2% decrease in degree days from FY 2006. In addition, pipeline supplier refunds in FY 2007 decreased by $0.2 million while demand charges increased by $0.7 million, compared to FY 2006.

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

The average natural gas commodity prices for utilized gas for FY 2008, FY 2007, and FY 2006 were $8.48, $8.23, and $10.25 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2008 were $68.9 million, down from the FY 2007 total of $69.5 million as a result of lower labor costs and up from the FY 2006 total of $66.1 million as a result of an increase in the value of gas used from the time customers request shutoff to the occupancy of the premise by a subsequent customer. This cost was partially reduced by lower operating expenses due to warmer weather conditions. In addition, the cost for customer services, collection and account management, marketing, and the administrative area increased by $4.9 million or 5.7% in FY 2008 primarily due to costs related to the business transformation initiative and a decrease in the gas used by the utility. This category decreased by $4.1 million or 4.5% in FY 2007, which was offset somewhat by higher premiums for active and retired employee health insurance coverage. Pension costs decreased by $1.0 million and $2.3 million in FY 2008 and FY 2007, respectively, based on the most recent actuarial valuation of the pension plan.

Provision for Uncollectible Accounts – The provision for uncollectible accounts in FY 2008 totaled $37.0 million, a decrease of $3.0 million or 7.5% lower than FY 2007, which totaled $40.0 million, a decrease of $0.1 million or 0.3% compared to FY 2006 based on the most recent accounts receivable collectibility evaluation. The accumulated provision for uncollectible accounts at August 31, 2008 reflects a balance of $140.4 million, compared to the $150.2 million balance in FY 2007 and $168.9 million in FY 2006. 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 $3.1 million in FY 2008 compared with FY 2007. Depreciation expense increased by $1.7 million in FY 2007 compared with FY 2006. The effective composite depreciation rates for FY 2008, FY 2007 and FY 2006 were 2.4%, 2.3% and 2.3%, respectively. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income was $2.7 million greater than FY 2007 as the result of increased earnings on higher restricted fund balances. Interest and other income in FY 2007 was $4.6 million greater than FY 2006 as the result of increased earnings rates on higher restricted fund balances.

Interest Expense – Total interest expense decreased by $0.8 million or 1.1% in FY 2008 compared with FY 2007 and increased by $3.1 million or 4.7% in FY 2007 compared with FY 2006. Interest on long-term debt was $3.9 million higher than the FY 2007 level as a result of the full year effect of the FY 2007 issuance of revenue bonds in May 2007. Other interest costs decreased by $4.8 million or 28.0% in FY 2008 principally due to the reduction in the borrowing cost of the commercial paper program. Other interest costs increased by $2.2 million or 14.6% in FY 2007 and increased by $4.0 million or 36.4% in FY 2006 reflecting additional costs associated with PGW's commercial paper program and the amortization of the loss on reacquired debt.

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Excess (Deficiency) of Revenues Over (Under) Expenses – In FY 2008, the Company's excess of revenues over expenses was $28.9 million prior to recording the expense of $25.8 million related to OPEB. As a result, the Company ended with an excess of revenues over expenses of $3.1 million. The Company had an excess of revenues over expenses of $10.3 million in FY 2007 prior to recording the expense of $26.4 million related to OPEB and $16.8 million in FY 2006.

Condensed Balance Sheets

(Thousands of dollars)

		August 31		
Assets		**2008**	**2007**	**2006**
Utility plant, net	$	1,062,095	1,040,373	1,007,648
Restricted investment funds		219,788	277,139	135,625
Current assets:				
Accounts receivable (net of accumulated provision for uncollectible accounts of $140,435, $150,231, and $168,889 for 2008, 2007, and 2006, respectively)		99,304	88,618	74,360
Other current assets and deferred debits, cash and cash equivalents, gas inventories, materials, and supplies		242,503	205,083	181,394
Total current assets		341,807	293,701	255,754
Other assets and deferred debits		105,975	103,727	106,983
Total assets	$	1,729,665	1,714,940	1,506,010
Fund Equity and Liabilities				
Fund equity	$	226,408	223,301	239,405
Total long-term debt		1,127,163	1,201,792	1,076,131
Current liabilities:				
Note payable		90,000	51,600	55,000
Current portion of long-term debt		76,030	86,995	39,591
Other current liabilities and deferred credits		126,235	103,276	73,854
Total current liabilities		292,265	241,871	168,445
Other liabilities and deferred credits		83,829	47,976	22,029
Total fund equity and liabilities	$	1,729,665	1,714,940	1,506,010

Assets

Utility Plant – Utility plant, net of depreciation, totaled $1,062.1 million in FY 2008, an increase of $21.7 million or 2.1% compared with the FY 2007 balance of $1,040.4 million. The FY 2007 balance of $1,040.4 million, increased by $32.8 million or 3.3% compared with the FY 2006 balance of $1,007.6 million. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $61.2 million in FY 2008 compared to $69.1 million in FY 2007 and $60.7 million in FY 2006. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amounts of $60.9 million, $60.7 million and $63.1 million in FY 2008, FY 2007 and FY 2006, 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 $57.4 million in FY 2008 primarily due to the drawdown from its Capital Improvement Fund offset by interest income. Interest income on these funds, to the extent not drawn, is reflected as an increase and approximated $2.7 million in FY 2008 and $6.8 million in FY 2007. A drawdown from the Sinking Fund's capitalized interest account in the amount of $0.1 million was utilized to offset the debt service payment in FY 2007. In FY 2006, this amount was $6.0 million.

Accounts Receivable – In FY 2008 accounts receivable (net) of $99.3 million increased by $10.7 million, or 12.1% from FY 2007 due to firm transportation suppliers' billings and an increase in participation in the Customer Responsibility Program (CRP). Accounts receivable (net) increased by $14.3 million, or 19.2% in FY 2007 compared to FY 2006. The accumulated provision for uncollectible accounts, totaling $140.4 million decreased by $9.8 million in FY 2008 and totaled $150.2 million in FY 2007 and $168.9 million in FY 2006.

Other Current Assets and Deferred Debits, Cash and Cash Equivalents, Gas Inventories, Materials, and Supplies – In FY 2008 cash and cash equivalents were $49.3 million, a decrease of $2.4 million from FY 2007, and totaled $51.7 million in FY 2006. Gas storage increased by $41.4 million or 29.9%. The increase in gas inventory reflects an increase in the gas cost per Mcf plus an increase in the amount of storage at year-end. Materials and supplies of $187.5 million, which principally include gas inventory, maintenance spare parts, and material, increased by $39.7 million and were $147.8 million in FY 2007 and $149.4 million in FY 2006. Other current assets and deferred debits totaled $5.6 million in FY 2008, up $0.1 million from FY 2007. In FY 2007 other current assets and deferred debits totaled $5.6 million, down $19.6 million from FY 2006, primarily due to the recovery of under-recovered GCR amounts from the prior year.

Other Assets and Deferred Debits – In FY 2008 other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled $106.0 million, an increase of $2.3 million from FY 2007, mainly due to an increase in the workers' compensation injuries and damages reserve. In FY 2007 the total was $103.7 million and reflected an increase of $3.3 million from FY 2006. The major portion of this change was related to the bond issuance costs on the $313.4 million of debt issued in FY 2006, offset partially by deferred environmental costs.

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Liabilities

Long-Term Debt – Long-term debt, including the current portion and unamortized discount and premium, totaled $1,203.2 million in FY 2008, $85.6 million less than the previous year as a result of the Company paying off the City Loan and normal debt principal payments. This represents 84.2% of total capitalization in FY 2008. Long-term debt, including the current portion and unamortized discount, premium, and note payable – City Loan totaled $1,288.8 million in FY 2007, $173.1 million greater than the previous year as a result of principal payments on outstanding debt and the issuance of the Seventh Series and Nineteenth Series revenue bonds during FY 2007. This represents 85.2% of total capitalization in FY 2007 The total long-term debt for FY 2006 totaled $1,115.7 million, which represented 82.3% of total capitalization.

Debt Service Coverage Ratio and Ratings – PGW has a mandatory debt service coverage ratio of 1.50 times debt service on the 1975 Ordinance Bonds and the 1998 Ordinance Bonds, respectively. In FY 2008, the debt service coverage was at 4.28 times debt service on the outstanding 1975 Ordinance Bonds and 1.88 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 3.70 and 2.00 times, respectively, in FY 2007 and 3.36 and 1.94 times, respectively, in FY 2006. PGW's current bond ratings are "Baa2" from Moody's Investors Service (Moody's), "BBB-" from Standard and Poor's Ratings Service (S&P), and "BBB-" from Fitch Ratings.

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 $200.0 million outstanding at any one time as compared to $150.0 million in FY 2006. The letter of credit supporting PGW's commercial paper program fixed the maximum level of outstanding notes plus interest at $150.0 million in FY 2008 and FY 2007, respectively. These notes are intended to provide additional working capital and are supported by an irrevocable letter of credit and a security interest in PGW's revenues. The notes outstanding at August 31, 2008 had a weighted average interest rate of 1.63% and a remaining weighted average time to maturity of 61 days. The principal amounts outstanding at August 31, 2008 and 2007 were $90.0 million and $51.6 million, respectively. In addition, the City provided PGW with a $45.0 million, 0.0% interest loan in FY 2001. In FY 2007, PGW paid $2.0 million of the loan leaving an outstanding balance of $43.0 million. In FY 2008, PGW paid $20.5 million and $22.5 million in December 2007 and August 2008, respectively to completely repay the remaining balance of the loan.

Liquidity/Cash Flow – At December 18, 2008, $2.0 million was available from the Commercial Paper Program. Additionally, PGW had $111.7 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 18, 2008 was $65.5 million.

Accounts Payable – In FY 2008 accounts payable increased $6.9 million or 11.4% compared with FY 2007 primarily due to an increase in natural gas payables. In FY 2007 accounts payable increased $3.1 million or 7.8% compared with FY 2006 reflecting a $3.3 million increase in accounts payables associated with natural gas partially offset by a $0.2 million decrease in trade payables.

Other Liabilities and Deferred Credits – In FY 2008 other liabilities and deferred credits totaling $83.8 million increased $35.8 million compared to FY 2007. In FY 2007 other liabilities and deferred credits totaling $48.0 million increased $26.0 million compared to FY 2006. The increase in FY 2008 is the effect of recording the change in the liability for OPEB in the amount of $25.8 million, an increase in the injuries and damages reserve and an increase in the environmental remediation liability. The increase in FY 2007 is the effect of recording the liability for OPEB in the amount of $26.4 million.

Other Financial Factors

The City has made a major commitment to PGW by granting back its annual $18.0 million payment, in each of the last three fiscal years, thereby improving PGW's overall liquidity position. PGW must continue to focus its efforts on becoming a competitive utility in the deregulated marketplace. PGW remains committed to achieving its tradition of providing high-quality service to customers, while continuing as a valuable enterprise of the City.

The Company's total OPEB actuarial accrued liability as of August 31, 2008 was $591.6 million if the Company continued to provide for its OPEB obligations on a pay-as-you-go basis. The Company's actuarial accrued liability would be reduced to $382.7 million if the Company adopted a policy of funding its ARC. 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 excess) over a period of 30 years. The actuarial valuation utilized a discount rate of 8.25% for purposes of developing the liabilities and ARC to demonstrate the effect of funding the Plan. This rate is based on the investment return expected on investments segregated in a funded trust.

The annual OPEB cost was $52.3 million for the fiscal year ended August 31, 2008 and is projected to increase to $70.2 million per year over the ensuing 20-year period on a pay-as-you-go basis. The annual OPEB cost was $45.2 million for the fiscal year ended August 31, 2007.

On December 22, 2006, PGW filed for a $100.0 million base rate increase with the Public Utility Commission (PUC). On September 28, 2007, the PUC approved a rate increase of $25.0 million. PGW appealed this decision to Commonwealth Court on or about October 18, 2007 and this matter is still pending in the courts. The $25.0 million rate increase was implemented in November 2007.

In November 2008, the Company filed for an extraordinary or emergency base rate increase of approximately $60.0 million or 5.2% and simultaneously requested an $85.0 million or 7.4% decrease in the GCR for a net 2.2% overall rate decrease of approximately $25.0 million. The proposed base rate increase will serve several purposes. First, the increase will cover the additional financing costs that the Company anticipates it will incur in the next few months. Second, the increase will improve the Company's financial position so as to enhance its ability to access the financial markets and maintain its bond rating. Third, the increase will provide 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 $60.0 million or 5.2% and a decrease in the GCR of $107.0 million for a net decrease in rates of $47.0 million or 4.2%. These rates are effective as of January 1, 2009.

The Company had $90.0 million of commercial paper that was outstanding at August 31, 2008. Subsequent to year-end, all outstanding commercial paper matured, and additional commercial paper was issued. As of December 18, 2008, $148.0 million of commercial paper was outstanding which matures on February 12, February 13 and March 12, 2009.

As of December 18, 2008, $271.4 million of the Sixth Series Bonds are held by the providers of the Standby Bond Purchase Agreement as bank bonds. The providers of the Standby Bond Purchase Agreement continue, on a weekly basis, to remarket the bonds in accordance with the bond authorization. The Standby Bond Purchase Agreement expires on January 26, 2009. If the Standby Bond Purchase Agreement is not renewed, and no substitute liquidity facility is provided, any bank bonds held at that time will be amortized in ten payments payable the first business day of July and the first business day of December for the next five years. The Company has therefore recorded as current debt at August 31, 2008 one tenth of the outstanding Sixth Series Bonds as of August 31, including $1.9 million due to mature in 2009 under the original amortization schedule and an additional $29.3 million for a total of $31.2 million.

The fair value of the interest rate swap as of December 18, 2008 was negative $72.6 million. This means that the Company would have to pay this amount to terminate the swap. Per the swap agreement, the refunding or defeasance of the Sixth Series Bonds, in whole or in part, without the prior written consent of both the counterparty and the insurer, may constitute an event of termination unless certain conditions are met. There is a termination risk related to the interest rate swap agreement if PGW's bond rating falls below Baa2 or BBB (Moody's/S&P). Because the City's swap payments are insured by Financial Security Assurance Inc. (FSA) as long as FSA is rated at or above A2 or A (Moody's/S&P) the termination event based on the City's rating is stayed. Neither the Company's credit rating nor FSA's credit rating has declined below the levels required in the agreement as of December 18, 2008.

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, 2008 and 2007

(Thousands of dollars)

Assets		**2008**	**2007**
Utility plant, at original cost:			
In service	$	1,685,593	1,633,300
Under construction		46,969	48,013
Total		1,732,562	1,681,313
Less accumulated depreciation		670,467	640,940
Utility plant, net		1,062,095	1,040,373
Restricted investment funds:			
Sinking fund, revenue bonds		106,198	102,438
Capital improvement fund		111,207	172,134
City of Philadelphia		—	643
Workers' compensation escrow fund		2,383	1,924
Total restricted investment funds		219,788	277,139
Current assets:			
Cash and cash equivalents		49,338	51,698
Accounts receivable (net of provision for uncollectible accounts of $140,435 and $150,231 for 2008 and 2007, respectively)		99,304	88,618
Gas inventories, materials, and supplies		187,539	147,770
Other current assets and deferred debits		5,626	5,615
Total current assets		341,807	293,701
Unamortized bond issuance costs		38,738	42,086
Unamortized losses on reacquired debt		47,902	53,359
Other assets and deferred debits		19,335	8,282
Total assets	$	1,729,665	1,714,940

See accompanying notes to financial statements.

(Continued)

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

Balance Sheets

August 31, 2008 and 2007

(Thousands of dollars)

Fund Equity and Liabilities		**2008**	**2007**
Fund equity:			
Deficiency of capital assets, net of related debt	$	(4,466)	(5,690)
Restricted		108,581	105,005
Unrestricted		122,293	123,986
Total fund equity		226,408	223,301
Long-term debt:			
Revenue bonds		1,127,163	1,201,792
Total long-term debt		1,127,163	1,201,792
Current liabilities:			
Note payable		90,000	51,600
Current portion of revenue bonds		76,030	43,995
Note payable – City Loan		—	43,000
Accounts payable		67,508	60,615
Customer deposits		7,325	9,049
Other current liabilities and deferred credits		32,581	15,524
Accrued accounts:			
Interest, taxes, and wages		15,821	15,088
Distribution to the City		3,000	3,000
Total current liabilities		292,265	241,871
Other liabilities and deferred credits		83,829	47,976
Total fund equity and liabilities	$	1,729,665	1,714,940

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, 2008 and 2007

(Thousands of dollars)

		2008	2007
Operating revenues:			
Gas revenues:			
Nonheating	$	78,687	90,798
Gas transport service		19,215	12,949
Heating		733,526	736,358
Total gas revenues		831,428	840,105
Appliance and other revenues		8,607	9,398
Other operating revenues		9,592	9,848
Total operating revenues		849,627	859,351
Operating expenses:			
Natural gas		511,976	539,300
Gas processing		14,436	16,240
Field services		37,126	36,100
Distribution		17,319	17,119
Collection and account management		15,447	15,221
Provision for uncollectible accounts		37,000	40,000
Customer services		12,305	11,783
Marketing		2,628	2,418
Administrative and general		60,716	56,819
Pensions		14,258	15,217
Other postemployment benefits		25,834	26,421
Taxes		5,677	6,730
Total operating expenses before depreciation		754,722	783,368
Depreciation		42,868	39,708
Less depreciation expense included in operating expenses above		3,344	3,328
Total depreciation		39,524	36,380
Total operating expenses		794,246	819,748
Operating income		55,381	39,603
Interest and other income		15,732	13,073
Income before interest expense		71,113	52,676
Interest expense:			
Long-term debt		56,075	52,146
Other		12,269	17,042
Allowance for funds used during construction		(338)	(408)
Total interest expense		68,006	68,780
Excess (deficiency) of revenues over (under) expenses	$	3,107	(16,104)

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, 2008 and 2007

(Thousands of dollars)

		2008	2007
Cash flows from operating activities:			
Receipts from customers	$	834,000	863,658
Payments to suppliers		(659,969)	(631,475)
Payments to employees		(105,596)	(106,018)
Claims paid		(2,691)	(2,958)
Other receipts		24,500	28,800
Net cash provided by operating activities		90,244	152,007
Cash flows from noncapital financing activities:			
Interest		3,548	4,766
Interest payments on notes payable		(4,099)	(8,098)
Net repayments of notes payable		38,400	(3,400)
Loan from City of Philadelphia		(43,000)	(2,000)
Restricted, City Loan deposit		643	(643)
Distribution to the City of Philadelphia		(18,000)	(18,000)
Grant back of distribution from the City of Philadelphia		18,000	18,000
Net cash used in noncapital financing activities		(4,508)	(9,375)
Cash flows from capital and related financing activities:			
Proceeds from long-term debt issued		—	245,350
Redemption of long-term debt		—	(45,450)
Long-term debt issuance costs		—	(5,652)
Long-term debt premium, discount, and issuance losses		—	(4,133)
Purchases of capital assets		(61,244)	(69,105)
Principal paid on long-term debt		(41,830)	(38,045)
Interest paid on long-term debt		(54,076)	(46,913)
Capital improvement fund deposits		—	(193,170)
Drawdowns on capital improvement fund		60,926	60,672
Interest income on capital improvement fund		8,089	4,497
Interest income on sinking fund		3,460	1,996
Sinking fund (deposits)		(3,759)	(8,086)
Other investment income		338	408
Net cash used in capital and related financing activities		(88,096)	(97,631)
Net increase (decrease) in cash and cash equivalents		(2,360)	45,001
Cash and cash equivalents at the beginning of the year		51,698	6,697
Cash and cash equivalents at the end of the year	$	49,338	51,698
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	55,381	39,603
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization expense		39,812	36,732
Change in assets and liabilities:			
Receivables, net		(11,215)	3,387
Inventories		(39,769)	1,668
Accounts payable		6,892	3,133
Other liabilities and deferred credits		50,879	31,366
Other assets and deferred debits		(11,736)	36,118
Net cash provided by operating activities	$	90,244	152,007

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, 2008 and 2007

(Thousands of dollars)

		2008	2007
Fund equity balance, beginning of the year	$	223,301	239,405
Excess (deficiency) of revenues over (under) expenses		3,107	(16,104)
Distribution to the City of Philadelphia		(18,000)	(18,000)
Grant back of distribution from the City of Philadelphia		18,000	18,000
Fund equity balance, end of the year	$	226,408	223,301

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

The accounting methods employed by the Philadelphia Gas Works (the Company) 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. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Company does not apply accounting standards promulgated by the Financial Accounting Standards Board (FASB) issued after November 30, 1989. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, is applicable to the Company. Under FASB Statement No. 71, certain assets or liabilities may be created by actions of regulatory bodies.

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

(a) Regulation

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

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

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

(b) Operating Budget

On May 29, 2008, the Company filed its fiscal year (FY) 2009 Operating Budget. The PGC conducted informal discovery concerning this budget in July and August 2008 and public hearings in September 2008. The PGC authorized interim spending authority of $88,140,000 for the period September 1, 2008 through December 31, 2008, pursuant to a Motion, dated September 23, 2008. A final Order approving interim spending was approved by the Commission at its September 23, 2008 meeting. Briefs were filed on October 15, 2008, a Recommended Decision was received on October 27, 2008 and a final budget approval was granted by the Commission on December 2, 2008.

On July 13, 2007, the Company filed its FY 2008 Operating Budget. The PGC conducted hearings concerning this budget in August 2007 and approved the Company's proposed operating revenues and expenses with net adjustments of $4,197,000.

(c) Capital Budget

On April 21, 2008, the Philadelphia Facilities Management Corporation (PFMC) Board approved the Company's Request to file an amendment to the FY 2008 budget in the amount of $2,300,000 for funding to support the Risk-Based Collections and Field operations projects. These projects are critical efforts in support of the Company's Business Transformation effort. The Commission, after review and evaluation, approved a recommendation to City Council supporting the Company's amendment on July 2, 2008. City Council approved the Commission's recommendation on October 23, 2008 and the Mayor signed the ordinance on November 5, 2008.

On January 2, 2008 the Company filed a proposed FY 2009 Capital Budget in the amount of $73,436,000. After review and evaluation, the PGC on April 30, 2008 approved a recommendation to City Council for a budget of $71,956,000. The Gas Commission's recommendation was approved by City Council on June 19, 2008 and the ordinance signed by the Mayor on July 2, 2008.

On September 27, 2007 the Company filed with the PGC a proposal to amend the approved FY 2008 Capital Budget for two new lines items totaling $1,433,000. These line items were Supplemental Funding – Consolidate Fire Protection System – Richmond Plant for $1,171,000 and Disaster Recovery for Richmond and Passyunk Plants for $262,000. On October 23, 2007 the Company filed a proposal to further amend the budget by adding another new line item. Partial Reauthorization – Customer Service Data Warehouse for $169,000. Concurrently, the Company proposed a reduction of $1,523,000 in FY 2008 budget authorization to compensate for the additional funding requested. The Commission, after review and evaluation, recommended that City Council approve an amended budget for FY 2008 in the amount of $70,727,000. Subsequently, City Council approved the PGC's recommendation on March 6, 2008, with the Mayor signing the budget ordinance on March 12, 2008.

On January 2, 2007, the Company filed with the PGC its FY 2008 Capital Budget requesting spending authority in the amount of $118,243,000. This budget request was amended by the Company to reflect the deferral of two projects, Construction of Phase II Liquefied Natural Gas (LNG) Replacement and Implementation of Billing Collection Customer Service (BCCS) for a reduction of $47,300,000. The PGC conducted hearings concerning this budget in February 2007. Briefs were filed on March 13, 2007. The Hearing Examiner issued a Recommended Decision on March 27, 2007 for consideration by the Commissioners further reducing the budget by $295,000. The PGC's Resolution and Order recommending approval of the FY 2008 Capital Budget to City Council was passed on April 25, 2007. This recommendation of $70,648,000 was approved by City Council on June 15, 2007. The Mayor of the City signed the Ordinance approving the FY 2008 Capital Budget on September 20, 2007.

(d) Base Rates

In November 2008, the Company filed for an extraordinary or emergency base rate increase of approximately $60,000,000 or 5.2% and simultaneously requested an $85,000,000 or 7.4% decrease in the GCR for a net 2.2% overall rate decrease of approximately $25,000,000. The base rate increase will serve several purposes. First, the increase will cover the additional financing costs that the Company anticipates it will incur in the next few months. Second, the increase will improve the Company's financial position so as to enhance its ability to access the financial markets and maintain its bond rating. Third, the increase will provide 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 are effective as of January 1, 2009.

On December 22, 2006, the Company filed for a $100,000,000 base rate increase with the PUC. The funds provided by this increase in base rates were to be used to pay increased operating and maintenance costs, establish an adequate level of working capital, repay the $45,000,000 City loan, reduce the outstanding level of short-term commercial paper, provide a source of internal funds for capital expenditures, meet bond covenant requirements in each fiscal year, and provide funds for long-term debt reduction. On September 28, 2007, the PUC approved a rate increase of $25,000,000 which was effective in November 2007. The Company appealed this decision to Commonwealth Court on or about October 18, 2007 and this matter is pending in the courts.

The previous increase in base rates of $36,000,000 was approved by the PUC on April 12, 2002.

(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, 2008. The adjustments for the years ended August 31, 2008 and 2007 were an increase in billings of $12,238,000 and $6,498,000, 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 gas cost rate (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, 2008 deferred approximately $15,494,000 for GCR under-recovery.

GCR effective dates and rates

Effective date		GCR rate per Mcf*	Change
September 1, 2008	$	12.6527	(0.3709)
June 1, 2008		13.0236	2.3010
March 1, 2008		10.7226	0.1447
December 1, 2007		10.5779	0.4671
September 1, 2007		10.1108	(0.6143)
June 1, 2007		10.7251	0.2913
March 1, 2007		10.4338	(0.4781)
December 1, 2006		10.9119	(0.3439)
September 1, 2006		11.2558	(1.3074)
Prior		12.5632	—

* Mcf - Thousand cubic feet

(g) Utility Plant

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

In a previous rate order, the PGC disallowed the accrual of the net negative salvage component in depreciation. Cost of removal in the amounts of $2,847,000 and $2,542,000 was charged to expense as incurred in FY 2008 and FY 2007, 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 2008 and FY 2007 was 2.4% and 2.3%, respectively. The composite rates are supported by a depreciation study of utility plant as of August 31, 2004. The effective composite depreciation rates, as a percentage of cost, for FY 2008 were as follows:

Production plant	0.14% – 4.39%
Transmission, distribution, and storage	0.18% – 4.07%
General plant	1.62% – 9.97%

The next depreciation study is scheduled to be completed in FY 2010.

Allowance for funds used during construction (AFUDC) is an estimate of the cost of funds used for construction purposes. The AFUDC, as calculated on borrowed funds, reduces interest expense. The AFUDC rate applied to construction work in progress was 4.96% in FY 2008 and FY 2007, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2008 and 2007, respectively (thousands of dollars):

	August 31, 2008			
	Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$ 5,267	328	—	5,595
Distribution and collection systems	1,221,067	52,803	(2,474)	1,271,396
Buildings and equipment	406,966	9,792	(8,156)	408,602
Total utility plant, at historical cost	1,633,300	62,923	(10,630)	1,685,593
Under construction	48,013	61,879	(62,923)	46,969
Less accumulated depreciation for:				
Distribution and collection systems	(556,620)	(28,609)*	2,768	(582,461)
Buildings and equipment	(84,320)	(11,412)*	7,726	(88,006)
Utility plant, net	$ 1,040,373	84,781	(63,059)	1,062,095

* Cost of removal in the amounts of $2,847 and $2,542 was charged to expense as incurred in FY 2008 and FY 2007, respectively, and is not included in accumulated depreciation.

		August 31, 2007			
		Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$	5,267	—	—	5,267
Distribution and collection systems		1,161,705	61,537	(2,175)	1,221,067
Buildings and equipment		388,697	25,500	(7,231)	406,966
Total utility plant, at historical cost		1,555,669	87,037	(9,406)	1,633,300
Under construction		65,122	70,055	(87,164)	48,013
Less accumulated depreciation for:					
Distribution and collection systems		(532,763)	(26,261)*	2,404	(556,620)
Buildings and equipment		(80,380)	(10,905)*	6,965	(84,320)
Utility plant, net	$	1,007,648	119,926	(87,201)	1,040,373

* Cost of removal in the amounts of $2,847 and $2,542 was charged to expense as incurred in FY 2008 and FY 2007, respectively, 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.

Operating expenses include 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 505,000 customers at August 31, 2008, nearly 95.0% were residential. Of the Company’s approximately 506,000 customers at August 31, 2007, nearly 94.3% were residential.

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 August 31, 2008 and 2007 was approximately 77,000 and 78,000, 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, 2008 and 2007 was approximately 40,000 and 44,000, 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 at the fiscal year-end. The methodology used in performing the collectibility study has been reviewed with the PGC. For FY 2008 and FY 2007, 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 $19,014,000 and $17,166,000 for FY 2008 and FY 2007, respectively, have been reclassified to accounts payable at year end.

(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, 2008 and 2007, as follows (thousands of dollars):

		2008	2007
Gas inventory	$	179,751	138,388
Material and supplies		7,788	9,382
Total	$	187,539	147,770

(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.

(n) Pensions and Postemployment Benefits

The Company sponsors a public employee retirement system (PERS), a single-employer defined-benefit plan, to provide pension benefits for all of its employees. The pension plan (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 1,920 and 1,935 participating retirees and their beneficiaries and dependents for FY 2008 and FY 2007, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,699 and 1,720 active employees and their dependents for FY 2008 and FY 2007, respectively, by charging the annual insurance premiums to expense.

GASB Statement No. 45 (GASB 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, becomes effective for the Company's fiscal year beginning September 1, 2007. This Statement requires the Company to account for and report the value of its future other postemployment benefit (OPEB) obligations currently rather than on a pay-as-you-go basis. The Company adopted the provisions of GASB 45 as of September 1, 2006. The Company had a zero net OPEB obligation at transition. As discussed in note 11, the difference between the FY 2008 annual OPEB expense of $44,114,000 and the expenses paid by the Company of $18,280,000 resulted in an increase in the liability of $25,834,000 which has been recorded in other liabilities and deferred credits and expensed in FY 2008.

Additionally, the Company adopted the provisions of GASB Statement No. 50, *Pension Disclosures*, which more closely aligns the financial reporting requirements for pensions with those of OPEB, as of September 1, 2006.

(o) Cash Equivalents

For the purpose of reporting cash equivalents, all nonrestricted highly liquid investments with original maturities of three months or less are considered cash equivalents.

(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.

(Continued)

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

GASB Statement No. 49 (GASB 49), *Accounting and Financial Reporting for Pollution Remediation Obligations*, is effective for the Company's fiscal year beginning September 1, 2008, however, the Company has chosen to implement the provisions of GASB 49 a year earlier than required by GASB because the Company is a component unit of the City for financial reporting requirements and the FY 2008 financial statements will be consolidated into the City's financial statements for the fiscal year ended June 30, 2009. This statement establishes a framework for the recognition and measurement of pollution remediation liabilities. A pollution remediation obligation addresses the current or potential detrimental effects of existing pollution by participation in pollution remediation activities.

Prior to the implementation of GASB 49, the Company recognized liabilities related to its voluntary participation in remediation activities under Pennsylvania Act 2, *Land Recycling and Environmental Remediation Standards* Act of 1995 (Act 2), which established the "land recycling program, and related to its mandatory participation in activities under Pennsylvania Act 32, *Storage Tank and Spill Prevention Act of 1989 (Act 32)*, which established a comprehensive program to prevent leaks and spills from underground and above ground tanks in accordance with existing U.S. GAAP related to the accrual of liabilities.

Under Act 2, the Notice of Intent to Remediate (NIR) process was conducted by the Company in October of 2004 and a total of four Public Involvement Plan meetings were conducted at multiple City Recreation Centers throughout Philadelphia during February and March of 2005. In March of 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.

In accordance with GASB 49, the Company revised its methodology for estimating its pollution remediation obligations to 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 Act 32 remediation efforts, adjusted as additional information becomes available.

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, price changes, changes in technology, or changes in applicable regulations.

The implementation of GASB 49 resulted in an additional $8,300,000 liability which is reflected in other liabilities and deferred credits at August 31, 2008. Although GASB 49 requires pollution remediation liabilities to be measured at the beginning of the first period presented in the financial statements, because the increase in the liability related to the implementation of GASB 49 is not material, the Company has not restated prior periods and instead recognized the effect of GASB 49 implementation in the current year.

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) Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

(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 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 2008, the applicable maximum amount was calculated to be $1,011,000. In FY 2007, the applicable maximum amount was calculated to be $976,000. The agreement requires the Company to make annual payments of $18,000,000 to the City. In FY 2008 and FY 2007, the Company made the annual payment of $18,000,000 to the City. The City then granted the $18,000,000 back to the Company in both years.

The Company engages in various other transactions with the City. The Company provides gas service to the City. Operating revenues include $13,914,000 and $17,245,000 in FY 2008 and FY 2007, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled $616,000 and $615,000 in FY 2008 and FY 2007, respectively. Net amounts receivable from the City were $375,000 and $240,000 at August 31, 2008 and 2007, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $788,000 and $684,000 in FY 2008 and FY 2007, 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 repurchase agreements. Bank balances of such deposits and accounts at August 31, 2008 and 2007 were $52,504,000 and $54,892,000, respectively. Book balances of such deposits and accounts at August 31, 2008 and 2007 were $49,338,000 and $51,698,000, respectively. Federal depository insurance on these balances at August 31, 2008 and 2007 was $158,000 and $222,000, respectively. The remaining balances are not insured.

For the Company's cash equivalents, the Company's cash balances fluctuate significantly during the year. Excess cash balances are usually invested in money market accounts and repurchase agreements.

The highest balance of money market accounts during the fiscal years ended August 31, 2008 and 2007 were $135,200,000 and $157,200,000, respectively. Money market accounts with a carrying amount (at fair value) of $51,200,000 and $53,702,000 at August 31, 2008 and 2007, respectively, are included in the balances presented above.

The highest balance of repurchase agreements during the fiscal year ended August 31, 2008 was $62,600,000. There were no repurchase agreements outstanding at August 31, 2008 and 2007.

(b) Restricted Investment Funds

The investments in the Company's Sinking Fund, Capital Improvement Fund, Workers' Compensation Escrow Fund, and City Loan Escrow Account 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, 2008 and 2007 was $111,207,000 and $172,134,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2008 and FY 2007, 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. The adjustment to market value for the Capital Improvement Fund resulted in a loss of $71,500 at August 31, 2008. The adjustment to market value for the Capital Improvement Fund resulted in a gain of $8,000 at August 31, 2007. The adjustment to market value for the Sinking Fund resulted in gains of $242,000 and $214,000 at August 31, 2008 and 2007, respectively.

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, 2008 and 2007, the trust account balances were $2,383,000 and $1,924,000, respectively.

(Continued)

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

	August 31, 2008			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government agencies and instrumentalities:				
Federal Home Loan Mortgage Corporation medium term notes	$ 32,244	0.4608	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage gold partner certificate	491	1.6694	N/A	
Federal National Mortgage Association global benchmark notes	7,129	0.2794	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association medium term notes	1,248	1.8506	Aaa/AAA	Moody's/S&P
Federal Home Loan Banks	9,405	0.8250	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	50,517			
Corporate obligations:				
Goldman Sachs Group senior unsubordinate	968	0.7083	Aa-/AA3	Moody's/S&P
Prioca Global	997	0.2917	Aa/AA3	Moody's/S&P
Societe Generale National Association commercial paper	4,950	1.6694	N/A/A-1+	S&P
HSBC Finance Corporation commercial paper	985	0.2403	P1/A-1+	Moody's/S&P
American Express commercial paper	985	0.2403	P1/A-1+	Moody's/S&P
Banco Santander PR San Juan certificate of deposit	98	0.0280	FDIC Insured	
Bank of Florida certificate of deposit	99	0.1043	FDIC Insured	

	August 31, 2008			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Bridgewater Savings Bank certificate of deposit	$ 98	0.0208	FDIC Insured	
Countrywide Bank certificate of deposit	99	0.0180	FDIC Insured	
Eurobank Hato Rey certificate of deposit	99	0.0205	FDIC Insured	
First Suburban National Bank certificate of deposit	98	0.1876	FDIC Insured	
Ironstone Bank certificate of deposit	98	0.1298	FDIC Insured	
Mutual Bank certificate of deposit	99	0.0745	FDIC Insured	
Ravenswood Bank certificate of deposit	97	0.1835	FDIC Insured	
Total corporate obligations	9,770			
Total fair value of investments	60,287			
Cash and cash equivalents:				
Citigroup Funding Inc. commercial paper	4,966	0.1474	N/A/A-1+	S&P
UBS Finance Delaware LLC commercial paper	2,988	0.0595	N/A/A-1+	S&P
Total cash and cash equivalents	7,954			
Money market:				
Morgan Stanley Prime Portfolio Institutional Class Funds	21,772	N/A	N/A	
First American Government Obligations Fund Class Z	13,884	N/A	N/A	
First American Prime Obligations Class Z	6,847	N/A	N/A	
Total money market	42,503			
Accrued interest	463			
Total fair value of investments, including cash deposits	$ 111,207			
Portfolio weighted modified duration		0.5898		

(Continued)

	August 31, 2007			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
U.S. government agencies and instrumentalities:				
Federal Home Loan Banks discount note	$ 2,369	0.1917	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association note	3,293	0.4194	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	5,662			
Corporate obligations:				
American Express commercial paper	492	0.2861	P1/A1	Moody's/S&P
General Electric commercial paper	1,004	0.2889	P1/A1	Moody's/S&P
HSBC Finance commercial paper	1,003	0.2972	P1/A1	Moody's/S&P
JP Morgan Chase & Co Global Sr Holding Co note	992	0.4194	Aa2/AA-	Moody's/S&P
Goldman Sachs Group global note	994	0.3750	Aa3/AA-	Moody's/S&P
Total corporate obligations	4,485			
Total fair value of investments	10,147			
Money market:				
First American Prime Obligations Fund Class Z	161,965	N/A	N/A	
Total money market	161,965			
Accrued interest	22			
Total fair value of investments, including cash deposits	$ 172,134			
Portfolio weighted modified duration		0.3304		

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

Investment type		Fair value	Weighted average maturity (years)	Credit rating	Rating agency
		August 31, 2008			
Guaranteed investment contracts	$	48,129	12.5000	*	*
U.S. government obligations:					
U.S. Treasury notes		16,806	2.5158	Aaa/AAA	Moody's/S&P
Total U.S. government obligations		16,806			
U.S. government agencies and instrumentalities:					
Federal Home Loan Mortgage Corporation medium term notes		10,176	2.0177	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association medium term notes		5,152	2.1446	Aaa/AAA	Moody's/S&P
Federal Home Loan Banks		16,514	1.9511	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities		31,842			
Corporate obligations:					
Wells Fargo note		2,688	0.5861	Aa1/AA+	Moody's/S&P
Associates Corp National Association		2,610	0.1694	Aa3/AA-	Moody's/S&P
Procter & Gamble Company		1,293	0.2917	Aa3/AA-	Moody's/S&P
Total corporate obligations		6,591			
Total fair value of investments		103,368			
Cash and cash equivalents:					
U.S. Treasury bills		1,860	0.0111	Aaa/AAA	Moody's/S&P
Total cash and cash equivalents		1,860			
Money market:				N/A	N/A
Fidelity Institutional Government Portfolio Class II		970			
Total money market		970			
Total fair value of investments, including cash deposits	$	106,198			
Portfolio weighted modified duration			1.9002		

* The credit rating of this investment is unrated.

Investment type		August 31, 2007 Fair value	Weighted average maturity (years)	Credit rating	Rating agency
Guaranteed investment contracts	$	49,504	13.5000	*	*
U.S. government obligations:					
U.S. Treasury notes		7,294	1.6153	Aaa/AAA	Moody's/S&P
Total U.S. government obligations		7,294			
U.S. government agencies and instrumentalities:					
Federal National Mortgage Corporation debentures		6,973	2.0417	Aaa/AAA	Moody's/S&P
Federal Farm Credit Bank bonds		4,680	1.3717	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage Corporation bonds		10,396	1.9650	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage Corporation debentures		8,810	1.8329	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association notes		5,861	2.3328	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage Corporation notes		6,358	1.3568	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities		43,078			
Corporate obligations:					
Procter & Gamble note		1,265	1.2917	Aa3/AA-	Moody's/S&P
U.S. Bank National Association		1,105	0.8750	Aa2/AA	Moody's/S&P
Total corporate obligations		2,370			
Total fair value of investments		102,246			
Money market:					
Fidelity Institutional Government Portfolio Class II		192	N/A	N/A	
Total money market		192			
Total fair value of investments, including cash deposits	$	102,438			
Portfolio weighted modified duration			1.7806		

* The credit rating of this investment is unrated.

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

	August 31, 2008			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
First American Treasury Obligations Fund	$ 2,383	N/A	N/A	N/A
Total money market	2,383			
Total fair value of investments, including cash deposits	$ 2,383			

	August 31, 2007			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
First American Treasury Obligations Fund	$ 1,924	N/A	N/A	N/A
Total money market	1,924			
Total fair value of investments, including cash deposits	$ 1,924			

(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 interest rate risk. Investments shall be diversified as to maturities, and as to kind of investment to eliminate 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.

(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 York Federal Reserve Bank; (3) U.S. agency obligations rated Aaa/AAA by Moody's Investor Services or Standard & Poor's; (4) collateralized certificates of deposit; (5) bankers acceptances, Eurodollars deposits, and Euro certificates of deposit that are collateralized; (6) commercial paper rated M1G1 or A1+ by Moody's Investor Services and Standard & Poor's, respectively; (7) general obligation bonds of corporations rated AA or better by Moody's Investor Services or Standard & Poor's, with a maturity of two years or less (except the Sinking Fund); (8) collateralized mortgage obligations and pass-through securities rated AA or better by Moody's Investor Services or Standard & Poor's or collateralized with securities that meet the Company's own investment criteria, with a maturity of two years or less (except the Sinking Fund); (9) money market mutual funds, as defined by the Securities and Exchange Commission; (10) repurchase agreements collateralized either through actual delivery of eligible collateral or through segregation of collateral by a depository that is holding the counterparty's securities, provided such collateral meets the Company's own investment criteria; and (11) obligations of the Commonwealth of Pennsylvania (the Commonwealth) or any municipality or other political subdivision of the Commonwealth, registered or otherwise as to principal and interest, with a maturity of two years or less (except the Sinking Fund).

Authorized investments for Sinking Fund Portfolios are dictated by the First Class City Revenue Bond Act. This also includes any investment vehicle permitted for any Commonwealth of Pennsylvania 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 (e.g., contracts, securities, and safekeeping receipts) 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

More than 5.0% of the Company's investments are in the First American Government Obligations Fund Class Z, U.S. Treasury notes, Morgan Stanley Prime Portfolio Institutional Class Fund, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation medium term notes and the GIC with Financial Security Assurance Inc. (FSA) Capital Markets Services, LLC. These investments represent 6.32% and 7.65%, 9.91%, 11.79%, 19.30% and 21.90%, respectively, of the Company's total investments.

(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. During FY 2008, there were costs of $157,000 incurred for rate case expenses and $437,000 incurred for the PUC's management audit that will be amortized over a four-year period and a seven-year period, respectively. The unamortized costs included in other assets and deferred debits were $607,000 and $324,000 as of August 31, 2008 and 2007, respectively. The unamortized costs included in other current assets and deferred debits were $210,000 and $397,000 as of August 31, 2008 and 2007, 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. As a result of settlements during FY 2008 by the Company's insurance carriers associated with environmental remediation costs, the Company received $1,100,000. Environmental remediation costs of approximately $652,000 in FY 2008 were offset by these insurance settlements, and the remainder was deferred. The Company estimates additional expenditures to be approximately $21,600,000 as discussed in note 12.

(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 $361,000 and $365,000 for the years ended August 31, 2008 and 2007, 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 $200,000,000 outstanding at any one time. These notes are intended to provide additional working capital. They are supported by an irrevocable letter of credit and a subordinated security interest in the Company's revenues.

A new Series E of the tax-exempt commercial paper program was instituted on January 18, 2006, concurrently with the expiration of Series D. Under the new credit agreement, the commitment amount was increased from $100,000,000 to $150,000,000. The credit agreement was further amended and restated as of May 22, 2007 to reflect a new term and rate structure. The expiration of the credit agreement was extended to May 29, 2010.

The notes outstanding at August 31, 2008 had a weighted average interest rate of 1.63% and remaining weighted average time to maturity of 61 days. The principal amount outstanding at August 31, 2008 and 2007 was $90,000,000 and $51,600,000, respectively.

Commercial paper activity for the years ended August 31, 2008 and 2007 was as follows (thousands of dollars):

	Year ended August 31, 2008			
	Beginning balance	Additions	Deletions	Ending balance
Commercial paper	$ 51,600	87,900	49,500	90,000

	Year ended August 31, 2007			
	Beginning balance	Additions	Deletions	Ending balance
Commercial paper	$ 55,000	94,900	98,300	51,600

See note 8(e) for detail of the Note Payable – City Loan.

(7) GCR Tariff Reconciliation

During the fiscal years ended August 31, 2008, 2007, and 2006, the Company's actual gas costs were below its billed gas costs by approximately $30,503,000, $24,904,000, and $8,466,000, respectively.

Natural Gas Pipeline Supplier Refund

The Company received refunds including interest in FY 2008 in the amount of $10,660,000 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 2008.

The Company received refunds including interest in FY 2007 in the amount of $648,000 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 2007.

(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, 2008 and 2007 (thousands of dollars):

	August 31, 2008			August 31, 2007		
	Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$ 73,941	1,103,828	1,177,769	41,830	1,176,368	1,218,198
Unamortized discount	(482)	(4,469)	(4,951)	(511)	(4,951)	(5,462)
Unamortized premium	2,571	27,804	30,375	2,676	30,375	33,051
Total revenue bonds	76,030	1,127,163	1,203,193	43,995	1,201,792	1,245,787
Note Payable – City Loan	—	—	—	43,000	—	43,000
Total	$ 76,030	1,127,163	1,203,193	86,995	1,201,792	1,288,787

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, 2008 and 2007 (thousands of dollars):

	Year ended August 31, 2008			
	Beginning balance	**Additions**	**Reductions**	**Ending balance**
Revenue bonds	$ 1,218,198	—	(40,429)	1,177,769
Other liabilities and deferred credits:				
Forward rate agreement	$ 8,431	—	(624)	7,807
Claims and judgments	3,111	2,966	—	6,077
Environmental clean-up	10,013	7,677	—	17,690
Other postemployment benefits	26,421	25,834	—	52,255
Total other liabilities and deferred credits	$ 47,976	36,477	(624)	83,829

	Year ended August 31, 2007			
	Beginning balance	**Additions**	**Reductions**	**Ending balance**
Revenue bonds	$ 1,055,038	246,655	(83,495)	1,218,198
Other liabilities and deferred credits:				
Forward rate agreement	$ 9,056	—	(625)	8,431
Claims and judgments	3,899	—	(788)	3,111
Environmental clean-up	9,074	939	—	10,013
Other postemployment benefits	—	26,421	—	26,421
Total other liabilities and deferred credits	$ 22,029	27,360	(1,413)	47,976

Liability amounts due within one year are reflected in the other current liabilities and deferred credits line of the balance sheet.

(Continued)

Principal maturities and scheduled interest payments for revenue bonds are as follows (thousands of dollars):

	Revenue bonds			
	Principal	**Interest**	**Net swap amount**	**Total**
Fiscal year ending August 31:				
2009*	$ 44,625	53,233	(5,717)	92,141
2010	46,365	50,965	(5,682)	91,648
2011	46,977	48,677	(5,648)	90,006
2012**	41,787	46,915	(5,611)	83,091
2013	45,055	45,269	(5,573)	84,751
2014 – 2018	229,865	192,562	(25,374)	397,053
2019 – 2023	242,520	137,093	(19,042)	360,571
2024 – 2028	244,915	81,657	(9,787)	316,785
2029 – 2033	140,565	35,093	(976)	174,682
2034 – 2038	95,095	8,175	—	103,270
Total	$ 1,177,769	699,639	(83,410)	1,793,998

* This does not include $29,317,000 of Sixth Series Bonds that is included in current liabilities due to the scheduled expiration of the Standby Bond Purchase Agreement as described in note 15. This amount is included in the years in which principal matures according to the original maturity schedule.

Future debt service is calculated using rates in effect at August 31, 2008 for variable rate bonds. The net swap payment amounts were calculated by subtracting the future variable rate interest payments subject to swap agreements from the synthetic fixed-rate amount intended to be achieved by the swap amount.

** Tax Exempt Capital Accumulator (TECA) accretions for the 11 "C" Series in the amount of $4,643,000 are not included in the principal amount in FY 2012.

(a) Bond Issuances

2007 Ordinances

On March 21, 2007, the Mayor signed two bills into law authorizing the City to issue revenue bonds. The first bill signed by the Mayor constituted the Nineteenth Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1975 (the 1975 General Ordinance). This ordinance authorizes the City to issue revenue bonds for the following purposes: (a) the current refunding of a portion of the outstanding City of Philadelphia, Pennsylvania Gas Works Revenue Bonds, Fifteenth Series (1975 Refunded Bonds); (b) paying the costs of issuing the Nineteenth Series Bonds; and (c) paying any other Project Costs (as defined in the Act).

The second bill signed by the Mayor constituted the Eight Supplemental Ordinance to the General Gas Works Revenue Bond Ordinance of 1998 (the 1998 General Ordinance). This ordinance authorizes the City to issue revenue bonds for the following purposes: (a) providing funding for the capital projects included in the capital program of the Company as from time to time included in the capital budgets of the Company, as approved by City Council; (b) advance refunding of the 1998 Refunded Bonds, which were issued under the 1998 General Ordinance; (c) paying the costs of issuing the Seventh Series Bonds and the required deposits to the 1998 Ordinance Sinking Fund Reserve; and (d) paying any other Project Costs (as defined in the Act).

1998 Ordinance Seventh Series Bonds

On May 15, 2007, the Company issued $230,900,000 of Seventh Series Bonds for the purpose of providing funds for the financing of the capital projects included in the capital program of the Company, and for the purpose of redeeming and refunding, on a current basis, a portion of the outstanding Second Series B, Third Series and Fourth Series Bonds. The refunded par amounts of the Second Series B, Third Series and Fourth Series Bonds were: $7,500,000, $3,145,000, and $20,005,000, respectively. The Seventh Series Bonds contained new money debt issued in the amount of $200,000,000. This new debt was issued under the 1998 Ordinance. The interest rate on the $137,720,000 of Serial Bonds ranged from 4.0% to 5.0%. The interest rate on the $93,180,000 of Term Bonds was 5.0%. The bonds, consisting of Serial Bonds and Term Bonds, have maturity dates through 2037.

1975 Ordinance Nineteenth Series Bonds

On May 15, 2007, the Company issued $14,450,000 of Nineteenth Series Bonds for the purpose of redeeming and refunding, on a current basis, the outstanding Fifteenth Series Bonds previously issued under the 1975 Ordinance. This new debt was issued under the 1975 Ordinance. The interest rate on the Serial Bonds was 5.0%. The bonds, consisting of Serial Bonds, have maturity dates through 2023.

2006 Ordinances

On December 22, 2005, the Mayor signed an ordinance into law authorizing the City to issue revenue bonds for the purpose of (a) refunding all or a portion of the following Series of Gas Works Revenue Bonds (the 1998 General Ordinance): First Series B, Second Series A, Third Series, Fourth Series, and Fifth Series; (b) paying the costs of issuing the bonds and making any required deposits to the Sinking Fund Reserve; and (c) paying any other Project Costs, which may include, without limitation, the repayment to any fund of the City or to accounts of the Company of amounts advanced for Project Costs.

1998 Ordinance Sixth Series Bonds

On January 26, 2006, the Company issued $313,390,000 of Sixth Series Bonds, maturing at various dates through 2031, for the purpose of redeeming and refunding, on a current basis, all of the First Series B and a portion of the outstanding Second Series A, Third Series, and Fourth Series City of Philadelphia, Pennsylvania, Gas Works Revenue Bonds previously issued under the 1998 Ordinance. The refunded par amounts of the First Series B, Second Series A, Third Series, and Fourth

Series Bonds were: $103,550,000, $79,355,000, $99,915,000, and $2,295,000, respectively. As of August 31, 2007, there were no Fifth Series Bonds refunded. The $313,390,000 of Serial Bonds have a variable rate set through a weekly reset mode and are paid monthly and are secured with a Standby Bond Purchase Agreement, which expires January 26, 2009. As discussed in note 15, substantially all of the Sixth Series Bonds are held by banks under the Standby Bond Purchase Agreement at December 18, 2008.

The Bonds were issued on a parity with other Senior 1998 Ordinance Bonds issued under the 1998 General Ordinance, but are subordinated in right of payment and security to all bonds issued and outstanding under the General Gas Works Revenue Bond Ordinance of 1975, approved on May 30, 1975, Bill No. 1871, as amended and supplemented from time to time (the 1975 General Ordinance and together with the 1998 General Ordinance). The Bonds were also issued on parity with the Obligations of the City to make periodic payments due under a Qualified Swap being entered into between the City and the counterparty in connection with the issuance of the bonds.

(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. The Company has satisfied the debt coverage requirements in FY 2008 and FY 2007.

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, 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.

Monies in the Sinking Fund reserves are to be applied to the payment of debt service if, for any reason, other monies 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 Agreement

Objective - In January 2006, the City entered into a swap to synthetically refund all or a portion of several series of outstanding bonds. The swap structure was used as a means to increase the City's savings, when compared with fixed-rate bonds at the time of issuance. The intention of the swap was to create a synthetic fixed rate structure.

Terms – The swap, executed with the counterparty, commenced 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% of one month LIBOR until maturity. The rates are based on an amortizing notional schedule (with an initial notional amount of $313,390,000). As of August 31, 2008, rates were as follows:

	Terms	Rates
Interest Rate Swap		
Fixed payment to counterparty under Swap	Fixed	3.6745%
Variable payment from counterparty under Swap	SIFMA	(1.8400)
Net interest rate swap payments		1.8345
Variable rate bond coupon payments	Weekly resets	2.0400
Synthetic interest rate on bonds		3.8745

As of August 31, 2008, the swap had a notional amount of $311,615,000 and the associated variable rate bond had a $311,615,000 principal amount. The bonds and the related swap agreement mature on August 1, 2031.

Fair value – As of August 31, 2008, the swap had a negative fair value of $14,285,000. This means that the Company would have to pay this amount to terminate the swap. Subsequently, the negative fair value has increased as discussed in note 15.

Risks **-** As of August 31, 2008, the City is not exposed to credit risk because the swap had a negative fair value. Should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the swap's fair value. The swap includes an additional termination event based on credit ratings. The swap may be terminated if the ratings 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 swap.

A termination event may also occur 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 FSA, as long as FSA is rated at or above A2 or A (Moody's/S&P), the termination event based on the City's ratings is stayed. As of December 18, 2008, neither the Company's nor FSA's credit ratings have fallen below these levels.

The City is subject to traditional basis risk should the relationship between SIFMA and the bonds change; if SIFMA resets at a rate below the variable rate bond coupon payments, the synthetic interest rate on the bonds will increase. In addition, after September 1, 2011, the City would be exposed to (i) basis risk, as reflected by the relationship between the rate payable on the bonds and 70% 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% of one month LIBOR received on the swap.

(d) Forward Rate Agreement and Guaranteed Investment Contracts

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 Forward Rate Agreement is 18½ years, with 12½ years remaining at August 31, 2008.

The GICs are recorded at fair value in the Sinking Fund and had fair values of $48,129,000 and $49,504,000 at August 31, 2008 and 2007, respectively.

The Company also paid $1,650,000 to terminate an existing Forward Rate 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 Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 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 $7,807,000 and $8,431,000 at August 31, 2008 and 2007, respectively.

(e) Note Payable – City Loan

On November 15, 2000, the Mayor signed an ordinance authorizing the City to advance in whole or in part, up to $45,000,000 to the Company, to provide liquidity in the winter of 2000-2001. The loan from the City carried no interest. The loan repayment period was extended to August 2008.

The loan from the City was subordinate to the Company’s other repayment obligations on its revenue bonds and commercial paper program. The outstanding balance of the City loan was $43,000,000 at August 31, 2007. The remaining balance of the City loan was remitted to the City in payments of $20,500,000 and $22,500,000 in December 2007 and August 2008, 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, 2008 was as follows:

	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	47,910,000
2nd Series	7/1/29	5.00	84,640,000
3rd Series	8/1/31	5.50	99,445,000
4th Series	8/1/32	5.25	20,005,000

The Company issued $230,900,000 of Seventh Series Bonds during FY 2007. The proceeds of $30,900,000 from the sale were utilized to refund a portion of the Second Series B, Third Series, and Fourth Series Bonds, in the amounts of $7,500,000, $3,145,000, and $20,005,000, respectively. The refunding of this existing debt resulted in an accounting loss of $2,218,000. This loss is being deferred and amortized as interest expense over the life of the new bonds. The refunding generated a present value savings of $2,146,000.

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 $278,271,000 at August 31, 2008, bearing interest on face value from 4.30% to 5.89%.

(10) Pension Costs

(a) Plan Description

The Company sponsors a public employee retirement system (PERS), a single-employer defined-benefit plan, to provide pension benefits for all of its employees, whose annual covered payroll (which was substantially equal to total payroll) was $105,596,000 and $106,018,000 at August 31, 2008 and 2007, respectively.

At September 1, 2007, 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	$	2,151
Current employees:		
Vested		1,395
Nonvested		270
Total current employees		1,665
Total membership	$	3,816

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% of the highest annual earnings during the last 10 years of credited service, or
- 2% 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.

(Continued)

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

		Normal cost	Amortization of the underfunded balance	Contributions
Fiscal year:				
2008	$	8,085,000	6,173,000	14,258,000
2007		7,693,000	7,524,000	15,217,000
2006		7,617,000	9,946,000	17,563,000

Withdrawals from pension assets of $18,564,000 and $16,776,000 in FY 2008 and FY 2007, respectively, 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% 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 Pension Plan had an actuarial value of assets of $416,183,000 and an actuarial accrued liability of $482,380,000 resulting in a funded ratio of 86.28% based on a biennial actuarial valuation of the pension fund as of September 1, 2007. The resulting unfunded actuarial accrued liability of $66,197,000 was 62.69% of covered payroll of $105,596,000.

(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).

(Continued)

(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 1,920 and 1,935 participating retirees and their beneficiaries and dependents for FY 2008 and FY 2007, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,699 and 1,720 active employees and their dependents for FY 2008 and FY 2007, respectively, by charging the annual insurance premiums to expense. The annual covered payroll (which was substantially equal to total payroll) was $105,596,000 and $106,018,000 at August 31, 2008 and 2007, 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.

Total expense incurred for healthcare amounted to $34,226,000 and $36,111,000 in FY 2008 and FY 2007, respectively, of which approximately 48.1% and 52.0%, respectively, represents payments on behalf of retired employees and their dependents. Employees and retirees contributed $1,477,000 and $1,470,000 in FY 2008 and FY 2007, 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 $2,103,000 and $2,080,000 in FY 2008 and FY 2007, respectively. The amount attributed to retirees was approximately 71.0% and 76.3% in FY 2008 and FY 2007, 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 and therefore the Company has included the schedule of employer contributions as a supplemental schedule (unaudited).

(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, 2007. 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 a 5.0% discount rate for purposes of developing the liabilities and ARC on the basis that the Plan would not be funded. This rate is based on the investment return expected on the Company's general investments, because the Company has not funded the Plan for FY 2008.

	Healthcare Cost Trend Rates		
	Medical	**Prescription**	**Dental**
Year:			
1	10.0%	10.0%	4.5%
2	9.0	9.0	4.5
3	8.0	8.0	4.5
4	7.0	7.0	4.5
5	6.0	6.0	4.5
6	5.0	5.0	4.5
7	4.5	4.5	4.5
8 and beyond	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 ARC for FY 2008 is estimated to be $44,114,000 which is also the annual OPEB cost. The amount paid by the Company for retiree benefits in FY 2008 was $18,280,000, consisting of $16,788,000 of healthcare expenses and $1,492,000 of life insurance expenses. The difference between the ARC and the expenses paid resulted in an increase in the OPEB liability of $25,834,000. This amount has been recorded in other liabilities and deferred credits and has been expensed in FY 2008.

As of August 31, 2008, the actuarial accrued liability for benefits was $591,599,000, all of which was unfunded and the ratio of the unfunded actuarial accrued liability to the covered payroll was 560.3%. Historical trend information reflecting funding progress and contributions made by the Company is presented in the Schedule of Other Postemployment Benefits Funding Progress (unaudited).

(d) Other Coverage Information

Also, 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 $161,320,000 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 $120,807,000 of accidental death and dismemberment insurance coverage for active employees.

(12) Pollution Remediation

Total pollution remediation obligations at August 31, 2008 are $21,600,000, which reflect the implementation of GASB 49 as described in note 1(t). The Company's prior year liability was $13,349,000 as measured prior to the implementation of the effective cash flow method under GASB 49.

(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 boiler and machinery, blanket crime, and other forms of property insurance.

The Company maintained $210,000,000 in liability (including terrorism) coverage, insuring against the risk of damage or injury to the public with a per occurrence self insured retention of $500,000; however, effective September 1, 2007, the self insured retention was increased to $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.

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:						
2008	$	8,468	7,757	(2,691)	13,534	7,456
2007		8,059	3,367	(2,958)	8,468	5,357
2006		8,510	2,808	(3,259)	8,059	4,159

(14) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately $8,727,000 as of August 31, 2008.

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:		
2009	$	440
2010		79
2011		42
2012		6

Rent expense for the fiscal years ended August 31, 2008 and 2007 amounted to $910,000 and $932,000, 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 $5,100,000 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, 2008 through March 31, 2009.

The Company's FY 2009 Capital Budget was approved by City Council in the amount of $71,956,000. Within this approval, funding is provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program. Main replacement cost for this program in FY 2009 is expected to be $15,606,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately $99,256,000.

The FY 2009 Capital Budget also includes $2,486,000 for the purchase of replacement Automatic Meter Reading (AMR) units. The total six-year cost of this program to replace AMR units is approximately $7,889,000.

(15) Subsequent Events

(a) Commercial Paper

As discussed in note 6, $90,000,000 of commercial paper was outstanding at August 31, 2008. Subsequent to year-end, all outstanding commercial paper matured, and additional commercial paper was issued. As of December 18, 2008, $148,000,000 of commercial paper was outstanding which matures on February 12, February 13 and March 12, 2009.

(b) Emergency Rate Relief

As discussed in note 1(d), in November 2008 the Company filed for an extraordinary or emergency base rate increase of approximately $60,000,000 or 5.2% and simultaneously requested an $85,000,000 or 7.4% decrease in the GCR for a net 2.2% overall rate decrease of $25,000,0000. 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 are effective as of January 1, 2009.

(c) Sixth Series Bonds

As discussed in note 8(b), as of December 18, 2008, $271,370,000 of the Sixth Series Bonds are held by the providers of the Standby Bond Purchase Agreement as bank bonds. The providers of the Standby Bond Purchase Agreement continue, on a weekly basis, to remarket the bonds in accordance with the bond authorization. The Standby Bond Purchase Agreement expires on January 26, 2009. If the Standby Bond Purchase Agreement is not renewed, and no substitute liquidity facility is provided, any bank bonds held at that time will be amortized in ten payments payable the first business day of July and the first business day of December for the next five years. The Company has therefore recorded as current debt at August 31, 2008 one tenth of the outstanding Sixth Series Bonds as of August 31, including $1,900,000 due to mature in 2009 under the original amortization schedule and an additional $29,300,000 for a total of $31,200,000.

(d) Swap – Sixth Series Bonds

As discussed in note 8(c), the City entered into a swap related to the Sixth Series Bonds. The fair value of the interest rate swap as of December 18, 2008 was negative $72,600,000. This means that the Company would have to pay this amount to terminate the swap. Per the swap agreement, the refunding or defeasance of the Sixth Series Bonds, in whole or in part, without the prior written consent of both the counterparty and the insurer, may constitute an event of termination unless certain conditions are met.

Additionally, note 8 identifies a termination risk related to the interest rate swap agreement if the Company's bond rating falls below Baa2 or BBB (Moody's/S&P). Because the City's swap payments are insured by FSA as long as FSA is rated at or above A2 or A (Moody's/S&P) the termination event based on the City's rating is stayed. Neither the Company's credit rating nor FSA's credit rating has declined below the levels required in the agreement as of December 18, 2008.

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 (overfunded) AAL (UAAL [OAAL])	(a/b) Funded ratio	Covered payroll	UAAL (OAAL) as a percent of covered payroll
September 1, 2003*	$356,000	$427,006	$71,006	83.37%	$101,200	70.16%
September 1, 2004**	366,783	436,255	69,472	84.08	102,500	67.78
September 1, 2005+	383,517	450,866	67,349	85.06	102,544	65.68
September 1, 2006++	411,886	474,250	62,364	86.85	106,018	58.82
September 1, 2007+++	416,183	482,380	66,197	86.28	105,596	62.69

* The required supplementary information is based on a biennial actuarial valuation of the pension fund for the plan year September 1, 2003 through August 31, 2004.

** The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the plan year September 1, 2004 through August 31, 2005.

\+ 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.

++ The required supplementary information is based on a biennial actuarial valuation of the pension fund as updated for the plan year September 1, 2006 through August 31, 2007.

++ 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.

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 (overfunded) AAL (UAAL [OAAL])	(a/b) Funded ratio	Covered payroll	UAAL (OAAL) as a percent of covered payroll
August 31, 2007	—	$573,734	$573,734	—	$106,018	541.17%
August 31, 2008	—	591,599	591,599	—	105,596	560.25

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 Employer Contributions

(Thousands of dollars)

Year-end		Annual required contribution	Percentage contributed
August 31, 2007	$	45,237	41.60%
August 31, 2008		44,114	41.44

See accompanying independent auditors' report.

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

Supplemental Statements of Net Assets (City Format)

August 31, 2008 and 2007

(Thousands of dollars)

		2008	2007
Assets:			
Cash on deposit and on hold	$	49,332	51,692
Equity in pooled cash and investments		—	—
Equity in treasurer's account		—	—
Investments		—	—
Internal balances		—	—
Amounts held by fiscal agent		6	6
Notes receivable		—	48
Taxes receivable		—	—
Accounts receivable – net		99,304	88,570
Interest and dividends receivable		—	—
Due from other governments		—	—
Restricted assets		219,788	277,139
Inventories		187,539	147,770
Unamortized loss and discount		52,852	58,818
Other assets		63,699	55,982
Property, plant, and equipment		1,732,562	1,681,313
Accumulated depreciation		(670,467)	(640,940)
Total assets	$	1,734,615	1,720,398
Liabilities:			
Notes payable	$	90,000	94,600
Vouchers and accounts payable		67,508	60,615
Salaries and wages payable		3,430	2,797
Accrued expenses		107,484	67,425
Funds held in escrow		—	—
Due to other governments		—	—
Deferred revenue		31,641	20,411
Current portion of long-term obligations		73,942	41,830
Noncurrent portion of long-term obligations		1,103,827	1,176,368
Unamortized gain and premium		30,375	33,051
Total liabilities	$	1,508,207	1,497,097
Net assets:			
Invested in capital assets, net of related debt	$	(4,466)	(5,690)
Restricted for:			
Capital projects		—	—
Debt service		108,581	105,005
Community development projects		—	—
Behavioral health programs		—	—
Intergovernmental financing		—	—
Emergency phone system		—	—
Rate stabilization		—	—
Unrestricted		122,293	123,986
Total net assets	$	226,408	223,301

See accompanying independent auditors' report.

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

Supplemental Statements of Activities (City Format)

Years ended August 31, 2008 and 2007

(Thousands of dollars)

		August 31, 2008				
		Expenses	**Charges for services**	**Operating grants and contributions**	**Capital grants and contributions**	**Total**
Gas services	$	(740,819)	840,035	25,324*	—	124,540
Interest on debt		(56,075)	—	—	—	(56,075)
Unallocated depreciation		(39,524)	—	—	—	(39,524)
Other postemployment benefits		(25,834)	—	—	—	(25,834)
Total	$	(862,252)	840,035	25,324*	—	3,107

* Includes $15,732 of interest and other income and $9,592 of other operating revenues.

		August 31, 2007				
		Expenses	**Charges for services**	**Operating grants and contributions**	**Capital grants and contributions**	**Total**
Gas services	$	(773,581)	849,503	22,921*	—	98,843
Interest on debt		(52,146)	—	—	—	(52,146)
Unallocated depreciation		(36,380)	—	—	—	(36,380)
Other postemployment benefits		(26,421)	—	—	—	(26,421)
Total	$	(888,528)	849,503	22,921*	—	(16,104)

* Includes $13,073 of interest and other income and $9,848 of other operating revenues.

See accompanying independent auditors' report.

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

Supplemental Statements of Revenues, Expenses, and Changes in Fund Net Assets (City Format)

Years ended August 31, 2008 and 2007

(Thousands of dollars)

		2008	2007
Operating revenues:			
Charges for goods and services	$	831,428	840,105
Sales of land and improvements		—	—
Rentals and concessions		—	—
Miscellaneous operating revenues		18,199	19,246
Total operating revenues		849,627	859,351
Operating expenses:			
Personal services		73,351	74,054
Purchase of services		75,640	76,299
Material and supplies		6,216	4,290
Employee benefits		41,488	41,863
Indemnities and taxes		—	—
Depreciation and amortization		42,868	39,708
Cost of goods sold		511,976	539,300
Other		—	—
Total operating expenses		751,539	775,514
Operating income		98,088	83,837
Nonoperating revenues (expenses):			
Operating grants		—	—
Passenger facility charges		—	—
Other income		1,834	1,262
Interest income		13,897	11,811
Debt service – interest		(56,075)	(52,146)
Other expenses		(54,637)	(60,868)
Total nonoperating expenses		(94,981)	(99,941)
Income (loss) before transfers		3,107	(16,104)
Transfer in		18,000	18,000
Transfer out		(18,000)	(18,000)
Capital contributions		—	—
Change in net assets		3,107	(16,104)
Net assets – beginning of year		223,301	239,405
Net assets – end of year	$	226,408	223,301

See accompanying independent auditors' report.

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

Supplemental Schedule of Interfund Transfers

Year ended August 31, 2008

(Thousands of dollars)

Due to the City, September 1, 2007	$	3,000
Accrued distributions		18,000
Payments to the City		(18,000)
Due to the City, August 31, 2008	$	3,000

See accompanying independent auditors' report.