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

Basic Financial Statements and Supplementary Information

August 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

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

Table of Contents

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, 2010 and 2009, 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.

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, 2010 and 2009, 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 28, 2010 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.

The required supplementary information of management's discussion and analysis on pages 3 to 13 and the schedules of pension funding progress and other postemployment benefits funding progress on pages 58 and 59 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 60 to 63 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 28, 2010

The narrative overview and analysis of the financial statements of Philadelphia Gas Works (the Company or PGW) for the years ended August 31, 2010 and 2009 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) 2010 reflected a 15.5% warmer than normal winter. The FY 2010 period was 10.8% warmer than the prior year and firm gas sales decreased by 3.2 billion cubic feet (Bcf). In addition, the Weather Normalization Adjustment (WNA), which was in effect from October 2009 through May 2010, resulted in heating customers receiving charges totaling $13.4 million as a result of the temperatures experienced during the period. The 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 Bcf. In addition, the 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.
- PGW achieved a collection rate of 98.7% in the current period, 93.8% in FY 2009 and 95.5% in FY 2008. The collection rate is calculated by dividing the total gas receipts collected in FY 2010 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 2009 and FY 2008, respectively.
- On July 29, 2010, the Pennsylvania Public Utility Commission (PUC) approved the settlement of the base rate filing filed by the Company in December 2009, under which PGW will be permitted to maintain virtually all of the $60.0 million extraordinary rate increase granted by the PUC in 2008 that was effective as of January 1, 2009, as well as receiving an incremental rate increase of $16.0 million annually to fund Other Postemployment Benefits (OPEB). PGW is required under the settlement to fund annually, $15.0 million of its Unfunded Actuarial Accrued Liability (UAAL) in each of the fiscal years 2011 through 2015. Additionally, PGW must fund $3.5 million a year which represents a 30 year amortization of the Net OPEB obligation of $105.5 million as of August 31, 2010. The settlement also permitted the implementation of the Demand Side Management Program, which is an energy efficiency and conservation plan.
- In addition to the rate increases noted above, various business initiatives were implemented to improve collections, productivity, and operational efficiencies throughout the Company, and achieved positive results. PGW, at the end of FY 2010 and FY 2009, had no tax exempt commercial paper outstanding and a cash balance of $79.1 million and $13.8 million, respectively. This reflects an overall improvement of $65.3 million in PGW's liquidity.
- On August 26, 2010, the City of Philadelphia (the City) issued Gas Works Revenue Bonds, Ninth Series in the amount of $150.0 million for the purpose of financing capital projects, and paying the costs of issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Ninth Series Bonds consist of $53.0 million of serial bonds with interest rates that range from 2.0% to 5.0% and have maturity dates through 2025. The Bonds also included $97.0 million of term bonds with interest rates of 5.0% and 5.25% and have maturities through 2040.

- On August 20, 2009, the City of Philadelphia issued Gas Works Revenue Refunding Bonds, Eighth Series in the amount of $313.3 million 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 A 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 B, in the amount of $105.0 million and the Eighth Series C, Eighth Series D, and Eighth Series E Bonds in the amount of $50.0 million, respectively, were issued as variable rate term bonds. The variable rate term bonds totaled $255.0 million and have variable rates set through a weekly reset mode. Interest is paid monthly and the bonds are secured with letters of credit that expire 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 that was a hedging derivative instrument associated with the Sixth Series Bonds, was deferred and will be amortized over the life of the Eighth Series Bonds.
- The Company adopted the provisions of Governmental Accounting Standards Board (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 for financial reporting requirements and the Company's FY 2009 financial statements are included in the City's financial statements for the year ended June 30, 2010.

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

  The Company's only derivative instruments within the scope of GASB 53 are four interest rate swaps entered into to hedge the interest payments on its variable rate debt. These swaps originate from an interest rate swap used as a hedge of the Sixth Series Bonds. Because the hedges were effective at August 31 2010, the change in fair value of the swaps of $24.7 million for FY 2010 has been recorded as an increase in the interest rate swap liability and the related deferred outflow of resources. The balance of the interest rate swap liability at August 31, 2010 is $52.2 million, and the related deferred outflow of resources balance is $25.9 million. The difference between the balances is due to the impact of refunding the Sixth Series bonds, which the original swap previously hedged, during FY 2009, and establishing a hedging relationship between the portion of the original swap remaining after the refunding (divided into four swaps) and the refunding Eighth Series bonds. Because the hedges were determined effective for both periods presented, there was no impact on the Statements of Revenues and Expenses for either year other than swap settlement payments.

Overview of the Financial Statements

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

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

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

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

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

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

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

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

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Condensed Statements of Revenues and Expenses

(Thousands of dollars)

	Years ended August 31		
	2010	2009	2008
Total gas revenues	$ 742,342	910,457	831,428
Other revenues	16,890	18,984	18,199
Total operating revenues	759,232	929,441	849,627
Total operating expenses	662,594	845,558	794,246
Operating income	96,638	83,883	55,381
Interest and other income	5,301	12,240	15,732
Total interest expense	(71,123)	(78,912)	(68,006)
Excess of revenues over expenses	$ 30,816	17,211	3,107

Operating Revenues

Operating revenues in FY 2010 were $759.2 million, a decrease of $170.2 million or 18.3% from the FY 2009 level. The decrease in FY 2010 was due to significantly lower natural gas costs. 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. Please see the discussion of the cost of fuel in the Operating Expenses section below.

Total sales volumes, including gas transportation deliveries, in FY 2010 decreased by 2.5 Bcf to 69.3 Bcf or 3.5% from FY 2009 sales volumes of 71.8 Bcf. In FY 2009 total sales volumes, including gas transportation deliveries, increased by 5.5 Bcf to 71.8 Bcf or 8.3% from FY 2008 sales volumes of 66.3 Bcf. Firm gas sales of 44.8 Bcf were 3.2 Bcf or 6.7% lower than FY 2009 firm gas sales of 48.0 Bcf which were 2.5 Bcf or 5.5% higher than FY 2008. Interruptible customer sales decreased by 0.1 Bcf compared to FY 2009 which decreased by 0.6 Bcf compared to FY 2008. Gas transportation sales in FY 2010 increased by 0.5 Bcf to 23.1 Bcf from the 22.6 Bcf level experienced in FY 2009. In FY 2009, the volume increased by 3.6 Bcf to 22.6 Bcf from the 19.0 Bcf level experienced in FY 2008.

In FY 2010, customers served by PGW decreased by 0.4% from the previous year to approximately 502,000 customers. The number of customers served by PGW at the end of FY 2009 and FY 2008 were approximately 504,000 and 505,000, respectively. Commercial accounts were approximately 25,000, reflecting no change from the previous two fiscal years. Industrial accounts reflected no change from the prior two fiscal year's level of 800. Residential customers decreased to 476,000 customers, a decrease of 2,000 from the prior year. The number of residential customers in FY 2009 decreased to approximately 478,000 customers, a decrease of 1,000 from the FY 2008 level.

Operating Expenses

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

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

The cost of natural gas utilized increased by $33.9 million or 6.6% to $545.9 million in FY 2009 compared with $512.0 million in FY 2008. The average commodity price per 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.

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 2010, FY 2009, and FY 2008 were $5.45, $8.55, and $8.48 per Mcf, respectively.

Other Operating Expenses – Expenditures for street operations, infrastructure improvements, and plant operations in FY 2010 were $72.4 million, a decrease from the FY 2009 total of $75.6 million as a result of lower costs associated with the soft-off program under which the Company manages its costs associated with customer-requested shut-offs by determining whether it is cost-beneficial to the Company to final bill the account as a result of the customer's request without physically shutting off the gas. This decision is based on seasonality, the likelihood of being granted access to the premises, and other factors. The FY 2009 total of $75.6 million was $6.7 million higher than the FY 2008 total of $68.9 million.

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

Pension costs increased by $9.2 million to $24.6 million in FY 2010 as compared to FY 2009. Pension costs increased by $1.2 million to $15.4 million in FY 2009 as compared to FY 2008. Costs increased primarily due to an increase in underfunding of the plan due to the economic downturn, resulting in additional amortization of the underfunded balance into the Annual Required Contribution (ARC).

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OPEB costs increased by $1.3 million to $27.3 million in FY 2010 as compared to FY 2009, and by $.2 million in FY 2009 as compared to FY 2008. The net OPEB obligation was $105.5 million for the fiscal year ended August 31, 2010. The net OPEB obligation was $78.2 million for the fiscal year ended August 31, 2009.

Provision for Uncollectible Accounts – The provision for uncollectible accounts in FY 2010 totaled $35.0 million, a decrease of $7.0 million or 16.7% lower than FY 2009. The 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 accumulated provision for uncollectible accounts at August 31, 2010 reflects a balance of $103.6 million, compared to the $123.0 million balance in FY 2009 and $140.4 million in FY 2008. PGW is committed to continuing its collection efforts in an attempt to reduce outstanding delinquent account balances and to provide assistance to those customers who qualify for low-income grants and payment programs to help those customers maintain their gas service.

Depreciation Expense – Depreciation expense increased by $0.7 million in FY 2010 compared with FY 2009. Depreciation expense decreased by $1.7 million in FY 2009 compared with FY 2008. The effective composite depreciation rates for FY 2010, FY 2009, and FY 2008 were 2.3%, 2.3%, and 2.4%, respectively. Cost of removal is charged to expense as incurred.

Interest and Other Income – Interest and other income in FY 2010 was $6.9 million lower than FY 2009. Interest and other income in FY 2009 was $3.5 million lower than FY 2008. The year to year decrease is the result of a continual decline in interest rates coupled with lower restricted fund balances for most of the fiscal year.

Interest Expense – Total interest expense decreased by $7.8 million or 9.9% in FY 2010 compared with FY 2009 and increased by $10.9 million or 16.0% in FY 2009 compared with FY 2008. Interest on long-term debt was $11.1 million lower in FY 2010 due to both the reduction in long-term debt for the majority of the fiscal year and declining interest costs associated with PGW's variable rate demand notes. Interest on long-term debt increased $7.5 million in FY 2009 as a result of the full year effect of the issuance of the Seventh Series Bonds in May 2007. Other interest costs increased by $3.4 million or 22.0% due to a $7.0 million increase in the cost associated with the letters of credit that support PGW's variable rate demand notes and commercial paper program in FY 2010. This increase was partially offset by a $3.6 million decrease in interest expense associated with both PGW's variable rate demand notes and commercial paper program. 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.

Excess of Revenues Over Expenses – In FY 2010, the Company's excess of revenues over expenses was $30.8 million, an increase of $13.6 million from FY 2009. The Company's had an excess of revenues over expenses of $17.2 million in FY 2009, an increase of $14.1 million from FY 2008.

Condensed Balance Sheets

(Thousands of dollars)

		Years ended August 31		
Assets		**2010**	**2009**	**2008**
Utility plant, net	$	1,094,009	1,076,467	1,062,095
Restricted investment funds		284,813	175,534	219,788
Current assets:				
Accounts receivable (net of accumulated provision for uncollectible accounts of $103,600, $123,009, and $140,435 for 2010, 2009, and 2008, respectively)		92,173	105,496	99,304
Other current assets and deferred debits, cash and cash equivalents, gas inventories, materials, and supplies		209,397	143,668	242,503
Total current assets		301,570	249,164	341,807
Other assets, deferred debits, and deferred outflows of resources		146,770	130,926	119,765
Total assets	$	1,827,162	1,632,091	1,743,455
Fund Equity and Liabilities				
Fund equity	$	274,435	243,619	226,408
Total long-term debt		1,224,987	1,114,488	1,127,163
Current liabilities:				
Note payable		—	—	90,000
Current portion of long-term debt		42,537	48,175	76,030
Other current liabilities and deferred credits		95,229	85,580	126,235
Total current liabilities		137,766	133,755	292,265
Other liabilities and deferred credits		189,974	140,229	97,619
Total fund equity and liabilities	$	1,827,162	1,632,091	1,743,455

(Continued)

Assets

Utility Plant – Utility plant, net of depreciation, totaled $1,094.0 million in FY 2010, an increase of $17.5 million or 1.6% compared with the FY 2009 balance of $1,076.5 million. The FY 2009 balance increased by $14.4 million or 1.4% compared with the FY 2008 balance of $1,062.1 million. Capital expenditures for construction of distribution facilities, purchase of equipment, information technology enhancements, and other general improvements were $59.1 million in FY 2010 compared to $52.2 million in FY 2009 and $61.2 million in FY 2008. PGW funded capital expenditures through drawdowns from the Capital Improvement Fund in the amounts of $41.0 million, $48.5 million, and $60.9 million in FY 2010, FY 2009, and FY 2008, 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 increased by $109.3 million in FY 2010 primarily due to proceeds deposited into the Capital Improvement Fund from a new money bond sale in August 2010. Interest income on these funds, to the extent not drawn, is reflected as an increase and approximated $1.7 million in FY 2010, $4.8 million in FY 2009, and $11.7 million in FY 2008. A drawdown from the accrued interest in the Capital Improvement Fund in the amount of $5.0 million was utilized for working capital purposes in FY 2009. There was no drawdown of interest from the Capital Improvement Fund in FY 2010 and FY 2008.

Accounts Receivable – In FY 2010, accounts receivable (net) of $92.2 million decreased by $13.3 million, or 12.6% from FY 2009 due to lower gas billings during FY 2010 and an increase in the collection rate experienced during FY 2010 as compared to FY 2009. 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). The accumulated provision for uncollectible accounts, totaling $103.6 million decreased by $19.4 million in FY 2010 and totaled $123.0 million in FY 2009 and $140.4 million in FY 2008.

Other Current Assets and Deferred Debits, Cash and Cash Equivalents, Gas Inventories, Materials, and Supplies – In FY 2010, cash and cash equivalents were $79.1 million, an increase of $65.3 million from $13.8 million in FY 2009, and totaled $49.4 million in FY 2008. In FY 2010, gas storage decreased by $21.8 million or 18.5% compared to FY 2009. The decrease in gas inventory reflects a decrease in the gas cost per Mcf plus a decrease in the amount of storage at year end. 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 prices and volumes stored. Materials and supplies of $103.1 million, which principally include gas inventory, maintenance spare parts, and material, decreased by $21.9 million and were $125.0 million in FY 2009 and $187.5 million in FY 2008. Other current assets and deferred debits totaled $27.2 million in FY 2010, an increase of $22.3 million from FY 2009 primarily as a result of an increase in the deferred GCR of $11.8 million and an increase in the pension fund receivable of $11.1 million. Other current assets and deferred debits totaled $4.9 million in FY 2009, down $0.7 million from FY 2008.

Other Assets, Deferred Debits, and Deferred Outflows of Resources – In FY 2010, other assets, deferred debits, and deferred outflows of resources including unamortized bond issuance costs, unamortized loss on reacquired debt, and a deferred regulatory asset for environmental expenses totaled $146.8 million, an increase of $15.8 million from FY 2009, mainly due to the increase in the interest rate swap liability. In FY 2009, the total was $130.9 million and reflected an increase of $11.1 million from FY 2008.

Liabilities

Long-Term Debt – Long-term debt, including the current portion and unamortized discount and premium, totaled $1,267.5 million in FY 2010, $104.9 million more than the previous year primarily as a result of the issuance of the Ninth Series bonds. This represents 82.2% of total capitalization in FY 2010. 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 represented 82.7% of total capitalization in FY 2009 and 84.2% of total capitalization in FY 2008.

Debt Service Coverage Ratio and Ratings – PGW has a mandatory debt service coverage ratio of 1.50 times debt service on both the 1975 and 1998 Ordinance Bonds. In FY 2010, the debt service coverage was at 6.28 times debt service on the outstanding 1975 Ordinance Bonds and 2.44 times debt service on the Senior 1998 Ordinance Bonds compared to debt service coverage ratios of 5.65 and 2.13 times, respectively, in FY 2009 and 4.28 and 1.88 times, respectively, in FY 2008. 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 (Fitch).

Short-Term Debt – Due to the highly seasonal nature of PGW's business, short-term debt is utilized to meet working capital requirements. PGW, pursuant to the provisions of the City of Philadelphia Note Ordinance, may sell short-term notes in a principal amount, which together with interest, may not exceed $150.0 million outstanding at any one time. These notes are supported by irrevocable letters of credit and a security interest in PGW's revenues. The letters of credit supporting PGW's commercial paper program fixed the maximum level of outstanding notes plus interest at $120.0 million in FY 2010 and $150.0 million FY 2009. In June 2010, PGW renewed the letters of credit supporting the commercial paper program at $120.0 million.

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

Liquidity/Cash Flow – At December 15, 2010, $90.0 million was available from the commercial paper program. Additionally, PGW had $170.0 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, 2010 was $40.7 million.

Accounts Payable – In FY 2010, accounts payable totaled $59.3 million, an increase of $13.1 million or 28.3% compared with FY 2009 primarily due to an increase in credit balances in accounts receivable which have been reclassified to accounts payable. Credit balances of $22.8 million and $14.1 million for FY 2010 and FY 2009, respectively, have been reclassified to accounts payable. Natural Gas payables were $3.1 million higher at the end of FY 2010 than FY 2009. 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.

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

Other Financial Factors

The City has granted back its annual $18.0 million payment, in each of the last three fiscal years, thereby improving PGW's overall liquidity position. The City has indicated that it will not grant back the $18.0 million payment in FY 2011. The Company intends to fund the majority of the FY 2011 payment to the City through sale of assets. Future year grantbacks are currently under consideration by the City and PGW.

Recent Rate Filings

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

Establishment of OPEB Trust Fund

As part of the July 29, 2010 rate case settlement, which provided for the establishment of an irrevocable trust for the deposit of funds derived through a Rider from all customer classes to fund OPEB liabilities, PGW established the trust in July 2010 and began funding the trust in accordance with the settlement agreement in September 2010. The settlement provides that PGW shall deposit $15.0 million annually towards the ARC and an additional $3.5 million annually, which represents a 30 year amortization of the OPEB liability of $105.5 million at August 31, 2010. These deposits will be funded primarily through increased rates of $16.0 million granted in the settlement.

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

Because the OPEB trust fund was not established until subsequent to year-end, the actuarial accrued liability as of August 31, 2010 of $654.1 million assumes that the Company will continue to fund its OPEB obligations on a pay-as-you-go basis. If the Company had adopted a policy of funding its ARC prior to year-end, the actuarial accrued liability would have been reduced to $465.7 million.

Contacting the Company's Financial Management

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

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

Balance Sheets

August 31, 2010 and 2009

(Thousands of dollars)

Assets	**2010**	**2009**
Utility plant, at original cost:		
In service	$ 1,794,277	1,754,297
Under construction	46,339	30,953
Total	1,840,616	1,785,250
Less accumulated depreciation	746,607	708,783
Utility plant, net	1,094,009	1,076,467
Restricted investment funds:		
Sinking fund, revenue bonds	111,409	110,227
Capital improvement fund	170,809	62,714
Workers' compensation escrow fund	2,595	2,593
Total restricted investment funds	284,813	175,534
Current assets:		
Cash and cash equivalents	79,052	13,750
Accounts receivable (net of provision for uncollectible accounts of $103,600 and $123,009 for 2010 and 2009, respectively)	92,173	105,496
Gas inventories, materials, and supplies	103,133	125,023
Other current assets and deferred debits	27,212	4,895
Total current assets	301,570	249,164
Unamortized bond issuance costs	27,066	27,516
Unamortized losses on reacquired debt	70,873	79,945
Other assets, deferred debits, and deferred outflows of resources	48,831	23,465
Total assets	$ 1,827,162	1,632,091

See accompanying notes to financial statements.

(Continued)

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

Balance Sheets

August 31, 2010 and 2009

(Thousands of dollars)

Fund Equity and Liabilities		**2010**	**2009**
Fund equity:			
Excess (deficiency) of capital assets, net of related debt	$	(2,706)	1,019
Restricted		114,004	112,820
Unrestricted		163,137	129,780
Total fund equity		274,435	243,619
Long-term debt:			
Revenue bonds		1,224,987	1,114,488
Current liabilities:			
Current portion of revenue bonds		42,537	48,175
Accounts payable		59,303	46,205
Customer deposits		3,998	4,224
Other current liabilities and deferred credits		12,185	16,203
Accrued accounts:			
Interest, taxes, and wages		16,743	15,948
Distribution to the City		3,000	3,000
Total current liabilities		137,766	133,755
Other liabilities and deferred credits		189,974	140,229
Total fund equity and liabilities	$	1,827,162	1,632,091

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, 2010 and 2009

(Thousands of dollars)

		2010	2009
Operating revenues:			
Gas revenues:			
Nonheating	$	51,343	67,295
Gas transport service		26,860	24,913
Heating		664,139	818,249
Total gas revenues		742,342	910,457
Appliance and other revenues		8,959	9,311
Other operating revenues		7,931	9,673
Total operating revenues		759,232	929,441
Operating expenses:			
Natural gas		354,004	545,846
Gas processing		14,952	16,779
Field services		34,026	37,727
Distribution		23,426	21,059
Collection and account management		15,266	16,248
Provision for uncollectible accounts		35,000	42,000
Customer services		13,030	12,897
Marketing		3,900	3,436
Administrative and general		71,620	63,820
Pensions		24,633	15,425
Other postemployment benefits		27,269	25,952
Taxes		6,990	6,588
Total operating expenses before depreciation		624,116	807,777
Depreciation		43,168	42,200
Less depreciation expense included in operating expenses above		4,690	4,419
Total depreciation		38,478	37,781
Total operating expenses		662,594	845,558
Operating income		96,638	83,883
Interest and other income		5,301	12,240
Income before interest expense		101,939	96,123
Interest expense:			
Long-term debt		52,527	63,602
Other		18,986	15,558
Allowance for funds used during construction		(390)	(248)
Total interest expense		71,123	78,912
Excess of revenues over expenses	$	30,816	17,211

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, 2010 and 2009

(Thousands of dollars)

		2010	2009
Cash flows from operating activities:			
Receipts from customers	$	741,000	878,000
Payments to suppliers		(457,406)	(608,180)
Payments to employees		(106,003)	(107,918)
Claims paid		(3,252)	(3,591)
Other receipts		10,944	8,900
Net cash provided by operating activities		185,283	167,211
Cash flows from noncapital financing activities:			
Interest and fees		(5,787)	(847)
Net repayments of notes payable		—	(90,000)
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		(5,787)	(90,847)
Cash flows from capital and related financing activities:			
Proceeds from long-term debt issued		150,000	313,285
Redemption of long-term debt		—	(311,615)
Premium from long-term debt issues		1,420	—
Long-term debt issuance costs		(2,167)	(2,312)
Swap termination payment		—	(3,791)
Purchases of capital assets		(59,063)	(52,154)
Principal paid on long-term debt		(46,045)	(42,780)
Interest paid on long-term debt		(51,136)	(62,092)
Capital improvement fund deposits		(149,058)	—
Drawdowns on capital improvement fund		40,963	48,493
Interest income on capital improvement fund		322	1,499
Interest income on sinking fund		1,362	3,296
Sinking fund withdrawals (deposits)		(1,182)	(4,029)
Other investment income		390	248
Net cash used in capital and related financing activities		(114,194)	(111,952)
Net (decrease) increase in cash and cash equivalents		65,302	(35,588)
Cash and cash equivalents at the beginning of the year		13,750	49,338
Cash and cash equivalents at the end of the year	$	79,052	13,750
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	96,638	83,883
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation expense		41,521	37,781
Provision for uncollectible accounts		35,000	42,000
Change in assets and liabilities:			
Accounts receivable		(21,677)	(48,192)
Gas inventories, materials and supplies		21,890	62,516
Other current assets and deferred debits		(22,317)	731
Other assets, deferred debits, and deferred outflows of resources		(25,366)	9,660
Accounts payable		13,098	(21,303)
Customer deposits		(226)	(3,101)
Other current liabilities and deferred credits		(3,818)	(15,901)
Accrued accounts		795	127
Other liabilities and deferred credits		49,745	19,010
Net cash provided by operating activities	$	185,283	167,211

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, 2010 and 2009

(Thousands of dollars)

		2010	2009
Fund equity balance, beginning of the year	$	243,619	226,408
Excess of revenues over expenses		30,816	17,211
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	$	274,435	243,619

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 Accounting Standards Codification (ASC) 980, *Regulated Operations*, is applicable to the Company. Under FASB ASC 980, 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 June 23, 2010, PGW filed a proposed fiscal year (FY) 2011 Operating Budget. The PGC conducted informal discovery concerning the budget in July and August, with a formal hearing held on August 12, 2010. At the PGC meeting on September 21, 2010, PGW was granted interim spending authority for operating and maintenance expenses for the first three months of FY 2011. On September 29, 2010, the PGC staff filed a recommended decision on PGW's proposed FY 2011 Operating Budget. Exceptions to the decision were filed on October 8, 2010. The PGC approved the FY 2011 Operating Budget on November 16, 2010.

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

(c) Capital Budget

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

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

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

(d) Base Rates

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

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

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

(e) Weather Normalization Adjustment Clause

The Weather Normalization Adjustment Clause (WNA) was approved by PUC Order dated August 8, 2002. The purpose of the WNA is to neutralize the impact of weather on the Company's revenues. This allows the Company to achieve the recovery of appropriate costs as authorized by the PUC. The WNA results in neither a rate increase nor a rate decrease, but acts as a billing adjustment. The main benefits of the WNA are the stabilization of cash flow and the reduction of the need for short-term borrowing from year to year. The WNA is applied to customer invoices rendered during the period of October 1 through May 31 of each year for each billing cycle. The WNA will continue in place unless the PUC issues an order directing that it be discontinued. The Company cannot predict when the PUC will complete its review of the WNA, and the review was not completed as of August 31, 2010. The adjustments for the years ended August 31, 2010 and 2009 were an increase in billings of $13,425,000 and $505,000, 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, 2010 deferred approximately $11,778,000 for GCR under-recovery. At August 31, 2009, the Company was $5,873,000 over-recovered for GCR costs.

GCR effective dates and rates

Effective date	GCR rate per Mcf*	Change
June 1, 2010	6.5139	(0.8316)
March 1, 2010	7.3455	0.0958
December 1, 2009	7.2497	0.1597
September 1, 2009	7.0900	(0.0915)
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)

* 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 $1,647,000 and $1,710,000, was charged to expense as incurred in FY 2010 and FY 2009, 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 both FY 2010 and FY 2009 was 2.3%. The composite rates are supported by a depreciation study of utility plant as of August 31, 2009. The effective composite depreciation rates, as a percentage of cost, for FY 2010 were as follows:

Production plant	0.00% – 4.39%
Transmission, distribution, and storage	0.00% – 4.07%
General plant	0.00% – 9.74%

The next depreciation study is scheduled to be completed in FY 2014.

Allowance for funds used during construction (AFUDC) is an estimate of the cost of funds used for construction purposes. The AFUDC, as calculated on borrowed funds, reduces interest expense. The AFUDC rate applied to construction work in progress was 5.69% and 4.72% in FY 2010 and FY 2009, respectively.

The following is a summary of utility plant activity for the fiscal years ended August 31, 2010 and 2009, respectively (thousands of dollars):

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

* Cost of removal in the amount of $1,647 was charged to expense as incurred in FY 2010 and is not included in accumulated depreciation.

		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.

(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 502,000 customers at August 31, 2010 and 504,000 at August 31, 2009, 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 both August 31, 2010 and 2009 was approximately 82,000.

The Senior Citizen Discount also provides customers with a discounted payment plan. The total number of customers receiving the discount as of August 31, 2010 and 2009 was approximately 33,000 and 36,000, 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 2010 and FY 2009, 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 $22,760,000 and $14,143,000 for FY 2010 and FY 2009, 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, 2010 and 2009, as follows (thousands of dollars):

		2010	2009
Gas inventory	$	96,097	117,889
Material and supplies		7,036	7,134
Total	$	103,133	125,023

(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 1,963 and 1,936 participating retirees and their beneficiaries and dependents for FY 2010 and FY 2009, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,669 and 1,702 active employees and their dependents for FY 2010 and FY 2009, respectively, by charging the annual insurance premiums to expense.

The difference between the annual OPEB expense and the amounts 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 highly liquid investments with original maturities of three months or less are considered cash equivalents, except those held for long-term purposes in the Sinking Fund, Capital Improvement Fund, and Workers’ Compensation Escrow Fund as described in Note 3.

(p) Reserve for Injuries and Damages

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

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

(q) Segment Information

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

(r) Estimates

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

(s) Pollution Remediation

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

The Company estimates its pollution remediation obligations 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.

The Company recorded an additional liability for pollution remediation obligations of $1,624,000 and $1,390,000 for FY 2010 and FY 2009, respectively. The pollution remediation liability is reflected in other liabilities and deferred credits and in other current liabilities and deferred credits. In accordance with U.S. GAAP for regulated entities, the Company has also recognized the long-term portion of its environmental remediation liability as a regulatory asset because based on available evidence it is probable that the previously incurred costs will be recovered through rates.

(t) New Accounting Pronouncements

The Company adopted the provisions of GASB Statement No. 53, Accounting and Reporting for Derivative Instruments (GASB 53), for the year ended August 31, 2009. This was a year earlier than the required implementation, because the Company's FY 2009 financial statements are included in the City's financial statements of the year ended June 30, 2010.

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

(Continued)

The Company's only derivative instruments within the scope of GASB 53 are four interest rate swaps entered into to hedge the interest payments on its variable rate debt. These swaps originate from an interest rate swap used as a hedge of the Sixth Series Bonds. Because the hedges were effective at August 31 2010, the change in fair value of the swaps of $24,662,000 for FY 2010 has been recorded as an increase in the interest rate swap liability and the offsetting deferred outflow of resources. The balance of the interest rate swap liability at August 31, 2010 is $52,217,000, and the deferred outflow of resources balance is $25,906,000. The difference between the balances is due to the impact of refunding the Sixth Series bonds, which the original swap previously hedged, during FY 2009, and establishing a hedging relationship between a portion of the existing swap (divided into four swaps) and the refunding Eighth Series bonds. Because the hedges were determined effective for both periods presented, there was no impact on the Statements of Revenues and Expenses for either year, other than swap settlement payments.

The required disclosures under GASB 53 are presented in 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 Public Financial Management Corporation (PFMC). The agreement, as amended, provides for reimbursement to PFMC of actual costs incurred in managing the Company, not to exceed a total of the prior fiscal year's maximum amount adjusted to reflect the percentage change in the Consumer Price Index for All Urban Consumers (CPI-U) All Items Index, Philadelphia, Pennsylvania, United States Department of Labor, Bureau of Labor Statistics, as most recently published and available to the Director of Finance of the City on March 1 of each such fiscal year. In FY 2010, the applicable maximum amount was calculated to be $1,066,000. In FY 2009, the applicable maximum amount was calculated to be $1,009,000. The agreement requires the Company to make annual payments of $18,000,000 to the City. In FY 2010 and FY 2009, 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 $14,240,000 and $13,739,000 in FY 2010 and FY 2009, respectively, relating to sales to the City. Water and sewer services and licenses are purchased from the City. Such purchases totaled $402,000 and $395,000 in FY 2010 and FY 2009, respectively. Net amounts receivable from the City were $145,000 and $139,000 at August 31, 2010 and 2009, respectively.

Certain activities of the PGC are paid for by the Company. Such payments totaled $750,000 and $711,000 in FY 2010 and FY 2009, respectively.

(3) Cash, Cash Equivalents, and Investments

(a) Cash and Cash Equivalents

Cash and cash equivalents consist primarily of bank deposits, money market accounts, and investments purchased through various brokerage relationships. Bank balances of such deposits, accounts, and investments at August 31, 2010 and 2009 were $83,281,000 and $16,732,000, respectively. Book balances of such deposits and accounts at August 31, 2010 and 2009 were $79,052,000 and $13,750,000, respectively. Federal depository insurance on these balances at August 31, 2010 and 2009 was $528,000 and $534,000, respectively. The remaining balances are not insured. Excess cash balances are invested in money market accounts, U.S. Treasury bills, U.S. government agencies and instrumentalities, and Corporate obligations (short term investments).

The highest balance of short term investments during the fiscal years ended August 31, 2010 and 2009 were $148,000,000 and $143,800,000, respectively. Short term investments with a carrying amount (at fair value) of $75,900,000 and $13,700,000 at August 31, 2010 and 2009, respectively, are included in the balances presented above.

(b) Restricted Investment Funds

The investments in the Company's Sinking Fund, Capital Improvement Fund, and Workers' Compensation Escrow Fund consist primarily of a Guaranteed Investment Contract (GIC), U.S. Treasury and government agency obligations, corporate obligations, and money market accounts. These investments are maintained by the City or in the Company's name by its agent. The balance of the Capital Improvement Fund at August 31, 2010 and 2009 was $170,809,000 and $62,714,000, respectively. The unexpended Capital Improvement Fund proceeds are restricted to the purchase of utility plant. In FY 2010 and FY 2009, the Company utilized the Capital Improvement Fund to provide liquidity for the additions to utility plant.

Investments are recorded at fair value except for certain money market funds recorded at amortized cost and guaranteed investment contracts recorded at contract value. The adjustment to market value for the Capital Improvement Fund resulted in a loss of $275,000 at August 31, 2010 and a gain of $5,000 at August 31, 2009. The adjustment to market value for the Sinking Fund resulted in a loss of $292,000 at August 31, 2010 and a gain of $734,000 at August 31, 2009.

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, 2010 and 2009, the trust account balances were $2,595,000 and $2,593,000, respectively.

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

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

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

	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			
Total fair value of investments	6,674			
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		

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

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

(Continued)

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

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

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

* The credit rating of this investment is unrated.

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

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

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

(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 or S&P; (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 and S&P, respectively; (7) general obligation bonds of corporations rated AA or better by Moody's or S&P, 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 or S&P 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 of the General Assembly of the Commonwealth of Pennsylvania, approved October 18, 1972. 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

More than 5.0% of the Company's investments are in U.S. Treasury notes, U.S. Treasury bills, a GIC with FSA Capital Management Services, LLC and Fidelity Governmental Fund. These investments represent 5.01%, 10.35%, 12.45%, and 42.04%, respectively, of the Company's total investments, which is in accordance with the City's investment policy. In addition, the GIC with Assured 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 2010, there were costs of $703,000 incurred for rate case expenses that will be amortized over a five-year period. The unamortized costs included in other assets, deferred debits, and deferred outflows of resources were $704,000 and $538,000 as of August 31, 2010 and 2009, respectively. The unamortized costs included in other current assets and deferred debits were $398,000 and $257,000 as of August 31, 2010 and 2009, respectively.

In accordance with U.S. GAAP for regulated entities, the Company has recognized the long-term portion of its environmental remediation liability as a regulatory asset because based on available evidence it is probable that the previously incurred costs will be recovered through rates. The Company received $13,000 as a result of settlements during FY 2010 by the Company's insurance carriers associated with

(Continued)

environmental remediation costs. Environmental remediation costs of approximately $588,000 in FY 2010 were offset by these insurance settlements, and the remainder was deferred. The Company estimates additional expenditures to be approximately $24,614,000.

(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 $322,000 and $337,000 for the years ended August 31, 2010 and 2009, respectively.

(6) Notes Payable

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

The commitment amount is $120,000,000 under the current credit agreement. The expiration of the credit agreement is June 1, 2012.

There were no notes outstanding at August 31, 2010 and 2009, respectively.

Commercial paper activity for the years ended August 31, 2010 and 2009 was as follows (thousands of dollars):

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

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

(7) GCR Tariff Reconciliation

During the fiscal years ended August 31, 2010, 2009, and 2008, the Company's actual gas costs were below its billed gas costs by approximately $8,939,000, $24,638,000, and $30,503,000, respectively.

Natural Gas Pipeline Supplier Refund

The Company received refunds including interest in FY 2010 in the amount of $264,000 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 2010.

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

(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, 2010 and 2009 (thousands of dollars):

		August 31, 2010			August 31, 2009		
		Current portion	Long-term	Total	Current portion	Long-term	Total
Revenue bonds	$	40,459	1,203,274	1,243,733	46,045	1,092,117	1,138,162
Unamortized discount		(364)	(2,961)	(3,325)	(396)	(3,324)	(3,720)
Unamortized premium		2,442	24,674	27,116	2,526	25,695	28,221
Total revenue bonds	$	42,537	1,224,987	1,267,524	48,175	1,114,488	1,162,663

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, 2010 and 2009 (thousands of dollars):

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

	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:				
Guaranteed Investment Contract in Sinking Fund	$ 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

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

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

	Revenue bonds			
	Principal	**Interest**	**Net swap amount**	**Total**
Fiscal year ending August 31:				
2011	$ 49,157	56,225	8,671	114,053
2012*	47,316	55,022	8,910	111,248
2013	47,990	53,283	8,910	110,183
2014	50,035	50,923	8,910	109,868
2015	51,340	48,345	8,910	108,595
2016 – 2020	250,740	203,399	42,912	497,051
2021 – 2025	268,445	142,800	29,928	441,173
2026 – 2030	239,955	83,651	10,317	333,923
2031 – 2035	160,215	37,195	280	197,690
2036 – 2040	78,540	9,703	—	88,243
Total	$ 1,243,733	740,546	127,748	2,112,027

* Tax Exempt Capital Accumulator (TECA) accretions for the 11 "C" Series in the amount of $1,524,000 are not included in the principal amount in FY 2012.

Future debt service is calculated using rates in effect at August 31, 2010 for variable rate bonds. As described in note 8(c), the variable rate received under the swaps is the lesser of the actual bond rate and the SIFMA Municipal Swap Index until September 1, 2011, when the variable rate received changes to 70% of LIBOR until maturity. Therefore, through August 31, 2011, the net swap amounts were calculated by subtracting swap receipts payments based on the lesser of the bond rate or SIFMA rate from the payments related to the fixed rate of the swaps. Subsequent to August 31, 2011, swap receipts payments were based on 70% of LIBOR.

(a) Bond Issuances

1998 Ordinance Ninth Series Bonds

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

1998 Ordinance Eighth Series Bonds

On August 20, 2009, the City of Philadelphia issued Gas Works Revenue Refunding Bonds, Eighth Series in the amount of $313,285,000 for the purpose of refunding the outstanding Sixth Series Bonds previously issued under the 1998 Ordinance, paying the costs of terminating a portion of the interest rate swap agreement, and issuing the bonds and any required deposits to the Sinking Fund Reserve established under the 1998 General Ordinance. The Eighth Series Bonds consist of $58,285,000 of serial bonds with interest rates ranging from 4.0% to 5.25% and have maturity dates through 2017. The Eighth Series Bonds also consist of four serial bonds totaling $255,000,000 that have variable rates set through a weekly reset mode. Interest is paid monthly and the bonds are secured with letters of credit that expire 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):

	Interest rates	Maturity date (fiscal year)	Balance outstanding August 31, 2010	Balance outstanding August 31, 2009
Series 11C	6.80%	2012	$ 23,498	21,882
1st Series A	4.50% – 5.50%	2026	74,315	84,995
1st Series C	3.85% – 5.00%	2014	7,050	8,615
16th Series	4.00% – 5.50%	2015	16,915	16,915
2nd Series	4.63% – 5.38%	2012	5,715	8,370
3rd Series	4.25% – 5.50%	2012	5,815	8,515
4th Series	4.00% – 5.25%	2032	89,915	92,585
17th Series	4.00% – 5.38%	2026	132,675	140,225
5th Series	4.00% – 5.25%	2034	117,520	120,000
5th Series A-2	Variable	2035	30,000	30,000
18th Series	5.00% – 5.25%	2021	39,490	50,470
19th Series	5.00%	2024	14,450	14,450
7th Series	4.00% – 5.00%	2038	193,785	196,955
7th Series Refunding	5.00%	2029	30,900	30,900
8th Series A	4.00% – 5.25%	2017	56,690	58,285
8th Series B	Variable	2031	105,000	105,000
8th Series C	Variable	2031	50,000	50,000
8th Series D	Variable	2031	50,000	50,000
8th Series E	Variable	2031	50,000	50,000
9th Series	2.00% – 5.25%	2040	150,000	—
			$ 1,243,733	1,138,162

(b) *Debt Coverage and Sinking Fund Requirements*

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

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

Funds in the Sinking Fund Reserve are to be applied to the payment of debt service if, for any reason, other funds in the Sinking Fund should be insufficient.

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

Portions of certain revenue bonds were issued as zero-coupon securities. Interest on these securities is accrued and compounded on the payment dates of the current interest bonds within the issue. The accrued interest is reported as long-term debt.

(c) Interest Rate Swap Agreements

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

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

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

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

As of August 31, 2010, the swaps had a notional amount of $255,000,000 and the associated variable rate debt had a $255,000,000 principal amount, broken down by series as follows:

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

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

Fair value – As of August 31, 2010, the swaps had a combined negative fair value for all series of $52,217,000. 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, 2010, the City is not exposed to credit risk because the swaps had a negative fair value. Should interest rates change and the fair value of the swaps become positive, the City would be exposed to credit risk in the amount of the swaps' fair value. The swaps include a termination event additional to those in the standard ISDA master agreement based on credit ratings. The swaps may be terminated by the City if the rating of the counterparty falls below A3 or A- (Moody's/S&P), unless the counterparty has: (i) assigned or transferred the swap to a party acceptable to the City; (ii) provided a credit support provider acceptable to the City whose obligations are pursuant to a credit support document acceptable to the City; or (iii) executed a credit support annex, in form and substance acceptable to the City, providing for the collateralization by the counterparty of its obligations under the swaps.

The swaps may be terminated by the counterparty if the rating on the Company's bonds falls below Baa2 or BBB (Moody's/S&P). However, because the City's swap payments are insured by Assured Guaranty Municipal Corporation, as long as Assured Guaranty Municipal Corporation is rated at or above A2 or A (Moody's/S&P), the termination event based on the City's ratings is stayed. At the present time, the rating for Assured Guaranty Municipal Corporation is at Aa3/AA+ (Moody's/S&P).

The City is 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 will 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 swaps on the financial statements for the year ended August 31, 2010 and 2009 is as follows (thousands of dollars):

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

		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, deferred debits, and deferred outflows of resources on the balance sheet.

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

(d) Guaranteed Investment Contracts in Sinking Fund

On August 23, 2002, the City entered into GICs in connection with a portion of its 1975 and 1998 Ordinance Sinking Fund Reserves for the Company. At settlement, approximately 65.0% of the Sinking Fund Reserves, from the two ordinances, totaling $61,396,000 were invested in the GICs. In exchange for this investment, the Company received an up-front payment of $21,800,000 in lieu of receiving interest payments over the life of the GICs. The life of the GIC is 18½ years, with 10½ years remaining at August 31, 2010.

The GICs are recorded at contract value in the Sinking Fund and had contract values of $45,734,000 and $46,351,000 at August 31, 2010 and 2009, respectively.

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

Under the 1998 General Ordinance, the Company is entitled to the earnings on the portion of the Sinking Fund allocated to bonds issued under the 1998 General Ordinance. Therefore, the $11,554,000 received under the 1998 ordinance was deferred and is being amortized on a straight-line basis over the life of the agreement. The unamortized balance of the proceeds was $6,558,000 and $7,183,000 at August 31, 2010 and 2009, respectively.

(9) Defeased Debt

Defeased debt of the Company (bonds issued by the Company payable from the proceeds of irrevocably pledged assets) at August 31, 2010 was as follows (thousands of dollars):

	Latest date maturing to	Interest rate		Bonds outstanding
7th Series	3/15/13	6.00%	$	10,675,000
12th Series B	5/15/20	7.00		42,365,000
3rd Series	8/1/31	5.125 – 5.50		99,445,000
4th Series	8/1/20	5.25		20,005,000

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

The assets pledged, primarily noncallable U.S. government securities, had a market value of $182,284,000 at August 31, 2010, bearing interest on face value from 0.0% to 7.7%.

(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 $106,003,000 and $107,918,000 at August 31, 2010 and 2009, respectively.

At September 1, 2009, the beginning of the plan year of the last actuarial valuation, the Pension Plan membership consisted of:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	2,232
Current employees:	
Vested	1,347
Nonvested	306
Total current employees	1,653
Total membership	3,885

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

- 1.25% of the first $6,600 of Final Average Earnings plus 1.75% of the excess of Final Average Earnings over $6,600, times years of credited service, with a maximum of 60.0% of the highest annual earnings during the last 10 years of credited service, or
- 2.0% of total earnings received during the period of credited service plus 22.5% of the first $1,200 annual amount, applicable only to participants who were employees on or prior to March 24, 1967.

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

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

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

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

The normal cost, amortization of the unfunded balance, and annual required and actual contributions for FY 2010 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:				
2010	$	8,292	16,341	24,633
2009		8,125	7,300	15,425
2008		8,085	6,173	14,258

Beneficiary payments in FY 2010 were made from operating funds. Instead, the Company set up a receivable to draw the FY 2010 funds of $11,139,000 in FY 2011, which is recorded in other current assets and deferred debits on the balance sheet. The withdrawals from the pension assets in FY 2009 of $18,528,000 were utilized to meet beneficiary payment obligations.

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

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

The Pension Plan funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. Level percentages of payroll employer contribution rates are determined using the Projected Unit Credit actuarial funding method. The actuarial value of assets, actuarial accrued liability, unfunded actuarial accrued liability, funded ratio, covered payroll and the unfunded actuarial accrued liability of covered payroll for FY 2010 and the two preceding fiscal years were as follows (thousands of dollars):

Actuarial valuation date	(a) Actuarial value of assets	Actuarial accrued liability (AAL)	(b)-(a) Unfunded AAL (UAAL)	(a/b) Funded ratio	Covered payroll	UAAL as a percent of covered payroll
September 1, 2009	$ 355,499	519,773	164,274	68.40%	$ 106,003	154.97%
September 1, 2008	430,390	495,155	64,765	86.92	107,918	60.01
September 1, 2007	416,183	482,380	66,197	86.28	105,596	62.69

The annual required contributions, contributions made and net pension obligation for FY 2010 and the two preceding fiscal years were as follows (thousands of dollars):

	2010	2009	2008
Annual required contribution	$ 24,633	15,425	14,258
Contributions made	(24,633)	(15,425)	(14,258)
Net pension obligation	$ —	—	—

(c) *Historical Trend Information (Unaudited)*

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

(11) Other Postemployment Benefits

(a) Plan Description

The Company sponsors a single employer defined benefit healthcare plan and provides postemployment healthcare and life insurance benefits to approximately 1,963 and 1,936 participating retirees and their beneficiaries and dependents for FY 2010 and FY 2009, respectively, in accordance with their retiree medical program. The Company also provides such benefits to approximately 1,669 and 1,702 active employees and their dependents for FY 2010 and FY 2009, respectively, by charging the annual insurance premiums to expense. The annual covered payroll (which was substantially equal to total payroll) was $106,003,000 and $107,918,000 at August 31, 2010 and 2009, 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 $42,083,000 and $37,064,000 in FY 2010 and FY 2009, respectively, of which approximately 48.9% and 50.7%, respectively, represents payments on behalf of retired employees and their dependents. Employees and retirees contributed $1,029,100 and $1,329,000 in FY 2010 and FY 2009, 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 $1,874,000 and $1,832,000 in FY 2010 and FY 2009, respectively. The amount attributed to retirees was approximately 76.5% and 76.0% in FY 2010 and FY 2009, respectively. The contribution requirements of nonunion plan members are established by management and may be amended. The contribution requirements for union plan members are subject to collective bargaining.

The Plan does not issue a stand-alone report.

(b) Actuarial Valuation and Assumptions

The Company engaged an actuarial consulting firm to provide an actuarial valuation of the Company's OPEB obligations as of August 31, 2010. 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 2010.

	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 2010 was $21,706,000, consisting of $20,576,000 of healthcare expenses and $1,130,000 of life insurance expenses. The difference between the ARC and the expenses paid resulted in an increase in the OPEB liability of $27,269,000 and $25,952,000 recorded in other liabilities and deferred credits and expensed in FY 2010 and FY 2009, respectively. As of August 31, 2010, the actuarial accrued liability for benefits was $654,126,000, all of which was unfunded and the ratio of the unfunded actuarial accrued liability to the covered payroll was 617.1%. 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 2010, the amount actually contributed to the plan, and the Company's net OPEB obligation (thousands of dollars):

		2010	2009
Annual required contribution	$	50,152	46,795
Interest on net OPEB obligation		3,910	2,613
Adjustment to the annual required contribution		(5,087)	(3,399)
Annual OPEB cost		48,975	46,009
Contributions made		(21,706)	(20,057)
Net OPEB obligation as prior year		78,207	52,255
Net OPEB obligation as of August 31,	$	105,476	78,207

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

The Company's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for FY 2010 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:				
2010	$	48,975	44.32	105,476
2009		46,009	43.59	78,207
2008		44,114	41.44	52,255

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

(Continued)

As described in note 15, subsequent to year-end, the Company began to fund the plan through an OPEB trust.

(d) Other Coverage Information

The Company has entered into several one-year contracts to provide healthcare for both active and retired employees that are experience rated, and premiums are adjusted annually. In addition, the Company has in place approximately $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, 2010 and 2009 are $24,614,000 and $22,990,000, 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:						
2010	$	11,881	1,237	(3,252)	9,866	5,380
2009		13,534	1,938	(3,591)	11,881	5,236
2008		8,468	7,757	(2,691)	13,534	7,457

(14) Commitments and Contingencies

Commitments for major construction and maintenance contracts were approximately $9,004,000 as of August 31, 2010.

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:		
2011	$	559
2012		233
2013		233
2014		62
2015		4

Rent expense for the fiscal years ended August 31, 2010 and 2009 amounted to $1,225,000 and $1,520,000, 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 $6,356,000 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 2011 Capital Budget was approved by City Council in the amount of $67,689,000. Within this approval, funding was provided to continue the implementation of an 18-mile Cast Iron Main Replacement Program. Main replacement cost for this program in FY 2011 is expected to be $17,982,000. The total six-year cost of the Cast Iron Main Replacement Program is forecasted to be approximately $113,044,000.

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

(15) Subsequent Events

OPEB Trust Fund

On July 29, 2010, the PUC approved a settlement with PGW, which provided for the establishment of an irrevocable trust for the deposit of funds derived through a Rider from all customer classes to fund OPEBs. The funding contained in the Rider is $16,000,000 annually. PGW is required under the settlement to fund annually $15,000,000 of the UAAL in each of the fiscal years 2011 through 2015. Additionally, PGW must fund $3,503,000 a year representing a 30 year amortization of the Net OPEB obligation of $105,500,000 at August 31, 2010. PGW established the Trust in July 2010 and began funding the Trust in accordance with the settlement agreement in September 2010.

Commercial Paper Program

Effective October 29, 2010, PGW requested that each of the three banks reduce the stated amounts of their respective letters of credit for the commercial paper Series F-1, F-2, and F-3 from $40,000,000 to $30,000,000. As a result of the reduction of each of the letters of credit, PGW's commercial paper program was reduced from $120,000,000 to $90,000,000.

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, 2009*	$	355,499	519,773	164,274	68.40%	$	106,003	154.97%
September 1, 2008**		430,390	495,155	64,765	86.92		107,918	60.01
September 1, 2007***		416,183	482,380	66,197	86.28		105,596	62.69
September 1, 2006+		411,886	474,250	62,364	86.85		106,018	58.82
September 1, 2005++		383,517	450,866	67,349	85.06		102,544	65.68
September 1, 2004+++		366,783	436,255	69,472	84.08		102,500	67.78

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

** The required supplementary information is based on a biennial actuarial valuation of the 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.

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, 2010*	$	—	654,126	654,126	—%	$	106,003	617.08%
August 31, 2009**		—	635,792	635,792	—		107,918	589.14
August 31, 2008***		—	591,599	591,599	—		105,596	560.25

* The required supplementary information is based on a biennial actuarial valuation of the OPEB fund for the plan year September 1, 2008 through August 31, 2009 updated for contributions and additional accrued benefits in the subsequent fiscal year.

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

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

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, 2010 and 2009

(Thousands of dollars)

		2010	2009
Assets:			
Cash on deposit and on hold	$	79,052	13,744
Equity in pooled cash and investments		—	—
Equity in treasurer's account		—	—
Investments		—	—
Internal balances		—	—
Amounts held by fiscal agent		—	6
Notes receivable		—	—
Taxes receivable		—	—
Accounts receivable – net		92,173	105,496
Interest and dividends receivable		—	—
Due from other governments		—	—
Restricted assets		284,813	175,534
Inventories		103,133	125,023
Unamortized loss and discount		74,198	83,666
Other assets		103,109	55,876
Property, plant, and equipment		1,840,616	1,785,250
Accumulated depreciation		(746,607)	(708,783)
Total assets	$	1,830,487	1,635,812
Liabilities:			
Notes payable	$	—	—
Vouchers and accounts payable		59,303	46,205
Salaries and wages payable		4,411	3,719
Accrued expenses		208,851	156,627
Funds held in escrow		—	—
Due to other governments		—	—
Deferred revenue		12,639	19,258
Current portion of long-term obligations		40,459	46,045
Noncurrent portion of long-term obligations		1,203,274	1,092,118
Unamortized gain and premium		27,115	28,221
Total liabilities	$	1,556,052	1,392,193
Net assets:			
Invested in (deficiency in) capital assets, net of related debt	$	(2,706)	1,019
Restricted for:			
Capital projects		—	—
Debt service		114,004	112,820
Community development projects		—	—
Behavioral health programs		—	—
Intergovernmental financing		—	—
Emergency phone system		—	—
Rate stabilization		—	—
Unrestricted		163,137	129,780
Total net assets	$	274,435	243,619

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, 2010 and 2009

(Thousands of dollars)

		August 31, 2010				
		Expenses	**Charges for services**	**Operating grants and contributions**	**Capital grants and contributions**	**Total**
Gas services	$	(615,443)	751,301	13,232*	—	149,090
Interest on debt		(52,527)	—	—	—	(52,527)
Unallocated depreciation		(38,478)	—	—	—	(38,478)
Other postemployment benefits		(27,269)	—	—	—	(27,269)
Total	$	(733,717)	751,301	13,232*	—	30,816

* Includes $5,301 of interest and other income and $7,931 of other operating revenues.

		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.

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, 2010 and 2009

(Thousands of dollars)

	2010	2009
Operating revenues:		
Charges for goods and services (net of estimated uncollectible amounts of $35,000 and $42,000, respectively)	$ 707,342	868,457
Sales of land and improvements	—	—
Rentals and concessions	—	—
Miscellaneous operating revenues	16,890	18,984
Total operating revenues	724,232	887,441
Operating expenses:		
Personal services	80,576	77,486
Purchase of services	88,403	86,106
Material and supplies	6,422	7,064
Employee benefits	51,229	43,500
Indemnities and taxes	—	—
Depreciation and amortization	43,168	42,200
Cost of goods sold	354,004	545,846
Other	—	—
Total operating expenses	623,802	802,202
Operating income	100,430	85,239
Nonoperating revenues (expenses):		
Operating grants	—	—
Passenger facility charges	—	—
Other income	3,985	5,530
Interest income	1,316	6,710
Debt service – interest	(52,527)	(63,602)
Other expenses	(22,388)	(16,666)
Total nonoperating expenses	(69,614)	(68,028)
Income before transfers	30,816	17,211
Transfer in	18,000	18,000
Transfer out	(18,000)	(18,000)
Capital contributions	—	—
Change in net assets	30,816	17,211
Net assets – beginning of year	243,619	226,408
Net assets – end of year	$ 274,435	243,619

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, 2010

(Thousands of dollars)

Due to the City, September 1, 2009	$	3,000
Accrued distributions		18,000
Payments to the City		(18,000)
Due to the City, August 31, 2010	$	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, 2010, and have issued our report thereon dated December 28, 2010. 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*.

We noted certain matters that we reported to management of the Company on a separate letter dated December 28, 2010.

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 28, 2010