PHILADELPHIA GAS WORKS

(A Component Unit of the City of Philadelphia)

Basic Financial Statements and Supplementary Information

August 31, 2009 and 2008

(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, 2009 and 2008, and the related statements of revenues and expenses, cash flows, and changes in fund equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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.

As discussed in note 1(t), the Company changed its method of accounting for derivative instruments in 2008 and 2009 due to the adoption of Governmental Accounting Standards Board Statement (GASB) No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

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, 2009 and 2008, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2009 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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The required supplementary information of management's discussion and analysis on pages 3 to 12 and the schedules of pension funding progress and other postemployment benefits funding progress on pages 59 and 60 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. This supplementary information is the responsibility of the Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and express no opinion on it.

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 61 to 64 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

December 18, 2009

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2009 and 2008 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) 2009 reflected a 6.1% warmer than normal winter. The FY 2009 period was 11.9% colder than the prior year and firm gas sales increased by 2.5 Billion cubic feet (Bcf). In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2008 through May 2009, resulted in heating customers receiving charges totaling $0.5 million as a result of the temperatures experienced during the period. The 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 Bcf. In addition, the 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.

- PGW achieved a collection rate of 93.8% in the current period, 95.5% in FY 2008 and 95.8% in FY 2007. The collection rate is calculated by dividing the total gas receipts collected in FY 2009 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 2008 and FY 2007, respectively.

- PGW implemented a $60.0 million extraordinary rate increase granted by the Pennsylvania Public Utility Commission (PUC) effective December 1, 2008. In addition to this rate increase, various business initiatives were implemented to improve collections, productivity, and operational efficiencies throughout the company, and achieved positive results. PGW, at the end of FY 2009, had no tax exempt commercial paper outstanding and a cash balance of $13.8 million. This compares favorably to the FY 2008 balance of $90.0 million of tax exempt commercial paper outstanding and a cash balance of $49.3 million. This resulted in an overall improvement of $54.5 million in PGW's liquidity.

- The Company adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53), for the fiscal year ended August 31, 2009, a year earlier than required by GASB, because the Company is a component unit of the City of Philadelphia (the City) for financial reporting requirements and the Company's FY 2009 financial statements will be included in the City's financial statements for the year ended June 30, 2010.

  GASB 53 establishes a framework for accounting and financial reporting related to derivative instruments, requiring the fair value of derivatives to be recognized in the financial statements.

  The Company's only derivative instrument is an interest rate swap entered into to hedge the interest payments on its variable rate Sixth Series Bonds. The Company determined the hedging relationship between the Sixth Series Bonds and related interest rate swap to be effective at August 31, 2008. Therefore, the adoption of the provisions of GASB 53 had no impact on beginning net assets at September 1, 2007. The Company's August 31, 2008 balance sheet has been restated to reflect an interest rate swap liability and an offsetting deferred outflow of resources of $13.8 million, representing the fair value of the interest rate swap hedging the Sixth Series Bonds at August 31, 2008. These offsetting amounts are included in other liabilities and deferred credits, and other assets and deferred debits.

- On August 20, 2009, the Company issued $313.3 million of Eighth Series Bonds for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the costs of terminating a portion of the related interest rate swap agreement, and issuing the bonds and any required deposits to the Sinking Fund Reserve. The Eighth Series Bonds consist of $58.3 million of serial bonds with interest rates ranging from 4.0% to 5.25% and have maturity dates through 2017. The Eighth Series Bonds also consists of four serial bonds totaling $255.0 million that have variable rates set through a weekly reset mode, are paid monthly, and are secured with a letter of credit that expires August 19, 2011. These bonds mature at various dates from 2017 to 2031. The refunding of the Sixth Series Bonds triggered a termination of the hedging relationship between the interest rate swap and the Sixth Series Bonds. The difference between the carrying value of the Eighth Series Bonds and the net carrying value of the Sixth Series Bonds of $55.3 million, which included the elimination of the cumulative $26.3 million deferred outflow of resources representing the cumulative changes in fair value of the interest rate swap, was deferred and will be amortized over the life of the refunding bond issue.

  As part of the Eighth Series Bond issuance, the Company paid a swap termination payment of $3.8 million to the counterparty to partially terminate the swap. The remaining swap was amended and restated to hedge the variable rate portions of the Eighth Series Bonds. The Company determined the hedging relationship between the amended swap and the Eighth Series Bonds to be effective at August 31, 2009. The fair value of the swap is recorded as an interest rate swap liability of $27.6 million. The Company also recognized a deferred outflow of resources asset, which is included in other assets and deferred debits, of $1.2 million which represents the change in the fair value of the interest rate swap from the inception of the new hedging relationship on August 20, 2009 to August 31, 2009. Under GASB 53, the Company will reevaluate the effectiveness of the hedge at each reporting period. Should the hedge be determined to be ineffective in the future, the cumulative balance of the deferred outflow of resources will be recognized in the statement of revenues and expenses as a gain or loss, and future changes in fair value of the interest rate swap will be recorded in the statement of revenues and expenses as they occur.

Overview of the Financial Statements

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

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

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

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

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

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

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

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

Condensed Statements of Revenues and Expenses

(Thousands of dollars)

		Years ended August 31		
		2009	2008	2007
Total gas revenues	$	910,457	831,428	840,105
Other revenues		18,984	18,199	19,246
Total operating revenues		929,441	849,627	859,351
Total operating expenses		845,558	794,246	819,748
Operating income		83,883	55,381	39,603
Interest and other income		12,240	15,732	13,073
Total interest expense		(78,912)	(68,006)	(68,780)
Excess (deficiency) of revenues over (under) expenses	$	17,211	3,107	(16,104)

Operating Revenues

Operating revenues in FY 2009 were $929.4 million, an increase of $79.8 million or 9.4% from the FY 2008 level. The increase in FY 2009 was due to a colder winter. 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. Please see the discussion of the cost of fuel in the Operating Expenses section below.

(Continued)

Total sales volumes, including gas transportation deliveries, in FY 2009 increased by 5.5 Bcf to 71.8 Bcf or 8.3% from FY 2008 sales volumes of 66.3 Bcf. In FY 2008 total sales volumes, including gas transportation deliveries, increased by 2.5 Bcf to 66.3 Bcf or 3.9% from FY 2007 sales volumes of 63.8 Bcf. Firm gas sales of 48.0 Bcf were 2.5 Bcf or 5.5% higher than FY 2008 firm gas sales of 45.5 Bcf which were 2.4 Bcf or 5.0% lower than FY 2007. Interruptible customer sales decreased by 0.6 Bcf compared to FY 2008 which decreased by 0.9 Bcf compared to FY 2007. Gas transportation sales in FY 2009 increased by 3.6 Bcf to 22.6 Bcf from the 19.0 Bcf level experienced in FY 2008. In FY 2008, the volume increased by 5.9 Bcf to 19.0 Bcf from the 13.1 Bcf level experienced in FY 2007.

In FY 2009, customers served by PGW decreased by 0.2% from the previous year to approximately 504,000 customers. The number of customers served by PGW at the end of FY 2008 and FY 2007 were approximately 505,000 and 506,000, respectively. Commercial accounts were approximately 25,000, reflecting no change from the previous two fiscal years. Industrial accounts reflected no change from the prior year's level of 800. Industrial accounts were 800 and 900 customers in FY 2008 and FY 2007, respectively. Residential customers decreased to 478,000 customers, a decrease of 1,000 from the prior year. The number of residential customers in FY 2008 decreased to approximately 479,000 customers, a decrease of 1,000 from the FY 2007 level.

Operating Expenses

Total operating expenses, including fuel costs, in FY 2009 were $845.6 million, an increase of $51.3 million or 6.5% from FY 2008. The increase for FY 2009 reflects substantially higher natural gas utilization and a decrease in refunds received from pipeline suppliers. Total operating expenses in FY 2008 of $794.2 million decreased by $25.5 million or 3.1% from FY 2007. The decrease for FY 2008 reflects substantially lower natural gas utilization and an increase in refunds received from pipeline suppliers.

Cost of Fuel – The cost of natural gas utilized increased by $33.9 million or 6.6% to $545.8 million in FY 2009 compared with $512.0 million in FY 2008. The average commodity price per Thousand cubic feet (Mcf) increased by $0.06 or $3.5 million, while the volume of gas utilized increased by 2.0 Bcf, 3.7% or $16.6 million. In addition, pipeline supplier refunds in FY 2009 decreased by $10.5 million while demand charges increased by $3.4 million, compared to FY 2008.

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 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.

Variations in the cost of purchased gas are passed through to customers under the gas cost rate (GCR) provision of PGW's rate schedules. Over-recoveries or under-recoveries of purchased gas costs are subtracted from or added to gas revenues and are included in 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 2009, FY 2008, and FY 2007 were $8.55, $8.48, and $8.23 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2009 were $75.6 million, an increase from the FY 2008 total of $68.9 million as a result of higher labor costs. The FY 2008 total of $68.9 million was $0.6 million lower than the FY 2007 total of $69.5 million. Additionally, expenses related to customer services, collection and account management, marketing, and the administrative area increased by $5.3 million or 5.8% in FY 2009 primarily due to costs related to the business transformation initiative and offset by a decrease in the gas used by the utility. This category decreased by $4.9 million or 5.7% in FY 2008, which was offset somewhat by higher premiums for active and retired employee health insurance coverage. Pension costs increased by $1.2 million to $15.4 million in FY 2009 as compared to FY 2008. Pension costs were $1.0 million lower in FY 2008 as compared to FY 2007.

Provision for Uncollectible Accounts – The provision for uncollectible accounts in FY 2009 totaled $42.0 million, an increase of $5.0 million or 13.5% higher than FY 2008. The provision for uncollectible accounts in FY 2008 totaled $37.0 million, a decrease of $3.0 million or 7.5% compared to FY 2007. The accumulated provision for uncollectible accounts at August 31, 2009 reflects a balance of $123.0 million, compared to the $140.4 million balance in FY 2008 and $150.2 million in FY 2007. 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 decreased by $1.7 million in FY 2009 compared with FY 2008. Depreciation expense increased by $3.1 million in FY 2008 compared with FY 2007. The effective composite depreciation rates for FY 2009, FY 2008, and FY 2007 were 2.3%, 2.4%, and 2.3%, respectively. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income was $3.5 million lower than FY 2008 as a result of a decline in interest rates coupled with lower restricted fund balances. Interest and other income in FY 2008 was $2.7 million greater than FY 2007 as a result of increased earnings rates on higher restricted fund balances.

Interest Expense – Total interest expense increased by $10.9 million or 16.0% in FY 2009 compared with FY 2008 and decreased by $0.8 million or 1.1% in FY 2008 compared with FY 2007. Interest on long-term debt was $7.5 million higher in FY 2009 due to the increased interest cost associated with the Sixth Series Bonds and increased $3.9 in FY 2008 as a result of the full year effect of the issuance of the Seventh Series Bonds in May 2007. Other interest costs increased by $3.3 million or 26.8% in FY 2009 and was offset by a $1.0 million decrease in interest expense associated with PGW's commercial paper program as a result of lower borrowing costs coupled with decreased outstanding balances. 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.

Excess (Deficiency) of Revenues Over (Under) Expenses – In FY 2009, the Company's excess of revenues over expenses was $17.2 million, an increase of $14.1 million from FY 2008. The Company had an excess of revenues over expenses of $3.1 million in FY 2008, an increase of $13.0 million from FY 2007.

Condensed Balance Sheets

(Thousands of dollars)

		August 31		
Assets		**2009**	**2008**	**2007**
Utility plant, net	$	1,076,467	1,062,095	1,040,373
Restricted investment funds		175,534	219,788	277,139
Current assets:				
Accounts receivable (net of accumulated provision for uncollectible accounts of $123,009, $140,435, and $150,231 for 2009, 2008, and 2007, respectively)		105,496	99,304	88,618
Other current assets and deferred debits, cash and cash equivalents, gas inventories, materials, and supplies		143,668	242,503	205,083
Total current assets		249,164	341,807	293,701
Other assets and deferred debits		130,926	119,765	103,727
Total assets	$	1,632,091	1,743,455	1,714,940
Fund Equity and Liabilities				
Fund equity	$	243,619	226,408	223,301
Total long-term debt		1,114,488	1,127,163	1,201,792
Current liabilities:				
Note payable		—	90,000	51,600
Current portion of long-term debt		48,175	76,030	86,995
Other current liabilities and deferred credits		85,580	126,235	103,276
Total current liabilities		133,755	292,265	241,871
Other liabilities and deferred credits		140,229	97,619	47,976
Total fund equity and liabilities	$	1,632,091	1,743,455	1,714,940

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Assets

Utility Plant – Utility plant, net of depreciation, totaled $1,076.5 million in FY 2009, an increase of $14.4 million or 1.4% compared with the FY 2008 balance of $1,062.1 million. The FY 2008 balance of $1,062.1 million, increased by $21.7 million or 2.1% compared with the FY 2007 balance of $1,040.4 million. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $52.2 million in FY 2009 compared to $61.2 million in FY 2008 and $69.1 million in FY 2007. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amounts of $48.5 million, $60.9 million, and $60.7 million in FY 2009, FY 2008, and FY 2007, 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 $44.3 million in FY 2009 primarily due to the drawdown from the Capital Improvement Fund offset by interest income. Interest income on these funds, to the extent not drawn, is reflected as an increase and approximated $4.8 million in FY 2009, $11.7 million in FY 2008, and $6.8 million in FY 2007. A drawdown from the accrued interest in the Capital Improvement Fund in the amount of $5.0 million was utilized for working capital purposes in FY 2009. There was no drawdown of interest from the Capital Improvement Fund in FY 2008. 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.

Accounts Receivable – In FY 2009, accounts receivable (net) of $105.5 million increased by $6.2 million, or 6.2% from FY 2008 due to firm transportation suppliers' billings and an increase in participation in the Customer Responsibility Program (CRP). Accounts receivable (net) of $99.3 million increased by $10.7 million, or 12.1% in FY 2008 compared to FY 2007. The accumulated provision for uncollectible accounts, totaling $123.0 million decreased by $17.4 million in FY 2009 and totaled $140.4 million in FY 2008 and $150.2 million in FY 2007.

Other Current Assets and Deferred Debits, Cash and Cash Equivalents, Gas Inventories, Materials, and Supplies – In FY 2009, cash and cash equivalents were $13.8 million, a decrease of $35.6 million from FY 2008, and totaled $51.7 million in FY 2007. In FY 2009, gas storage decreased by $61.9 million or 34.4% compared to FY 2008. The decrease in gas inventory reflects a decrease in the gas cost per Mcf plus a decrease in the amount of storage at year end. In FY 2008, 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 $125.0 million, which principally include gas inventory, maintenance spare parts, and material, decreased by $62.5 million and were $187.5 million in FY 2008 and $147.8 million in FY 2007. Other current assets and deferred debits totaled $4.9 million in FY 2009, down $0.7 million from FY 2008. In FY 2008, other current assets and deferred debits totaled $5.6 million, up $0.1 million from FY 2007, primarily due to the recovery of under-recovered GCR amounts from the prior year.

Other Assets and Deferred Debits – In FY 2009, other assets and deferred debits including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled $130.9 million, an increase of $11.1 million from FY 2008, mainly due to the increase in the interest rate swap liability. In FY 2008, the total was $119.8 million and reflected an increase of $16.0 million from FY 2007.

Liabilities

Long-Term Debt – Long-term debt, including the current portion and unamortized discount and premium, totaled $1,162.7 million in FY 2009, $40.5 million less than the previous year primarily as a result of normal debt principal payments. This represents 82.7% of total capitalization in FY 2009. 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 repaying the City Loan and normal debt principal payments. This represented 84.2% of total capitalization in FY 2008. This represented 85.2% of total capitalization in FY 2007.

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 2009, the debt service coverage was at 5.65 times debt service on the outstanding 1975 Ordinance Bonds and 2.13 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 4.28 and 1.88 times, respectively, in FY 2008 and 3.70 and 2.00 times, respectively, in FY 2007. 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. 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 2009 and FY 2008, 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. There were no notes outstanding at August 31, 2009. The principal amount outstanding at August 31, 2008 was $90.0 million. 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 15, 2009, $150.0 million was available from the commercial paper program. Additionally, PGW had $42.0 million available in its Capital Improvement Fund to be utilized for construction expenditures. These funding sources may be utilized during the fall and early winter period to provide liquidity until billings from the winter heating season are collected. The cash balance at December 15, 2009 was $13.3 million.

Accounts Payable – In FY 2009 accounts payable totaled $46.2 million, a decrease of $21.3 million or 31.6% compared with FY 2008 primarily due to a decrease in natural gas payables. 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.

Other Liabilities and Deferred Credits – In FY 2009, other liabilities and deferred credits totaling $140.2 million increased $42.6 million compared to FY 2008. The increase in FY 2009 is primarily due to the effect of recording the liability for OPEB in the amount of $25.9 million and the net increase in the interest rate swap liability in the amount of $14.5 million. In FY 2008, other liabilities and deferred credits totaling $97.6 million increased $49.6 million compared to FY 2007. The increase in FY 2008 is primarily due to 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, an increase in the environmental remediation liability and the recording of the initial fair value of the swap in the amount of $13.8 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, 2009 was $635.8 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 $439.1 million if the Company adopted a policy of funding its Annual Required Contribution (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 net OPEB obligation was $78.2 million for the fiscal year ended August 31, 2009 and is projected to increase to $458.8 million over the ensuing 20-year period on a pay-as-you-go basis. The annual OPEB cost was $52.3 million for the fiscal year ended August 31, 2008.

On December 22, 2006, PGW filed for a $100.0 million base rate increase with the 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 the Commonwealth Court denied PGW's appeal by order entered February 4, 2009. PGW thereupon, submitted a Petition for Allowance of Appeal to the Pennsylvania Supreme Court and, by order dated December 2, 2009, the Supreme Court denied PGW's Petition. The $25.0 million rate increase was implemented in November 2007.

In November 2008, the Company filed for an extraordinary 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 served several purposes. First, the increase covered the additional financing costs that the Company incurred. Second, the increase improved the Company's financial position so as to enhance its ability to access the financial markets and maintain its bond rating. Third, the increase provided additional liquidity and financial flexibility in this tight credit market. On December 18, 2008, the PUC issued its decision approving a base rate increase of $60.0 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 were effective as of January 1, 2009.

On December 18, 2009, PGW submitted a base rate filing with the PUC (1) to maintain the $60.0 million base rate increase that the PUC granted in 2008; and (2) to fund PGW's OPEB liability in the amount of $42.5 million. PGW also moved to consolidate the Company's Demand Side Management Plan (i.e. an Energy Efficiency and Conservation Plan) into the base rate filing. PGW anticipates a PUC decision in September 2010.

The Company had no commercial paper outstanding at August 31, 2009. Prior to year end, all outstanding commercial paper matured and no additional commercial paper was issued.

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, 2009 and 2008

(Thousands of dollars)

Assets		**2009**	**2008**
Utility plant, at original cost:			
In service	$	1,754,297	1,685,593
Under construction		30,953	46,969
Total		1,785,250	1,732,562
Less accumulated depreciation		708,783	670,467
Utility plant, net		1,076,467	1,062,095
Restricted investment funds:			
Sinking fund, revenue bonds		110,227	106,198
Capital improvement fund		62,714	111,207
Workers' compensation escrow fund		2,593	2,383
Total restricted investment funds		175,534	219,788
Current assets:			
Cash and cash equivalents		13,750	49,338
Accounts receivable (net of provision for uncollectible accounts of $123,009 and $140,435 for 2009 and 2008, respectively)		105,496	99,304
Gas inventories, materials, and supplies		125,023	187,539
Other current assets and deferred debits		4,895	5,626
Total current assets		249,164	341,807
Unamortized bond issuance costs		27,516	38,738
Unamortized losses on reacquired debt		79,945	47,902
Other assets and deferred debits		23,465	33,125
Total assets	$	1,632,091	1,743,455

See accompanying notes to financial statements.

(Continued)

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

Balance Sheets

August 31, 2009 and 2008

(Thousands of dollars)

Fund Equity and Liabilities		**2009**	**2008**
Fund equity:			
Excess (deficiency) of capital assets, net of related debt	$	1,019	(4,466)
Restricted		112,820	108,581
Unrestricted		129,780	122,293
Total fund equity		243,619	226,408
Long-term debt:			
Revenue bonds		1,114,488	1,127,163
Current liabilities:			
Note payable		—	90,000
Current portion of revenue bonds		48,175	76,030
Accounts payable		46,205	67,508
Customer deposits		4,224	7,325
Other current liabilities and deferred credits		16,203	32,581
Accrued accounts:			
Interest, taxes, and wages		15,948	15,821
Distribution to the City		3,000	3,000
Total current liabilities		133,755	292,265
Other liabilities and deferred credits		140,229	97,619
Total fund equity and liabilities	$	1,632,091	1,743,455

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, 2009 and 2008

(Thousands of dollars)

		2009	2008
Operating revenues:			
Gas revenues:			
Nonheating	$	67,295	78,687
Gas transport service		24,913	19,215
Heating		818,249	733,526
Total gas revenues		910,457	831,428
Appliance and other revenues		9,311	8,607
Other operating revenues		9,673	9,592
Total operating revenues		929,441	849,627
Operating expenses:			
Natural gas		545,846	511,976
Gas processing		16,779	14,436
Field services		37,727	37,126
Distribution		21,059	17,319
Collection and account management		16,248	15,447
Provision for uncollectible accounts		42,000	37,000
Customer services		12,897	12,305
Marketing		3,436	2,628
Administrative and general		63,820	60,716
Pensions		15,425	14,258
Other postemployment benefits		25,952	25,834
Taxes		6,588	5,677
Total operating expenses before depreciation		807,777	754,722
Depreciation		42,200	42,868
Less depreciation expense included in operating expenses above		4,419	3,344
Total depreciation		37,781	39,524
Total operating expenses		845,558	794,246
Operating income		83,883	55,381
Interest and other income		12,240	15,732
Income before interest expense		96,123	71,113
Interest expense:			
Long-term debt		63,602	56,075
Other		15,558	12,269
Allowance for funds used during construction		(248)	(338)
Total interest expense		78,912	68,006
Excess of revenues over expenses	$	17,211	3,107

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, 2009 and 2008

(Thousands of dollars)

		2009	2008
Cash flows from operating activities:			
Receipts from customers	$	878,000	834,000
Payments to suppliers		(608,180)	(659,969)
Payments to employees		(107,918)	(105,596)
Claims paid		(3,591)	(2,691)
Other receipts		8,900	24,500
Net cash provided by operating activities		167,211	90,244
Cash flows from noncapital financing activities:			
Interest		2,160	3,548
Interest payments on notes payable		(3,007)	(4,099)
Net repayments of notes payable		(90,000)	38,400
Loan from City of Philadelphia		—	(43,000)
Restricted, City Loan deposit		—	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		(90,847)	(4,508)
Cash flows from capital and related financing activities:			
Proceeds from long-term debt issued		313,285	—
Redemption of long-term debt		(311,615)	—
Long-term debt issuance costs		(2,312)	—
Swap termination payment		(3,791)	—
Purchases of capital assets		(52,154)	(61,244)
Principal paid on long-term debt		(42,780)	(41,830)
Interest paid on long-term debt		(62,092)	(54,076)
Drawdowns on capital improvement fund		48,493	60,926
Interest income on capital improvement fund		1,499	8,089
Interest income on sinking fund		3,296	3,460
Sinking fund (deposits)		(4,029)	(3,759)
Other		248	338
Net cash used in capital and related financing activities		(111,952)	(88,096)
Net decrease in cash and cash equivalents		(35,588)	(2,360)
Cash and cash equivalents at the beginning of the year		49,338	51,698
Cash and cash equivalents at the end of the year	$	13,750	49,338
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	83,883	55,381
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization expense		37,781	39,812
Change in assets and liabilities:			
Receivables, net		(6,693)	(11,215)
Inventories		62,516	(39,769)
Other current assets and deferred debits		731	(11)
Other assets and deferred debits		(2,886)	(11,053)
Accounts payable		(21,303)	6,893
Customer deposits		(3,101)	(1,724)
Other current liabilities and deferred credits		(16,378)	17,057
Other liabilities and deferred credits		32,661	34,873
Net cash provided by operating activities	$	167,211	90,244

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, 2009 and 2008

(Thousands of dollars)

		2009	2008
Fund equity balance, beginning of the year	$	226,408	223,301
Excess of revenues over expenses		17,211	3,107
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	$	243,619	226,408

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

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

As described in note 2, the Company is a component unit of the City, and consequently follows accounting principles promulgated by the Governmental Accounting Standards Board (GASB) as they apply to proprietary fund-type activities. In accordance with GASB Statement No. 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 December 2, 2009 PGW filed its fiscal year (FY) 2010 Compliance Budget reflecting the adjustment incorporated into the PGC's Motion dated November 17, 2009. These adjustments reduced total operating expenses by $1,970,000 from PGW's original budget request.

On June 16, 2009, the Company filed its FY 2010 Operating Budget. The PGC conducted informal discovery concerning this budget in July and August 2009 and public hearings in September 2009. The PGC authorized interim spending authority of $64,163,000 for the period September 1, 2009 through November 30, 2009, pursuant to a Motion, dated September 22, 2009. Briefs were filed concerning the overall budget on September 22, 2009, a motion approving the FY 2010 Operating Budget was approved by the PGC on November 17, 2009 reflecting total non-fuel operating expenses of $258,412,000.

On May 29, 2008, the Company filed its 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 PGC 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 PGC 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 June 10, 2009, PGW requested that the PGC endorse a proposal to amend the FY 2010 Capital Budget in the amount of $2,552,000 for a project: Consolidate Fire Protection System – Richmond Plant. On September 9, 2009, the PGC staff issued a recommended decision approving PGW’s request. The PGC approved the staff recommendation on September 22, 2009. City Council approved an ordinance amending the FY 2010 Capital Budget on October 29, 2009, with the Mayor signing the ordinance on November 6, 2009.

On January 2, 2009, the Company filed a proposed FY 2010 Capital Budget in the amount of $74,407,000. After review and evaluation, the PGC on April 13, 2009 approved a recommendation to City Council for a budget of $72,215,000. The PGC’s recommendation was approved by City Council on May 21, 2009 and the ordinance was signed by the Mayor on May 27, 2009.

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 PGC, after review and evaluation, approved a recommendation to City Council supporting the Company’s amendment on July 2, 2008. City Council approved the PGC’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 PGC’s recommendation was approved by City Council on June 19, 2008 and the ordinance was signed by the Mayor on July 2, 2008.

(Continued)

On September 27, 2007, the Company filed with the PGC a proposal to amend the approved FY 2008 Capital Budget for two new line 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 PGC, 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 base rate increase of approximately $60,000,000 or 5.2% and simultaneously requested an $85,000,000 or 7.4% decrease in the gas cost rate (GCR) for a net 2.2% overall rate decrease of approximately $25,000,000. The base rate increase served several purposes. First, the increase covered the additional financing costs that the Company incurred. Second, the increase improved the Company's financial position so as to enhance its ability to access the financial markets and maintain its bond rating. Third, the increase provided additional liquidity and financial flexibility in this tight credit market. On December 18, 2008, the PUC issued its decision approving a base rate increase of $60,000,000 or 5.2% and a decrease in the GCR of $107,000,000 for a net decrease in rates of $47,000,000, or 4.2%. These rates were effective as of January 1, 2009.

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 the Commonwealth Court denied PGW's appeal by order entered February 4, 2009. PGW thereupon submitted a Petition for Allowance of Appeal to the Pennsylvania Supreme Court and, by order dated December 2, 2009, the Supreme Court denied PGW's Petition. The $25,000,000 rate increase was implemented in November 2007.

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, 2009. The adjustments for the years ended August 31, 2009 and 2008 were an increase in billings of $505,000 and $12,238,000, respectively.

(f) Gas Cost Rate

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

At the end of the fiscal year, costs recovered through the GCR are compared to the actual cost of fuel and other specific costs. Customers are then credited or charged for over-recovery or under-recovery of costs. The GCR may be adjusted quarterly or in the subsequent fiscal year to reflect the under-recovery or over-recovery. Changes in the GCR impact the reported amounts of gas revenues and operating expenses, but do not affect operating income or net income. The Company at August 31, 2009 deferred approximately $5,873,000 for GCR over-recovery and $15,494,000 for GCR under-recovery at August 31, 2009 and 2008, respectively.

GCR effective dates and rates

Effective date		GCR rate per Mcf*	Change
December 1, 2009	$	7.2497	0.1597
September 1, 2009		7.0900	(0.0915)
June 1, 2009		7.1815	(1.2377)
March 1, 2009		8.4192	(2.2815)
January 1, 2009		10.7007	(1.9520)
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)

* 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 $1,710,000, and $2,847,000 was charged to expense as incurred in FY 2009 and FY 2008, 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 2009 and FY 2008 was 2.3% and 2.4%, 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 2009 were as follows:

Production plant	0.14% – 4.39%
Transmission, distribution, and storage	0.18% – 4.08%
General plant	1.46% – 10.80%

(Continued)

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 4.72% and 4.96% in FY 2009 and FY 2008, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2009 and 2008, respectively (thousands of dollars):

	August 31, 2009			
	Beginning balance	**Additions and transfers**	**Retirements and transfers**	**Ending balance**
Land	$ 5,595	—	—	5,595
Distribution and collection systems	1,271,396	52,121	(1,312)	1,322,205
Buildings and equipment	408,602	19,099	(1,204)	426,497
Total utility plant, at historical cost	1,685,593	71,220	(2,516)	1,754,297
Under construction	46,969	54,961	(70,977)	30,953
Less accumulated depreciation for:				
Distribution and collection systems	(582,461)	(28,160) *	1,245	(609,376)
Buildings and equipment	(88,006)	(12,331) *	930	(99,407)
Utility plant, net	$ 1,062,095	85,690	(71,318)	1,076,467

* Cost of removal in the amount of $1,710 was charged to expense as incurred in FY 2009 and is not included in accumulated depreciation.

	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 amount of $2,847 was charged to expense as incurred in FY 2008 and is not included in accumulated depreciation.

(h) Revenue Recognition

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

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

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

(i) Customers (Unaudited)

The Company's service territory encompasses the City. Of the Company's approximately 504,000 customers at August 31, 2009 and 505,000 at August 31, 2008, nearly 95.0% 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, 2009 and 2008 was approximately 82,000 and 77,000, 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, 2009 and 2008 was approximately 36,000 and 40,000, 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 2009 and FY 2008, 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 $14,143,000 and $19,014,000 for FY 2009 and FY 2008, respectively, have been reclassified to accounts payable.

(k) Gas Inventories, Materials, and Supplies

Gas inventories, materials, and supplies, consisting primarily of fuel stock, gases stored to meet peak demand requirements, and spare parts, are stated at average cost at August 31, 2009 and 2008, as follows (thousands of dollars):

		2009	2008
Gas inventory	$	117,889	179,751
Material and supplies		7,134	7,788
Total	$	125,023	187,539

(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), Philadelphia Gas Works Pension Plan (the Pension Plan), a single-employer defined-benefit plan, to provide pension benefits for all of its employees. The Pension Plan is noncontributory, covering all employees and providing for retirement payments for vested employees at age 65 or earlier under various options, which includes a disability pension provision, a preretirement spouse or domestic partner's death benefit, a reduced pension for early retirement, various reduced pension payments for the election of a survivor option, and a provision for retirement after 30 years of service without penalty for reduced age. In accordance with Resolutions of the PGC, Ordinances of City Council, and as prescribed by the City's Director of Finance, the Pension Plan is being funded with contributions by the Company to the Sinking Fund Commission of the City. Management believes that the Pension Plan is in compliance with all applicable laws.

The Company sponsors a single employer defined benefit healthcare plan and provides postemployment healthcare and life insurance benefits to approximately 1,936 and 1,920 participating retirees and their beneficiaries and dependents for FY 2009 and FY 2008, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,702 and 1,699 active employees and their dependents for FY 2009 and FY 2008, respectively, by charging the annual insurance premiums to expense.

The difference between the annual other postemployment benefits (OPEB) expense and the expenses paid by the Company results in an increase in the liability which is recorded in other liabilities and deferred credits.

(o) Cash Equivalents

For the purpose of reporting cash equivalents, all 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.

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 chose 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 Company's FY 2008 financial statements will be included in the City's financial statements for the 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.

Under Pennsylvania Act 2, *Land Recycling and Environmental Remediation Standards Act of 1995* (Act 2), the Notice of Intent to Remediate (NIR) process was conducted by the Company in October 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 Pennsylvania Act 32, *Storage Tank and Spill Prevention Act of 1989* (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, and changes in price, technology, proposed land use or applicable regulations.

In FY 2009, the Company recorded an additional $1,390,000 liability for pollution remediation obligations. The implementation of GASB 49 resulted in an additional $8,300,000 liability in FY 2008. The pollution remediation liability is reflected in other liabilities and deferred credits and in other current liabilities and deferred credits. Although GASB 49 requires pollution remediation liabilities to be measured at the beginning of the first period presented in the financial statements,

(Continued)

because the increase in the liability related to the implementation of GASB 49 is not material, the Company did not restate prior periods and instead recognized the effect of GASB 49 implementation in FY 2008.

In accordance with U.S. GAAP for regulated entities, the Company has also recognized the long-term portion of its environmental remediation liability as a regulatory asset because based on available evidence it is probable that the previously incurred costs will be recovered through rates.

(t) New Accounting Pronouncements

The Company adopted the provisions of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB 51) and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53), for the year ended August 31, 2009. This was a year earlier than required implementation, because the Company is a component unit of the City for financial reporting requirements and the Company's FY 2009 financial statements will be included in the City's financial statements for the year ended June 30, 2010. Retroactive application of both standards is required, if practical, for all prior periods presented, with certain exceptions as discussed below.

Intangible Assets

GASB 51 establishes a framework for the recognition and measurement of intangible assets, including computer software. The Company's primary intangible asset relates to utility easements for its distribution system. Because GASB 51 does not require retroactive application for intangible assets with indefinite useful lives, the Company has elected not to record its historical utility easements. The Company also has internal use software, for which retroactive application is not required. Should the Company obtain future easements or internal use software, it will account for them in accordance with the provisions of GASB 51.

There was no impact of the implementation of GASB 51 on the financial statements as of and for the years ended August 31, 2009 and 2008.

Derivative Instruments

GASB 53 establishes a framework for accounting and financial reporting related to derivative instruments, requiring the fair value of derivatives to be recognized in the financial statements.

The Company's only derivative instrument is an interest rate swap entered into to hedge the interest payments on its variable rate Sixth Series Bonds. The Company determined the hedging relationship between the Sixth Series Bonds and related interest rate swap to be effective at August 31, 2008. Therefore, the adoption of the provisions of GASB 53 had no impact on beginning net assets at September 1, 2007. The Company's August 31, 2008 balance sheet has been restated to reflect an interest rate swap liability and an offsetting deferred outflow of resources of $13,800,000, representing the fair value of the interest rate swap hedging the Sixth Series Bonds at August 31, 2008. These offsetting amounts are included in other liabilities and deferred credits, and other assets and deferred debits.

Required disclosures related to the Company's swap are located at note 8(c).

(u) 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 2009, the applicable maximum amount was calculated to be $1,008,600. In FY 2008, the applicable maximum amount was calculated to be $1,011,000. The agreement requires the Company to make annual payments of $18,000,000 to the City. In FY 2009 and FY 2008, 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 $13,739,000 and $13,914,000 in FY 2009 and FY 2008, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled $395,000 and $616,000 in FY 2009 and FY 2008, respectively. Net amounts receivable from the City were $139,000 and $375,000 at August 31, 2009 and 2008, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $711,000 and $788,000 in FY 2009 and FY 2008, 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, 2009 and 2008 were $16,732,000 and $52,504,000, respectively. Book balances of such deposits and accounts at August 31, 2009 and 2008 were $13,750,000 and $49,338,000, respectively. Federal depository insurance on these balances at August 31, 2009 and 2008 was $534,000 and $158,000, 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, 2009 and 2008 were $143,800,000 and $135,200,000, respectively. Money market accounts with a carrying amount (at fair value) of $13,700,000 and $51,200,000 at August 31, 2009 and 2008, respectively, are included in the balances presented above.

There were no repurchase agreements outstanding at August 31, 2009 and 2008.

(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, 2009 and 2008 was $62,714,000 and $111,207,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2009 and FY 2008, 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 gain of $5,000 at August 31, 2009. The adjustment to market value for the Capital Improvement Fund resulted in a loss of $72,000 at August 31, 2008. The adjustment to market value for the Sinking Fund resulted in gains of $734,000 and $242,000 at August 31, 2009 and 2008, 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, 2009 and 2008, the trust account balances were $2,593,000 and $2,383,000, respectively.

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

	August 31, 2009			
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	$ 3,133	0.4608	Aaa/AAA	Moody's/S&P
Federal Home Loan Mortgage gold partner certificate	201	1.6694	N/A	
Federal National Mortgage Association debenture	3,139		Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	6,473			
Corporate obligations:				
First Suburban National Bank certificate of deposit	101		Aa-/AA3	Moody's/S&P
Ravenswood Bank certificate of deposit	100		Aa/AA3	Moody's/S&P
Total corporate obligations	201		N/A/A-1+	S&P
Total fair value of investments	6,674		P1/A-1+	Moody's/S&P
Cash and cash equivalents:				
American Express commercial paper	1,000		P1/A-1+	Moody's/S&P
General Electric Capital Service commercial paper	999		FDIC Insured	
Ironstone Bank certificate of deposit	99		FDIC Insured	
Total cash and cash equivalents	2,098			

	August 31, 2009			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
Dreyfus Cash Management Institutional Shares	$ 8,428	N/A	N/A	
First American Government Obligations Fund Class II	2,020	N/A	N/A	
Morgan Stanley Governmental Institutional Class	35,000	N/A	N/A	
Morgan Stanley Prime Portfolio Institutional Class	8,431	N/A	N/A	
Total money market	53,879			
Accrued interest	63			
Total fair value of investments, including cash deposits	$ 62,714			
Portfolio weighted modified duration		0.2918		

Investment type		August 31, 2008			
		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			

	August 31, 2008				
Investment type		**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
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		

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

	August 31, 2009			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Guaranteed investment contracts	$ 46,351	11.5000	*	*
U.S. government obligations:				
U.S. Treasury notes	22,994	2.0891	Aaa/AAA	Moody's/S&P
U.S. government agencies and instrumentalities:				
Federal Home Loan Mortgage Corporation medium term notes	5,391	1.5251	Aaa/AAA	Moody's/S&P
Federal National Mortgage Association medium term notes	4,948	2.1322	Aaa/AAA	Moody's/S&P
Federal Farm Credit Banks	5,931	1.9145		
Federal Home Loan Banks	17,201	2.0518	Aaa/AAA	Moody's/S&P
Total U.S. government agencies and instrumentalities	33,471			
Corporate obligations:				
JP Morgan Chase corporate note	955	1.4806	Aa1/AA+	Moody's/S&P
General Electric Capital Corp Global corporate note	2,230	1.5306	Aa3/AA-	Moody's/S&P
General Electric Capital Corp Global corporate note	1,480	1.4056	Aa3/AA-	Moody's/S&P
Total corporate obligations	4,665			
Total fair value of investments	107,481			

(Continued)

	August 31, 2009			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Cash and cash equivalents:				
U.S. Treasury bills	$ 239	0.7778	Aaa/AAA	Moody's/S&P
Money market:			N/A	N/A
Fidelity Institutional Government Portfolio Class II	2,507			
Total fair value of investments, including cash deposits	$ 110,227			
Portfolio weighted modified duration		1.9628		

* The credit rating of this investment is unrated.

	August 31, 2008			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
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
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

	August 31, 2008			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:			N/A	N/A
Fidelity Institutional				
Government Portfolio				
Class II	$ 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.

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

	August 31, 2009			
Investment type	**Fair value**	**Weighted average maturity (years)**	**Credit rating**	**Rating agency**
Money market:				
First American Treasury				
Obligations Fund	$ 2,593	N/A	N/A	N/A
Total fair value of investments, including cash deposits	$ 2,593			

	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 fair value of investments, including cash deposits	$ 2,383			

(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

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

	Percent of total portfolio allowed	Percent of total portfolio allowed in any one issuer	Maximum percent of any issuer's total outstanding securities
U.S. Government	No Restrictions	No Restrictions	No Restrictions
U.S. Treasury	No Restrictions	No Restrictions	No Restrictions
U.S. Agencies	No Restrictions	33%	No Restrictions
Certificates of Deposit	25%	10%	10%
Banker's Acceptances, Eurodollar Deposits, and Euro Certificates of Deposit	25%	10%	10%
Commercial Paper	25%	10%	10%
Corporate Bonds	25%	10%	10%
Collateralized Mortgage Obligation and Passthroughs	25%	10%	10%
Money Market Mutual Funds	25%	10%	10%
Repurchase Agreements	25%	10%	10%
Commonwealth of PA	25%	10%	10%

More than 5.0% of the Company's investments are in the Federal Home Loan Banks, U.S. Treasury Notes, Morgan Stanley Governmental Portfolio Institutional Class Fund, and the GIC with Financial Security Assurance Inc. (FSA) Capital Markets Services, LLC. These investments represent 9.80%, 13.10%, 19.95%, and 26.42%, respectively, of the Company's total investments, which is in accordance with the City's investment policy. In addition, the GIC with FSA is collateralized in amounts that meet the City's investment policy.

(4) Deferred Costs

In compliance with orders issued by the PGC, the cost of projects that produce benefits over an extended period is deferred. Such costs are being amortized to expense over a period matching their useful lives, which range from two to ten years. There is no return on the asset being charged to the customers. During FY 2009, there were costs of $236,000 incurred for rate case expenses that will be amortized over a five-year period. The unamortized costs included in other assets and deferred debits were $538,000 and $607,000 as of August 31, 2009 and 2008, respectively. The unamortized costs included in other current assets and deferred debits were $257,000 and $210,000 as of August 31, 2009 and 2008, 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 2009 by the Company's insurance carriers associated with environmental remediation costs, the Company received $179,000. Environmental remediation costs of approximately $370,000 in FY 2009 were offset by these insurance settlements, and the remainder was deferred. The Company estimates additional expenditures to be approximately $22,990,000.

(5) Deferred Compensation Plan

The Company offers its employees a deferred compensation plan (the Plan) created in accordance with Internal Revenue Code Section 457. The Plan, available to all Company employees with six months of service, permits them to defer a portion of their salary until future years. The Company provides an annual 10.0% matching contribution up to $500 that immediately vests to the employee. The Company contributed $337,000 and $361,000 for the years ended August 31, 2009 and 2008, 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.

The commitment amount is $150,000,000 under the current credit agreement. The expiration of the credit agreement is May 29, 2010.

The principal amount of notes outstanding at August 31, 2009 and 2008 was $0 and $90,000,000, respectively. 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.

(Continued)

Commercial paper activity for the years ended August 31, 2009 and 2008 was as follows (thousands of dollars):

		Year ended August 31, 2009			
		Beginning balance	Additions	Deletions	Ending balance
Commercial paper	$	90,000	58,000	148,000	—

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

(7) GCR Tariff Reconciliation

During the fiscal years ended August 31, 2009, 2008, and 2007, the Company's actual gas costs were below its billed gas costs by approximately $24,636,000, $30,503,000, and $24,904,000, respectively.

Natural Gas Pipeline Supplier Refund

The Company received refunds including interest in FY 2009 in the amount of $174,000 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 2009.

The Company received refunds including interest in FY 2008 in the amount of $10,956,000 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 2008.

(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, 2009 and 2008 (thousands of dollars):

		August 31, 2009			August 31, 2008		
		Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$	46,045	1,092,117	1,138,162	73,941	1,103,828	1,177,769
Unamortized discount		(396)	(3,324)	(3,720)	(482)	(4,469)	(4,951)
Unamortized premium		2,526	25,695	28,221	2,571	27,804	30,375
Total revenue bonds	$	48,175	1,114,488	1,162,663	76,030	1,127,163	1,203,193

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, 2009 and 2008 (thousands of dollars):

	Year ended August 31, 2009			
	Beginning balance	**Additions**	**Reductions**	**Ending balance**
Revenue bonds	$ 1,177,769	313,285	(352,892)	1,138,162
Other liabilities and deferred credits:				
Forward rate agreement	$ 7,807	—	(624)	7,183
Claims and judgments	6,077	568	—	6,645
Environmental clean-up	17,690	2,949	—	20,639
Other postemployment benefits	52,255	25,952	—	78,207
Interest rate swap liability	13,790	18,015	(4,250)	27,555
Total other liabilities and deferred credits	$ 97,619	47,484	(4,874)	140,229

	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
Interest rate swap liability	—	13,790	—	13,790
Total other liabilities and deferred credits	$ 47,976	50,267	(624)	97,619

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

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

		Revenue bonds			
		Principal	**Interest**	**Net swap amount**	**Total**
Fiscal year ending August 31:					
2010	$	46,045	43,055	8,192	97,292
2011		46,622	40,935	8,677	96,234
2012*		42,926	39,182	8,677	90,785
2013		45,135	37,526	8,677	91,338
2014		47,095	35,252	8,677	91,024
2015 – 2019		234,120	140,018	42,810	416,948
2020 – 2024		247,395	93,572	32,343	373,310
2025 – 2029		229,825	57,156	13,974	300,955
2030 – 2034		122,385	27,591	807	150,783
2035 – 2038		76,614	5,072	—	81,686
Total	$	1,138,162	519,359	132,834	1,790,355

* Tax Exempt Capital Accumulator (TECA) accretions for the 11 "C" Series in the amount of $3,139,000 are not included in the principal amount in FY 2012.

Future debt service is calculated using rates in effect at August 31, 2009 for variable rate bonds. The net swap payments were calculated by subtracting interest payments based on the lesser of the bond rate, SIFMA rate, or 70.0% of the LIBOR rate subject to swap agreements from the synthetic fixed rate achieved by the swap.

(a) Bond Issuances

2009 Ordinance

On June 3, 2009, the Mayor signed a bill into law authorizing the City to issue revenue bonds. The bill signed by the Mayor constituted the Ninth 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) to pay the cost of refunding or redeeming all or a portion of the outstanding Gas Works Revenue Bonds, Sixth Series (1998 Ordinance) and other Project Costs; (b) authorizing the City to obtain credit enhancement and liquidity for all or a portion of the Eighth Series Bonds, enter into or amend one or more Qualified Swap Agreements or to relate all or a portion of an existing Qualified Swap Agreement to all or a portion of a different series of outstanding Gas Works Revenue Bonds, and authorizing covenants and actions in order that the Eighth Series Bonds shall not be arbitrage bonds; and (c) making certain determinations and covenants relating to Gas Works Revenues and payment of interest and principal.

1998 Ordinance Eighth Series Bonds

On August 20, 2009, the Company issued $313,285,000 of Eighth Series Bonds for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the costs of terminating a portion of the Swap Agreement, and issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Eighth Series Bonds consist of $58,285,000 of serial bonds with an interest rate that ranges from 4.0% to 5.25% and have maturity dates through 2017. The Eighth Series Bonds also consist of four serial bonds totaling $255,000,000 that have variable rates set through a weekly reset mode, are paid monthly, and are secured with a letter of credit which expires August 19, 2011. These bonds mature at various dates from 2017 to 2031. The loss on refunding the Sixth Series Bonds and issuing the Eighth Series Bonds of $55,344,000, including $26,311,000 related to the elimination of the deferred outflow of resources upon termination of the Sixth Series hedging relationship was deferred and will be amortized over the life of the Eighth Series Bonds.

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

Description	Interest rates	Maturity date (fiscal year)	Balance outstanding August 31, 2009	Balance outstanding August 31, 2008
Series 11C	6.80%	2012	$ 21,882	20,379
1st Series A	4.50% – 5.50%	2026	84,995	95,815
1st Series C	3.85% – 5.00%	2014	8,615	10,115
16th Series	4.00% – 5.50%	2015	16,915	25,905
2nd Series	4.63% – 5.38%	2012	8,370	10,905
3rd Series	4.25% – 5.50%	2012	8,515	11,105
4th Series	4.00% – 5.25%	2032	92,585	95,125
17th Series	4.00% – 5.38%	2026	140,225	148,875
5th Series	4.00% – 5.25%	2034	120,000	120,000
5th Series A-2	Variable	2035	30,000	30,000
18th Series	5.00% – 5.25%	2021	50,470	52,580
6th Series	Variable	2031	—	311,615
19th Series	5.00%	2024	14,450	14,450
7th Series	4.00% – 5.00%	2038	196,955	200,000
7th Series Refunding	5.00%	2029	30,900	30,900
8th Series A	4.00% – 5.25%	2017	58,285	—
8th Series B	Variable	2031	105,000	—
8th Series C	Variable	2031	50,000	—
8th Series D	Variable	2031	50,000	—
8th Series E	Variable	2031	50,000	—
			$ 1,138,162	1,177,769

(b) Debt Coverage and Sinking Fund Requirements

Under the terms of both general ordinances, the City is required to maintain rates to allow the Company to satisfy 1975 and 1998 revenue bond debt coverage ratio requirements.

Also provided by both general ordinances is the establishment of a sinking fund into which deposits are made sufficient to meet all principal and interest requirements of the bonds as they become due. Both general ordinances also provide that sinking fund reserves be maintained as part of the Sinking Fund Reserve, which have previously been funded from the proceeds of each series of bonds in an amount equal to the maximum annual debt service requirement on the bonds of each respective general ordinance in any fiscal year.

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

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

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

As of August 31, 2009, the swap had a notional amount of $255,000,000 and the associated variable rate debt had a $255,000,000 principal amount, broken down by series as follows:

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

The final maturity date is on August 1, 2031.

Fair value – As of August 31, 2009, the swaps had a combined negative fair value for all series of $27,555,000. The fair values of the interest rate swaps were estimated using the zero coupon method. That method calculates the future net settlement payments required by the swap, assuming current forward rates are implied by the current yield curve for hypothetical zero coupon bonds due on the date of each future net settlement on the swaps.

Risks **-** As of August 31, 2009, 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 swaps' fair value. The swaps include an additional termination event based on credit ratings. The swaps may be terminated by the City if the rating of the counterparty falls below A3 or A- (Moody's/S&P), unless the counterparty has: (i) assigned or transferred the swap to a party acceptable to the City; (ii) provided a credit support provider acceptable to the City whose obligations are pursuant to a credit support document acceptable to the City; or (iii) executed a credit support annex, in form and substance acceptable to the City, providing for the collateralization by the counterparty of its obligations under the swaps.

The swaps may be terminated by the counterparty if the rating on the Company's bonds falls below Baa2 or BBB (Moody's/S&P). However, because the City's swap payments are insured by 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.

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

The impact of the interest rate swap on the financial statements for the year ended August 31, 2009 is as follows (thousands of dollars):

		Interest rate swap liability	Deferred outflow of resources
Balance August 31, 2008	$	13,790	13,790
Change in fair value through August 20, 2009 (refunding of Sixth Series Bonds)		16,771	16,771
Termination of a portion of swap		(4,250)	(4,250)
Termination of hedge upon refunding Sixth Series Bonds		—	(26,311)
Change in fair value from initiation of hedge related to Eighth Series Bonds to year end		1,244	1,244
Balance August 31, 2009	$	27,555	1,244

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

(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 11½ years remaining at August 31, 2009.

The GICs are recorded at fair value in the Sinking Fund and had fair values of $46,351,000 and $48,129,000 at August 31, 2009 and 2008, 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 General Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 General Ordinance. Therefore, the $11,554,000 received under the 1998 ordinance was deferred and is being amortized on a straight-line basis over the life of the agreement. The unamortized balance of the proceeds was $7,183,000 and $7,807,000 at August 31, 2009 and 2008, 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.

(f) Authorized and Unissued Financing

On June 3, 2009, the Mayor of the City of Philadelphia signed into law the Tenth Supplemental Ordinance to the 1998 General Ordinance; authorizing the City to sell, either at public or private sale, Gas Works Revenue Bonds, Ninth Series, in an amount not to exceed $150,000,000, plus accrued interest, to pay the costs of certain capital projects and other Project Costs; authorizing the City to obtain Credit Facilities for the Ninth Series Bonds; making certain determinations and covenants relating to Gas Works Revenues and the payment of interest and principal; and authorizing covenants and actions in order that the Ninth Series Bonds shall not be arbitrage bonds.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2009 was as follows (thousands of dollars):

	Latest date maturing to	Interest rate	Bonds outstanding
7th Series	3/15/13	6.00%	$ 10,675
12th Series B	5/15/20	7.00	45,230
3rd Series	8/1/31	5.50	99,445
4th Series	8/1/32	5.25	20,005

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 $187,854,000 at August 31, 2009, bearing interest on face value from 4.30% to 5.89%.

The Company issued $313,285,000 of Eighth Series Bonds during FY 2009. The Eighth Series A fixed rate bonds were issued in the amount of $58,285,000 and the Eighth Series B, Eighth Series C, Eighth Series D and the Eighth Series E variable rates bonds were issued in the amounts of $105,000,000, $50,000,000, $50,000,000 and $50,000,000, respectively. The proceeds of the sale were utilized to currently refund Sixth Series variable rate bonds in the amount of $311,615,000. The refunding of this existing debt resulted in an accounting loss of $29,033,000. This loss is being deferred and amortized as interest expense over the life of the new bond.

(10) Pension Costs

(a) Plan Description

The Pension Plan sponsored by the Company provides pension benefits for all of the Company's employees, whose annual covered payroll (which was substantially equal to total payroll) was $107,918,000 and $105,596,000 at August 31, 2009 and 2008, 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 60.0% of the highest annual earnings during the last 10 years of credited service, or

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

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

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

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

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

The normal cost, amortization of the unfunded balance, and annual required and actual contributions for FY 2009 and the two preceding fiscal years were as follows (thousands of dollars):

		Normal cost	Amortization of the underfunded balance	Annual required and actual contributions
Fiscal year ended August 31:				
2009	$	8,125	7,300	15,425
2008		8,085	6,173	14,258
2007		7,693	7,524	15,217

Withdrawals from pension assets of $18,528,000 and $18,564,000 in FY 2009 and FY 2008, 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 100.0% at age 62. The assumptions did not include postretirement benefit increases. These actuarial assumptions are consistent with the prior fiscal year.

(Continued)

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 $430,390,000 and an actuarial accrued liability of $495,155,000 resulting in a funded ratio of 86.92% based on a biennial actuarial valuation of the pension fund as of September 1, 2007, updated for contributions and accrued benefits in the subsequent year. The resulting unfunded actuarial accrued liability of $64,765,000 was 60.01% of covered payroll of $107,918,000.

(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).

(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 1,936 and 1,920 participating retirees and their beneficiaries and dependents for FY 2009 and FY 2008, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,702 and 1,699 active employees and their dependents for FY 2009 and FY 2008, respectively, by charging the annual insurance premiums to expense. The annual covered payroll (which was substantially equal to total payroll) was $107,918,000 and $105,596,000 at August 31, 2009 and 2008, 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 $37,064,000 and $34,226,000 in FY 2009 and FY 2008, respectively, of which approximately 50.7% and 48.1%, respectively, represents payments on behalf of retired employees and their dependents. Employees and retirees contributed $1,329,000 and $1,477,000 in FY 2009 and FY 2008, respectively, towards their healthcare. These contributions represent the additional cost of healthcare plans chosen by employees and retirees above the basic plan offered by the Company. Total premiums for group life insurance were $1,832,000 and $2,103,000 in FY 2009 and FY 2008, respectively. The amount attributed to retirees was approximately 76.0% and 71.0% in FY 2009 and FY 2008, 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.

(Continued)

The Plan does not issue a stand-alone report.

(b) Actuarial Valuation and Assumptions

The Company engaged an actuarial consulting firm to provide an actuarial valuation of the Company's OPEB obligations as of August 31, 2009. 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 2009.

	Healthcare cost trend rates		
	Medical	**Prescription**	**Dental**
Year:			
1	9.0%	9.0%	4.5%
2	8.0	8.0	4.5
3	7.0	7.0	4.5
4	6.0	6.0	4.5
5	5.0	5.0	4.5
6	4.5	4.5	4.5
7	4.5	4.5	4.5
8	4.5	4.5	4.5
9	4.5	4.5	4.5
10 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 amount paid by the Company for retiree benefits in FY 2009 was $20,057,000, consisting of $18,785,000 of healthcare expenses and $1,272,000 of life insurance expenses. The difference between the ARC and the expenses paid resulted in an increase in the OPEB liability of $25,952,000 and $25,834,000 recorded in other liabilities and deferred credits and expensed in FY 2009 and FY 2008, respectively. As of August 31, 2009, the actuarial accrued liability for benefits was $635,792,000, all of which was unfunded and the ratio of the unfunded actuarial accrued liability to the covered payroll was 589.1%. Historical trend information reflecting funding progress and contributions made by the Company is presented in the Schedule of Other Postemployment Benefits Funding Progress (unaudited).

The following table shows the components of the Company's annual OPEB cost for FY 2009, the amount actually contributed to the plan, and the Company's net OPEB obligation (thousands of dollars):

Annual required contribution	$	46,795
Interest on net OPEB obligation		2,613
Adjustment to the annual required contribution		(3,399)
Annual OPEB cost		46,009
Contributions made		(20,057)
Net OPEB obligation as of August 31, 2008		52,255
Net OPEB obligation as of August 31, 2009	$	78,207

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for FY 2009 and the two preceding fiscal years were as follows (thousands of dollars):

	Annual OPEB cost	Percentage of annual OPEB cost contributed	Net OPEB obligation
Fiscal year ended August 31:			
2009	$ 46,009	43.59%	$ 78,207
2008	44,114	41.44	52,255
2007	45,237	41.60	26,421

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

(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

The pollution remediation obligations at August 31, 2009 and 2008 are $22,990,000 and $21,600,000 respectively, which reflect the impact of 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 Blanket Crime, which is a form of Property Insurance.

The Company maintained $210,000,000 in liability (including terrorism) coverage, insuring against the risk of damage 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 as well as a $60,000,000 Fiduciary Liability policy with a $500,000 self insured 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:						
2009	$	13,534	1,938	(3,591)	11,881	5,236
2008		8,468	7,757	(2,691)	13,534	7,457
2007		8,059	3,367	(2,958)	8,468	5,357

(14) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately $5,312,000 as of August 31, 2009.

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:		
2010	$	359
2011		43
2012		6

Rent expense for the fiscal years ended August 31, 2009 and 2008 amounted to $1,520,000 and $910,000, respectively.

The Company, in the normal course of conducting business, has entered into long-term contracts for the supply of natural gas, firm transportation, and long-term firm gas storage service. The Company's cumulative obligations for demand charges for all of these services are approximately $6,285,000 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 2010 Capital Budget was approved by City Council in the amount of $72,215,000. 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 2010 is expected to be $17,445,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately $110,033,000.

The FY 2010 Capital Budget also includes $2,474,000 for the purchase of replacement Automatic Meter Reading (AMR) units. The total six-year cost of this program to replace AMR units is approximately $5,534,000.

(15) Subsequent Events

December Rate Case

On December 18, 2009, PGW submitted a base rate filing with the PUC (1) to maintain the $60,000,000 base rate increase that the PUC granted in 2008; and (2) to fund PGW's OPEB liability in the amount of $42,500,000. PGW also moved to consolidate the Company's Demand Side Management Plan (i.e. an Energy Efficiency and Conservation Plan) into the base rate filing. PGW anticipates a PUC decision in September 2010.

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

Required Supplementary Information (Unaudited)

Schedule of Pension Funding Progress

(Thousands of dollars)

Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability (AAL)	(b)-(a) Unfunded AAL (UAAL)	(a/b) Funded ratio	Covered payroll	UAAL as a percent of covered payroll
September 1, 2008*	$ 430,390	495,155	64,765	86.92%	$ 107,918	60.01%
September 1, 2007**	416,183	482,380	66,197	86.28	105,596	62.69
September 1, 2006+	411,886	474,250	62,364	86.85	106,018	58.82
September 1, 2005++	383,517	450,866	67,349	85.06	102,544	65.68
September 1, 2004+++	366,783	436,255	69,472	84.08	102,500	67.78
September 1, 2003++++	356,000	427,006	71,006	83.37	101,200	70.16

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

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

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

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

+++ 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, updated for contributions and additional accrued benefits in the subsequent fiscal year.

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

See accompanying independent auditors’ report.

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

Required Supplementary Information (Unaudited)

Schedule of Other Postemployment Benefits Funding Progress

(Thousands of dollars)

Actuarial valuation date	(a) Actuarial value of assets	(b) Actuarial accrued liability (AAL)	(b)-(a) Unfunded AAL (UAAL)	(a/b) Funded ratio	Covered payroll	UAAL as a percent of covered payroll
August 31, 2009	$ —	635,792	635,792	—%	$ 107,918	589.14%
August 31, 2008	—	591,599	591,599	—	105,596	560.25
August 31, 2007	—	573,734	573,734	—	106,018	541.17

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, 2009 and 2008

(Thousands of dollars)

		2009	2008
Assets:			
Cash on deposit and on hold	$	13,744	49,332
Equity in pooled cash and investments		—	—
Equity in treasurer's account		—	—
Investments		—	—
Internal balances		—	—
Amounts held by fiscal agent		6	6
Notes receivable		—	—
Taxes receivable		—	—
Accounts receivable – net		105,496	99,304
Interest and dividends receivable		—	—
Due from other governments		—	—
Restricted assets		175,534	219,788
Inventories		125,023	187,539
Unamortized loss and discount		57,451	52,852
Other assets		23,465	63,699
Property, plant, and equipment		1,785,250	1,732,562
Accumulated depreciation		(708,783)	(670,467)
Total assets	$	1,577,186	1,734,615
Liabilities:			
Notes payable	$	—	90,000
Vouchers and accounts payable		46,205	67,508
Salaries and wages payable		3,719	3,430
Accrued expenses		133,902	107,484
Funds held in escrow		—	—
Due to other governments		—	—
Deferred revenue		14,427	31,641
Current portion of long-term obligations		46,045	73,942
Noncurrent portion of long-term obligations		1,092,117	1,103,827
Unamortized gain and premium		28,221	30,375
Total liabilities	$	1,364,636	1,508,207
Net assets:			
Invested in (deficiency in) capital assets, net of related debt	$	1,019	(4,466)
Restricted for:			
Capital projects		—	—
Debt service		112,820	108,581
Community development projects		—	—
Behavioral health programs		—	—
Intergovernmental financing		—	—
Emergency phone system		—	—
Rate stabilization		—	—
Unrestricted		129,780	122,293
Total net assets	$	243,619	226,408

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, 2009 and 2008

(Thousands of dollars)

		August 31, 2009				
		Expenses	**Charges for services**	**Operating grants and contributions**	**Capital grants and contributions**	**Total**
Gas services	$	(797,135)	919,768	21,913*	—	144,546
Interest on debt		(63,602)	—	—	—	(63,602)
Unallocated depreciation		(37,781)	—	—	—	(37,781)
Other postemployment benefits		(25,952)	—	—	—	(25,952)
Total	$	(924,470)	919,768	21,913*	—	17,211

* Includes $12,240 of interest and other income and $9,673 of other operating revenues.

		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.

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, 2009 and 2008

(Thousands of dollars)

	2009	2008
Operating revenues:		
Charges for goods and services	$ 910,457	831,428
Sales of land and improvements	—	—
Rentals and concessions	—	—
Miscellaneous operating revenues	18,984	18,199
Total operating revenues	929,441	849,627
Operating expenses:		
Personal services	77,486	73,351
Purchase of services	86,106	75,640
Material and supplies	7,064	6,216
Employee benefits	43,500	41,488
Indemnities and taxes	—	—
Depreciation and amortization	42,200	42,868
Cost of goods sold	545,846	511,976
Other	—	—
Total operating expenses	802,202	751,539
Operating income	127,239	98,088
Nonoperating revenues (expenses):		
Operating grants	—	—
Passenger facility charges	—	—
Other income	5,530	1,834
Interest income	6,710	13,897
Debt service – interest	(63,602)	(56,075)
Other expenses	(58,666)	(54,637)
Total nonoperating expenses	(110,028)	(94,981)
Income before transfers	17,211	3,107
Transfer in	18,000	18,000
Transfer out	(18,000)	(18,000)
Capital contributions	—	—
Change in net assets	17,211	3,107
Net assets – beginning of year	226,408	223,301
Net assets – end of year	$ 243,619	226,408

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, 2009

(Thousands of dollars)

Due to the City, September 1, 2008	$	3,000
Accrued distributions		18,000
Payments to the City		(18,000)
Due to the City, August 31, 2009	$	3,000

See accompanying independent auditors' report.

KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Audit Committee of the Philadelphia Facilities
Management Corporation:

We have audited the financial statements of Philadelphia Gas Works (the Company) as of and for the year ended August 31, 2009, and have issued our report thereon dated December 18, 2009, which included an explanatory paragraph regarding the Company's adoption of Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of The City of Philadelphia, management, the audit committee, others within the Company, and regulatory bodies with responsibility for oversight of the Company, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 18, 2009