



## Public Gas Partners, Inc.

### Financial Statements and Supplemental Schedules

As of and for the Years Ended June 30, 2015  
and 2014

FINANCIAL STATEMENTS AND  
SUPPLEMENTAL SCHEDULES

Public Gas Partners, Inc.  
As of and for the Years Ended June 30, 2015 and 2014  
With Report of Independent Auditors

Public Gas Partners, Inc.

Financial Statements and Supplemental Schedules

As of and for the Years Ended June 30, 2015 and 2014

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## Independent Auditor's Report

To the Board of Directors of  
Public Gas Partners, Inc.  
Kennesaw, Georgia

We have audited the accompanying statements of financial position of Public Gas Partners, Inc., which comprise the statements of net position as of June 30, 2015 and 2014, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Gas Partners, Inc. as of June 30, 2015 and 2014, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### *Other Matters*

#### *Required Supplementary Information*

Management's discussion and analysis on pages 3-10 are presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide an assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other Information*

Our audits of the financial statements included in the preceding section of this report were conducted for the purpose of forming an opinion on those statements as a whole. The supplemental pool level schedules presented in the following section of this report are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*BDO USA, LLP*

Atlanta, Georgia  
September 28, 2015

## Management's Discussion and Analysis (Unaudited)

### **Corporate Structure**

Public Gas Partners, Inc. (PGP) is a nonprofit corporation organized under Georgia law, formed on November 15, 2004. PGP is comprised of six members: Florida Municipal Power Agency (FMPA), Municipal Gas Authority of Georgia (the Gas Authority), National Public Gas Agency, Patriots Energy Group, The Southeast Alabama Gas District, and Tennessee Energy Acquisition Corporation (collectively, the Members).

PGP's mission is to build a portfolio of economic long-term gas supplies for its Members. PGP is organized into projects in which Members may elect to participate. Each of the Members participating in a PGP project has executed a Production Sharing Agreement (PSA) for that project. PGP has undertaken three projects: Gas Supply Pool No. 1 (Pool 1), Gas Supply Pool No. 2 (Pool 2), and Gas Supply Pool No. 3 (Pool 3). Pool 1 was formed in 2004, Pool 2 was formed in 2005, and Pool 3 was formed in 2009. Five Members are participants in Pools 1 and 2, and four Members are participants in Pool 3. For Pools 1 and 2, PGP was authorized to acquire gas reserves or other contract rights during a three-year acquisition period that ended June 30, 2008. Pool 3 is authorized to acquire gas reserves or other contract rights on an ongoing basis, as necessary, to fulfill gas deliveries requested by Pool 3 participants. PGP utilizes wholly owned subsidiaries to own the assets and manage the operations of its various projects.

### **Joint Action**

Although the Members are individually governed, through joint action they can share the costs of mutual endeavors, such as natural gas purchasing, and accomplish those tasks more efficiently than if they were conducted individually. In addition, by contracting with PGP, the Members can diversify their source of long-term supplies through a portfolio of supply arrangements. Similarly, they can pool their credit strength to manage risks and reduce costs through joint financing of acquisitions, hedging of long-term gas supplies, and other financing activities. Through joint action, the Members can use economies of scale to reduce the overall cost and price volatility of natural gas to their ultimate customers.

### **Authority**

The Bylaws of PGP and each PSA provide that PGP will be governed by a Board of Directors that includes one representative from each PGP Member. In addition, each PGP project is managed by an Operating Committee made up of two representatives from each participating Member. The Operating Committees for each Pool have been authorized by the Board of Directors and their respective PSAs to undertake the acquisition and management of gas supplies that meet the property criteria or other requirements in the PSAs and to issue debt to finance the costs of such activities. The PSAs authorize the Board of Directors to establish rates and charges to produce revenue sufficient to cover all project costs, including allocations from PGP or other projects, and obligate the participating Members to pay those charges.

## Management's Discussion and Analysis (Unaudited) (continued)

### **Administrative Management**

The Gas Authority manages PGP's day-to-day administrative operations under a contract that ends on November 1, 2016. This contract renews annually until either party provides notice of termination no later than 180 days from the date of expiration.

### **Derivative Instruments**

PGP uses derivative instruments to hedge its commodity price risk associated with forecasted oil and gas sales from owned reserves by converting the revenues that PGP will receive from customers from a variable price, based on a spot market price, to a fixed price.

### **Proprietary Funds**

PGP operates only one type of proprietary fund, the enterprise fund type, to account for its general operations in accordance with Governmental Accounting Standards Board (GASB) pronouncements. Enterprise funds are used to report business-type activities (as contrasted with tax-supported governmental activities).

### **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to PGP's basic financial statements. These financial statements are designed to provide readers with a broad overview of PGP's finances in a manner similar to a private-sector business.

The statements of net position present information on PGP's assets, liabilities, and deferred inflows/outflows of resources with the differences between these amounts reported as net position. Because PGP is a nonprofit organization and an extension of the municipal utilities participating in the Pools, net position is likely to be limited since, generally, all billings and revenues in excess of actual costs are returned to the Members in the form of billing credits or rate changes. The statements of revenues, expenses, and changes in net position present information showing how PGP's net position changed during the most recent fiscal year. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Therefore, certain revenues and expenses, such as costs recoverable from future billings, will result in cash flows in future fiscal periods. All of the activities of PGP are considered business-type activities.

### **Notes to Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements.

## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2015 Compared to 2014

Following are the condensed statements of net position as of June 30, 2015 and 2014:

	<b>2015</b>	<b>2014</b>
Capital assets	<b>\$ 255,143,425</b>	\$ 345,656,530
Noncapital assets	<b>125,916,429</b>	81,335,377
Deferred outflows of resources – costs recoverable / (refundable)	<b>224,847,797</b>	157,842,189
Deferred outflows of resources – unrealized loss on derivative instruments	-	7,650,179
Total assets and deferred outflows of resources	<b>\$605,907,651</b>	\$ 592,484,275
Current liabilities	<b>\$ 28,266,922</b>	\$ 41,497,834
Long-term liabilities	<b>507,833,958</b>	550,986,441
Total liabilities	<b>536,100,880</b>	592,484,275
Deferred inflows of resources – unrealized gain on derivative instruments	<b>69,806,771</b>	
Net position	-	-
Total liabilities, deferred inflows of resources, and net position	<b>\$ 605,907,651</b>	\$ 592,484,275

The increase in total assets and deferred outflows of resources of \$13,423,376 was primarily due to an increase in market values of derivative instruments of \$67,734,346 and deferred outflows of resources – costs recoverable/(refundable) by \$67,005,608. These increases were offset by decreases to accounts receivable by \$11,971,154, investments by \$12,925,409, and capital assets by \$90,513,105; which included ordinary annual depletion of \$42,978,853 and a full-cost ceiling impairment of \$63,377,760. Additional capital expenditures during the year in the amount of \$16,156,334 offset the depletion expenses and the full-cost ceiling impairment charges.

The increase in total liabilities, deferred inflows of resources, and net position of \$13,423,376 was due to a net increase in the deferred inflows of resources – unrealized gain on derivative instruments of \$69,806,771, offset by net decreases in the advances from the Gas Authority by \$25,906,473; a principal payment of Series A debt of \$12,250,000; hedging positions moving from net liabilities to net assets in the amount of \$9,746,074; and other reductions in accrued expenses and accounts payable totaling \$10,925,465.



## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2015 Compared to 2014 (continued)

Following is a summary of operations for the years ended June 30, 2015 and 2014:

	<b>2015</b>	<b>2014</b>
Operating revenues:		
Production sold to customers and Members	<b>\$ 107,185,893</b>	\$ 117,046,449
Gas acquired and sold to Members	<b>65,358,234</b>	62,787,221
Total operating revenues	<b>172,544,127</b>	179,833,670
Operating expenses:		
Oil and gas field operations	<b>46,954,735</b>	45,990,477
Gas supplies delivered to Members	<b>64,895,688</b>	58,969,028
Depletion of oil and gas properties	<b>42,978,853</b>	41,356,035
Impairment of oil and gas properties	<b>63,377,760</b>	–
Depreciation of property, plant, and equipment	<b>393,195</b>	228,389
General and administrative	<b>3,584,939</b>	5,214,477
Total operating expenses	<b>222,185,170</b>	151,758,406
Operating income (loss)	<b>(49,641,043)</b>	28,075,264
Nonoperating income (expense):		
Interest expense and other, net	<b>(8,804,138)</b>	(9,466,381)
Equity in earnings of affiliates	<b>(8,560,427)</b>	1,592,331
Costs recoverable / (refundable) in future billings	<b>67,005,608</b>	(20,201,214)
Total nonoperating income (expense)	<b>49,641,043</b>	(28,075,264)
Changes in net position	–	–
Net position:		
Beginning of year	–	–
End of year	<b>\$ –</b>	\$ –

### Operating Revenues

Operating revenues from production sold to customers and Members decreased \$9,860,556, or 8.4%, due to lower average pricing of oil and gas year over year. Gas acquired and resold to Members increased \$2,571,013, or 4.1%, due to Members increasing their physical delivery requirements in relation to the additional production acquired.

## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2015 Compared to 2014 (continued)

#### Operating Expenses

Operating expenses increased \$70,426,764, or 46.4%, primarily due to a full-cost ceiling impairment of oil and gas properties of \$63,377,760. Oil and gas field operations expenses and gas supplies delivered to Members increased by \$6,890,918, or 6.6%, as a result of Members increasing their physical delivery requirements. General and administrative expenses decreased by \$1,629,538, or 31.3%, due to reduced legal expenses and improved operating margins in PGP Operating.

#### Liquidity and Capital Resources

PGP's cash balance increased \$210,258 to \$17,441,585 at June 30, 2015. See the accompanying statements of cash flows for details of cash activity during fiscal 2015.

PGP is exposed to credit risk in the normal course of business. PGP has adopted policies and procedures to minimize this risk. Expected borrowing arrangements with banks, along with operating cash flow, are expected to provide sufficient liquidity for planned operations. PGP uses derivative instruments, including swaps and options (collectively, commodity derivatives) to hedge its commodity price risk associated with short and long-term changes in oil and natural gas prices.

## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2014 Compared to 2013

Following are the condensed statements of net position as of June 30, 2014 and 2013:

	<b>2014</b>	<b>2013</b>
Capital assets	<b>\$ 345,656,530</b>	\$ 208,738,445
Noncapital assets	<b>81,335,377</b>	78,682,886
Deferred outflows of resources – costs recoverable / (refundable)	<b>157,842,189</b>	178,043,403
Deferred outflows of resources - unrealized loss on / Derivative instruments	<b>7,650,179</b>	-
Total assets and deferred outflows of resources	<b>\$ 592,484,275</b>	\$ 465,464,734
Current liabilities	<b>\$ 41,497,834</b>	\$ 29,664,345
Long-term liabilities	<b>550,986,441</b>	415,889,767
Total liabilities	<b>592,484,275</b>	445,554,112
Deferred inflows of resources – unrealized gain on derivative instruments	-	19,910,622
Net position	-	-
Total liabilities, deferred inflows of resources, and net position	<b>\$ 592,484,275</b>	\$ 465,464,734

In October 2013, Pool 3 closed on the acquisition of the leases, the related working and royalty interests, and other operating assets for approximately 1,155 coalbed methane gas wells in the Black Warrior Basin of Alabama (“the Acquisition”).

The increase in total assets and deferred outflows of resources of \$127,019,541 was primarily due to an increase in capital assets from the Acquisition in fiscal 2014. This acquisition resulted in the increase of natural gas and oil properties of \$134,102,316, net of current year depletion; increases in accounts receivable of \$16,218,780; and other property plant and equipment of \$2,815,769. These increases were offset by a decrease in deferred outflows of resources of \$20,201,214 related to the excess of revenues over expenses and a decrease in the market values of derivative instruments of \$18,710,352.

The increase in liabilities, deferred inflows of resources, and net position of \$127,019,541 was primarily due to a net decrease in advances from the Gas Authority of \$139,143,276 for borrowings related to the Acquisition, net of current year payments; offset by a principal payment of debt of \$12,250,000 and a decrease in the market values of derivative instruments of \$9,013,069. See Note 4 for further explanation of the changes in the debt balance during the fiscal year 2014.

## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2014 Compared to 2013 (continued)

Following is a summary of operations for the years ended June 30, 2014 and 2013:

	<b>2014</b>	<b>2013</b>
Operating revenues:		
Production sold to customers and Members	<b>\$ 117,046,449</b>	\$ 78,879,534
Gas acquired and sold to Members	<b>62,787,221</b>	31,235,241
Total operating revenues	<b>179,833,670</b>	110,114,775
Operating expenses:		
Oil and gas field operations	<b>45,990,477</b>	32,416,871
Gas supplies delivered to Members	<b>58,969,028</b>	23,923,364
Depletion of oil and gas properties	<b>41,356,035</b>	38,407,672
Depreciation of property, plant, and equipment	<b>228,389</b>	–
General and administrative	<b>5,214,477</b>	2,471,150
Total operating expenses	<b>151,758,406</b>	97,219,057
Operating income	<b>28,075,264</b>	12,895,718
Nonoperating income (expense):		
Interest expense and other, net	<b>(9,466,381)</b>	(9,094,089)
Equity in earnings of affiliates	<b>1,592,331</b>	5,468,578
Costs recoverable / (refundable) in future billings	<b>(20,201,214)</b>	(9,270,207)
Total nonoperating expense	<b>(28,075,264)</b>	(12,895,718)
Changes in net position	–	–
Net position:		
Beginning of year	–	–
End of year	<b>\$ –</b>	<b>\$ –</b>

### Operating Revenues

Operating revenues from production sold to Customers and Members increased \$38,166,915, or 48.4%, due to the additional working interests acquired as part of the Acquisition during fiscal 2014. Gas acquired and resold to Members increased \$31,551,980, or 101.0%, due to Members increasing their physical delivery requirements in relation to the additional production acquired.

## Management's Discussion and Analysis (Unaudited) (continued)

### Financial Analysis – 2014 Compared to 2013 (continued)

#### Operating Expenses

Operating expenses increased \$54,539,349, or 56.1%, primarily due to an increase in oil and gas field operations expenses and gas supplies delivered to Members of \$48,619,270, or 86.3%, as a result of the Acquisition. Also as a result of the Acquisition, depletion increased year over year by \$2,948,363, or 7.7%, and general and administrative increased by \$2,743,327, or 111.0%.

Public Gas Partners, Inc.  
Statements of Net Position

	June 30	
	2015	2014
<b>Assets and deferred outflows of resources</b>		
Current assets:		
Cash and cash equivalents	\$ 9,055,498	\$ 6,617,674
Restricted cash	8,386,087	10,613,653
Accounts receivable	19,112,741	31,083,895
Fair value of derivative instruments	22,311,412	670,002
Other assets	3,738,115	2,205,104
Total current assets	<u>62,603,853</u>	51,190,328
Noncurrent assets:		
Oil and gas properties – net	252,065,475	342,840,761
Property, plant, and equipment – net	3,077,950	2,815,769
Investments	15,356,366	28,281,775
Fair value of derivative instruments	47,356,210	1,263,274
Other assets	600,000	600,000
Total noncurrent assets	<u>318,456,001</u>	375,801,579
Deferred outflows of resources - costs recoverable/(refundable)	224,847,797	157,842,189
Deferred outflows of resources - unrealized loss on derivative instruments	–	7,650,179
Total assets and deferred outflows of resources	<u><u>\$ 605,907,651</u></u>	<u><u>\$ 592,484,275</u></u>
<b>Liabilities, deferred inflows of resources, and net position</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 12,388,671	\$ 18,777,493
Advance billings – FMPA	3,965,866	4,192,698
Fair value of derivative instruments	–	3,648,620
Current portion of long-term debt	11,912,385	13,318,150
Asset retirement obligations	–	1,560,873
Total current liabilities	<u>28,266,922</u>	41,497,834
Noncurrent liabilities:		
Advances from the Gas Authority	353,984,509	379,890,982
Advance billings – FMPA	75,351,448	79,661,259
Fair value of derivative instruments	–	6,097,454
Long-term debt	55,612,520	67,524,906
Asset retirement obligations	22,885,481	17,811,840
Total noncurrent liabilities	<u>507,833,958</u>	550,986,441
Total liabilities	<u>536,100,880</u>	592,484,275
Deferred inflows of resources - unrealized gain on derivative instruments	69,806,771	–
Net position	–	–
Total liabilities, deferred inflows of resources, and net position	<u><u>\$ 605,907,651</u></u>	<u><u>\$ 592,484,275</u></u>

See accompanying notes to the financial statements.

Public Gas Partners, Inc.  
Statements of Revenues,  
Expenses, and Changes in Net Position

	<b>Year Ended June 30</b>	
	<b>2015</b>	<b>2014</b>
Operating revenues:		
Production sold to customers and Members	<b>\$ 107,185,893</b>	\$ 117,046,449
Gas acquired and sold to Members	<b>65,358,234</b>	62,787,221
Total operating revenues	<b>172,544,127</b>	179,833,670
Operating expenses:		
Oil and gas field operations	<b>46,954,735</b>	45,990,477
Gas supplies delivered to Members	<b>64,895,688</b>	58,969,028
Depletion of oil and gas properties	<b>42,978,853</b>	41,356,035
Impairment of oil and gas properties	<b>63,377,760</b>	–
Depreciation of property, plant, and equipment	<b>393,195</b>	228,389
General and administrative	<b>3,584,939</b>	5,214,477
Total operating expenses	<b>222,185,170</b>	151,758,406
Operating income (loss)	<b>(49,641,043)</b>	28,075,264
Nonoperating income (expense):		
Interest expense and other, net	<b>(8,804,138)</b>	(9,466,381)
Equity in earnings/(losses) of affiliates	<b>(8,560,427)</b>	1,592,331
Deferred outflows of resources - costs recoverable/(refundable)	<b>67,005,608</b>	(20,201,214)
Total nonoperating income (expense)	<b>49,641,043</b>	(28,075,264)
Changes in net position	–	–
Net position:		
Beginning of year	–	–
End of year	<b>\$ –</b>	<b>\$ –</b>

*See accompanying notes to the financial statements.*

Public Gas Partners, Inc.  
Statements of Cash Flows

	<b>Year Ended June 30</b>	
	<b>2015</b>	<b>2014</b>
<b>Operating activities</b>		
Receipts from customers and Members	\$ 165,209,208	\$ 169,299,241
Payments to Members	(12,190,151)	(7,642,989)
Payments to operators and suppliers	(112,993,972)	(100,225,831)
Payments from (to) oil and gas derivative counterparties, net	17,504,666	(2,649,405)
Net cash provided by operating activities	<b>57,529,751</b>	<b>58,781,016</b>
<b>Capital and related financing activities</b>		
Acquisition of oil and gas properties and operating assets	–	(154,012,878)
Sales of oil and gas properties	3,902,974	2,037,768
Capital expenditures of property, plant, and equipment	(835,642)	(675,007)
Sale of property, plant, and equipment	200,418	9,500
Drilling and completion costs, net of refunds	(16,156,334)	(20,942,792)
Repayments of gas revenue bonds	(12,250,000)	(12,250,000)
Advances from (repayments to) the Gas Authority	(25,906,472)	139,143,276
Interest payments and debt issuance costs	(10,526,811)	(10,521,409)
Net cash used in capital and related financing activities	<b>(61,571,867)</b>	<b>(57,211,542)</b>
<b>Investing activities</b>		
Investment distributions/(additions)	4,252,374	(1,659,581)
Net cash provided by (used in) investing activities	<b>4,252,374</b>	<b>(1,659,581)</b>
Net increase/(decrease) in cash and cash equivalents	<b>210,258</b>	<b>(90,107)</b>
Cash and cash equivalents:		
Beginning of year	17,231,327	17,321,434
End of year	<b>\$ 17,441,585</b>	<b>\$ 17,231,327</b>
Reconciliation of revenues in excess of operating expenses to net cash provided by operating activities:		
Operating income (loss)	\$ (49,641,043)	\$ 28,075,264
Adjustments to reconcile to net cash flows provided by operating activities:		
Accretion of asset retirement obligation	840,757	479,827
Depreciation expense	393,195	228,389
Depletion of oil and gas properties	42,978,853	41,356,035
Impairment of oil and gas properties	63,377,760	–
Changes in certain assets and liabilities:		
Accounts receivable	11,971,154	(16,197,781)
Other assets	(1,535,111)	(1,089,870)
Accounts payable and accrued expenses	(6,319,171)	10,475,938
Advance billings – FMPA	(4,536,643)	(4,546,786)
Net cash provided by operating activities	<b>\$ 57,529,751</b>	<b>\$ 58,781,016</b>

*See accompanying notes to the financial statements.*



Public Gas Partners, Inc.  
Notes to Financial Statements  
June 30, 2015

**1. Summary of Significant Accounting Policies**

**Overview of Business and Reporting Entity**

Public Gas Partners, Inc. (PGP) is a nonprofit corporation organized under Georgia law, formed on November 15, 2004. PGP's mission is to build a portfolio of economic long-term gas supplies for its members (collectively, the Members). PGP is organized into projects in which the Members may elect to participate. Each of the Members participating in a PGP project has executed a Production Sharing Agreement (PSA) for that project. PGP has undertaken three projects: Gas Supply Pool No. 1 (Pool 1), Gas Supply Pool No. 2 (Pool 2), and Gas Supply Pool No. 3 (Pool 3). The following table summarizes the Members' participation share by Pool as of June 30, 2015 (totals may not equal 100% due to rounding). As described further below, in December 2008, Florida Municipal Power Agency (FMPA) prepaid for its share of acquisitions and, therefore, does not have a specific obligation with respect to PGP's debt (including advances payable to the Gas Authority).

Member	Pool 1 Participation Share	Pool 2 Participation Share	Pool 3 Participation Share
Florida Municipal Power Agency	22.04%	25.90%	0.00%
Municipal Gas Authority of Georgia	49.74%	58.10%	85.23%
National Public Gas Agency	0.00%	0.00%	2.20%
Patriots Energy Group	8.29%	10.00%	2.66%
The Southeast Alabama Gas District	17.91%	5.00%	9.91%
Tennessee Energy Acquisition Corp.	2.02%	1.00%	0.00%

Pool 1 was formed in 2004, Pool 2 was formed in 2005, and Pool 3 was formed in 2009. Each PSA obligates the Member to pay, as a component of its gas operations expense, its participation share of all costs incurred by the related PGP pool until all related debt has been paid and the last volumes have been delivered. The PSAs include a step-up provision that may obligate the Members to increase their participation share in the related pool in the event of default by another Member. The Members are obligated to purchase their share of gas produced by the respective Pools, or cash from the sale of the Members' share of gas produced may be received by the Members in lieu of physical supply. Each of PGP's gas supply pools is held by wholly-owned subsidiary limited liability companies which are blended component units of PGP.

# Public Gas Partners, Inc.

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

Additionally, Pool 3 has a wholly-owned subsidiary, PGP Operating, LLC (PGP Operating), which operates approximately 1,380 wells in the Black Warrior Basin of Alabama.

For Pools 1 and 2, PGP was authorized to acquire gas reserves or other contract rights during a three-year acquisition period that ended June 30, 2008. Pool 3 is authorized to acquire gas reserves or other contract rights on an ongoing basis as necessary to fulfill the gas deliveries requested by Pool 3 participants. PGP utilizes wholly owned subsidiaries to own the assets and manage the operations of its various projects. All intercompany transactions have been eliminated.

The Gas Authority manages PGP's day-to-day operations under a contract that ends on November 1, 2016, and renews automatically for one-year periods unless either party gives 180 days' notice. Under this agreement, PGP paid the Gas Authority \$2,039,227 and \$2,010,929 for management fees for the years ended June 30, 2015 and 2014, respectively. Also, PGP Operating paid \$7,653,509 and \$3,096,203 for the years ended June 30, 2015 and 2014, respectively, to the Gas Authority in salaries and benefits costs for field personnel who are employees of the Gas Authority.

### Subsequent Events

In preparing the accompanying financial statements, management reviewed all known events that have occurred after June 30, 2015, and through September 28, 2015, for inclusion in the financial statements and footnotes.

### Basis of Accounting

PGP follows proprietary fund accounting in accordance with Governmental Accounting Standards Board (GASB) pronouncements. Proprietary fund accounting is used to report business-type activities, as contrasted with tax-supported governmental activities.

PGP also complies with policies and practices prescribed by its Board of Directors and to practices common in the natural gas industry. As the Board of Directors has the authority to set rates, PGP follows GASB-regulated accounting guidance in GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62), which provides for the reporting of assets and liabilities consistent with the economic effect of the rate structure. Under GASB 62, regulatory assets are recorded to reflect probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities are recorded to reflect probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process.

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### **1. Summary of Significant Accounting Policies (continued)**

At June 30, 2015 and 2014, PGP's significant regulatory assets and liabilities are included in the accompanying statements of net position as deferred outflows of resources – costs recoverable/(refundable).

#### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (1) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (2) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

PGP's financial statements include certain significant estimates, including oil and gas reserve quantities, which are the basis for calculating depletion and impairment of oil and gas properties, the timing and cost of its asset retirement obligations, accrued revenues and expenses associated with oil and gas properties, and estimates of fair values of derivative contracts.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, bank demand accounts, and cash deposited in local government investment pools. Restricted cash represents funds held by a trustee restricted for future service pursuant to a bond resolution. PGP is subject to custodial credit risk, which is the risk that in the event of a bank failure, PGP's deposits may not be returned to it. At June 30, 2015, \$750,000 of PGP's cash balances was covered by federal depository insurance, \$8,010,250 was collateralized with securities held by a third-party bank's trust department, and \$10,594,792 was subject to custodial credit risk as it was uninsured and uncollateralized. At June 30, 2014, \$750,000 of PGP's cash balances was covered by federal depository insurance, \$10,283,983 was collateralized with securities held by a third-party bank's trust department, and \$8,006,740 was subject to custodial credit risk as it was uninsured and uncollateralized.

#### **Restricted Cash**

Cash or cash equivalents that are restricted as to withdrawal or use under the terms of certain contractual agreement or arrangements are recorded separately from cash and cash equivalents. As of June 30, 2015 and 2014, PGP restricted \$7,868,128 and \$10,142,038, respectively, for debt service, \$25,000 and \$25,000, respectively, for security against a letter of credit, and \$492,959 and \$446,615, respectively, for legal and administrative suspense for future royalty payments related to its oil and gas operations in Alabama.

# Public Gas Partners, Inc.

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Other Assets

Other assets include well materials such as pumps and rotors, advances on well drilling, and deposits. The well materials are used in PGP's gas production operations and are held at purchased cost on the statements of net position.

#### Oil and Gas Properties

Oil and gas properties represent working and royalty interests in oil and natural gas wells and related contract rights, facilities, and equipment. PGP uses the full-cost method of accounting for its investments in oil and gas properties. Under this method, PGP capitalizes all acquisition, exploration, and development costs incurred for the purpose of finding oil and gas reserves. Costs associated with production are expensed in the period incurred. PGP also includes the present value as of the date of incurrence of its dismantlement, restoration, and abandonment costs within the capitalized oil and gas property balance.

PGP computes the depreciation, depletion, and amortization (DD&A) of oil and gas properties using the unit-of-production method based upon a ratio of production and estimates of proved reserve quantities. The Company's total oil and gas properties consisted of the following:

<b>Oil and gas properties, full cost method of accounting:</b>	<b>2015</b>	<b>2014</b>
Proved properties	\$ 916,491,766	\$ 900,910,439
Total oil and gas properties	916,491,766	900,910,439
Accumulated depletion of proved properties	(664,426,291)	(558,069,678)
Total oil and gas properties, net	\$ 252,065,475	\$ 342,840,761

Accumulated depletion was \$423,306,364 for Pool 1, \$149,481,554 for Pool 2, and \$91,639,373 for Pool 3 as of June 30, 2015, and \$375,274,125 for Pool 1, \$136,001,423 for Pool 2, and \$46,794,130 for Pool 3 as of June 30, 2014.

Under the full-cost method, capitalized costs are limited to an amount not to exceed the value of the related oil and gas reserves (referred to as a ceiling on capitalized costs). In performing its annual ceiling test, PGP limits the capitalized costs of oil and gas properties, net of accumulated DD&A, to the present value of estimated future net cash flows, including cash flows from hedging transactions, from proved oil and gas reserves, plus the lower of cost or fair value of any unproved properties included in the costs being amortized. The full-cost method stipulates that future cash flows are discounted at 10%. If capitalized costs exceed this limit, the excess is charged as additional DD&A expense.

# Public Gas Partners, Inc.

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

The full-cost method also stipulates that revenues for all future periods are calculated by applying the arithmetic average first-day-of-the-month price over the preceding 12 months, except in those instances where future oil and natural gas prices are covered by derivative contracts. Consequently, the preceding 12-month average prices could have a significant impact on the ceiling test calculation and could result in write-downs of oil and gas properties. A full-cost ceiling impairment of \$63,377,760 was recognized during the current fiscal year as a result of the reduction in the average market index prices for natural gas and oil from \$4.20/mcf to \$3.42/mcf and \$101.24/bbl to \$69.22/bbl, from 2014 to 2015. No impairment loss was recognized during the year ended of June 30, 2014. Hedging transactions cover approximately 32% and 32% of expected future production from proved reserves for the years ended June 30, 2015 and 2014, respectively. If hedging transactions had not been considered in the impairment tests, additional DD&A expense of \$53,205,609 and \$10,288,546 for the years ended June 30, 2015 and 2014, respectively, would have been recognized.

Given the volatility of oil and gas prices, it is reasonably possible that PGP's estimate of discounted future net cash flows from proved oil and gas reserves could change in the near term. If oil and gas prices decline significantly, even if only for a short period of time, it is possible that additional impairments of oil and gas properties could occur.

### Property, Plant, and Equipment

PGP acquires and maintains property, plant and equipment in relation to its coalbed methane field operations in Alabama. All property, plant, and equipment are stated at cost less accumulated depreciation on the statements of net position. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful lives of property, plant, and equipment are described below:

<b>Property and Equipment</b>	<b>Useful Life</b>
Land	Indefinite
Vehicles	5 years
Furniture and fixtures	5 years
Machinery and equipment	5 years
Computer hardware and software	7 years
Buildings	40 years

### Investments

PGP owns a noncontrolling interest in a partnership, accounted for under the equity method (see Note 2).

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

##### Deferred Outflows of Resources - Costs Recoverable / (Refundable)

Under the provisions of the PSAs, the Board of Directors establishes rates and charges to produce revenues sufficient to cover PGP's costs. Expenses in excess of amounts currently billable to the Members under the pricing mechanism will be recovered from future billings to the Members and are classified as a deferred outflow.

##### Asset Retirement Obligations

Asset retirement obligations represent the present value of the estimated costs for well shut-ins and abandonments upon retirement of the related oil and gas properties. Such costs are recorded in oil and gas properties and amortized to expense using the units-of-production method.

##### Advance Billings – FMPA

Advance billings – FMPA represents FMPA's payment to PGP in December 2008 of \$101,649,489 for a portion of its participation share of future gas deliveries over the life of Pools 1 and 2, adjusted by payments to or from FMPA subsequent to December 2008 for FMPA's participation share of net cash flows from oil and gas operations. The original amount advanced was based on FMPA's participation share of the December 2008 balances of PGP's lines of credit, which had been used to fund acquisitions and certain capital development costs in accordance with the terms of FMPA's PSAs for Pools 1 and 2.

##### Derivative Instruments

PGP uses derivative instruments, including swaps and options, to hedge its commodity price risk associated with short-term and long-term changes in oil and natural gas prices. Realized gains or losses on hedging derivative instruments are recognized in operating revenues in the period to which the derivative instruments relate. Realized gains or losses on derivative instruments that do not meet the criteria to be accounted for as hedging derivative instruments (investment derivative instruments), if any, are recognized in investment income in the period to which the derivative instruments relate. GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53), requires PGP to record the fair value of derivative instruments on the statements of net position as an asset or liability. The change in fair value of hedging derivative instruments (unrealized gains or losses) is recorded as a deferred gain or deferred loss on the statements of net position (referred to as deferred inflows or outflows of resources). Changes in the fair value of investment derivative instruments (unrealized gains or losses) are recognized as investment income (loss) and then deferred as regulatory assets or liabilities under GASB 62. The fair values of derivative instruments with individual counterparties under master netting arrangements are offset as current and/or long-term net position or liabilities on the statements of net position. Cash receipts and payments for

# Public Gas Partners, Inc.

## Notes to Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

commodity instruments are classified as operating activities in the statements of cash flows. Unrealized gains and losses on commodity derivatives held on behalf of PGP are deferred and offset corresponding fair value changes in the Gas Authority's receivable from PGP.

#### **Deferred Inflows/Outflows of Resources – Unrealized Gain/Loss on Derivative Instruments**

Deferred inflows/outflows of resources represent the unrealized gain/loss on hedging derivative instruments.

#### **Revenues**

Oil and gas revenues are recognized when production or acquired gas is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Oil and gas are sold in their local markets and shown as Production sold to customers and Members in the statements of revenues, expenses, and changes in net position. PGP acquires comparable volumes of produced gas in its Members' service areas and delivers that gas to the Members, shown as Gas acquired and sold to Members in the statements of revenues, expenses, and changes in net position. Additionally, realized gains and losses related to PGP's natural gas and oil derivatives are recognized in operating revenues, as described above. Under the provisions of the PSAs, PGP is required to set rates sufficient to recover all its costs. Any excess revenues or expenses are either credited or billed, respectively, to the Members in accordance with policies established by the Board of Directors.

#### **Income Taxes**

PGP is a nonprofit corporation comprised of governmental entities and, therefore, claims exemption from federal and state income taxes. Accordingly, no provision for such taxes is made in the accompanying financial statements.

#### **Fair Value of Financial Instruments**

PGP's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, accounts payable, and other current liabilities, are carried at cost, which approximates fair values due to the short-term maturities of these instruments. PGP's derivative instruments to hedge its commodity price risk are recorded at estimated fair values.

#### **Reclassifications**

Certain amounts in the 2014 financial statements have been reclassified to conform to the 2015 presentation.

# Public Gas Partners, Inc.

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Business Combinations

PGP applies GASB Statement No. 69, *Government Combinations and Disposals of Government Operations* (GASB 69) in its accounting for acquisitions. It requires PGP to recognize the assets acquired and the liabilities assumed at their acquisition date fair values. While PGP uses its best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, the estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, PGP may record adjustments to the assets acquired and liabilities assumed.

#### 2. Investments

PGP owns a noncontrolling interest in a partnership that owns oil and gas properties. Summarized financial information for this investment as of and for the years ended June 30, 2015 and 2014, is as follows:

	<u>2015</u>	<u>2014</u>
Assets	\$ 33,388,595	\$ 36,877,855
Liabilities	\$ 527,433	\$ 1,619,648
Revenues	\$ 9,476,682	\$ 10,633,346
Expenses	(10,862,017)	(8,603,145)
Net income (loss)	\$ (1,385,335)	\$ 2,030,201

The difference between PGP's carrying amount and its share of net assets of investees at June 30, 2015 and 2014, primarily relates to the acquisition of additional interests from other partners.



Public Gas Partners, Inc.

Notes to Financial Statements (continued)

**3. Property, Plant, and Equipment**

Property and equipment activity for the year ended June 30, 2015 was as follows:

	<u>Balance at June 30, 2014</u>	<u>Additions</u>	<u>Disposals</u>	<u>Depreciation</u>	<u>Balance at June 30, 2015</u>
Buildings	\$ 1,266,888	\$ -	\$ -	\$ -	1,266,888
Vehicles	989,116	827,950	(246,762)	-	1,570,304
Computer hardware and software	649,961	7,692	-	-	657,653
Land	100,000	-	-	-	100,000
Machinery and equipment	37,563	-	-	-	37,563
Accumulated depreciation	(227,759)	-	66,496	(393,195)	(554,458)
Total property, plant, and equipment net	<u>\$ 2,815,769</u>	<u>\$ 835,642</u>	<u>\$ (180,266)</u>	<u>\$ (393,195)</u>	<u>\$ 3,077,950</u>

Depreciation expense relating to property, plant, and equipment was \$393,195 and \$228,389 for 2015 and 2014, respectively.

**4. Debt and Advances from the Gas Authority**

In October 2009, PGP issued 10-year, fixed-rate bonds (the Series A Bonds) in a principal amount of \$125,000,000. Annual principal payments are due through October 1, 2019.

Following is a summary of activity for the lines of credit and the Series A Bonds:

	<u>June 30, 2014</u>	<u>Proceeds</u>	<u>Payments</u>	<u>June 30, 2015</u>
Series A Bonds	\$ 77,250,000	\$ -	\$ 12,250,000	\$ 65,000,000
	<u>June 30, 2013</u>	<u>Proceeds</u>	<u>Payments</u>	<u>June 30, 2014</u>
Series A Bonds	\$ 89,500,000	\$ -	\$ 12,250,000	\$ 77,250,000

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### 4. Debt and Advances from the Gas Authority (continued)

The summary of annual debt service, along with expected interest payments, for the years ending June 30 is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
Years Ending June 30:			
2016	\$ 11,000,000	\$ 2,935,700	\$ 13,935,700
2017	11,000,000	2,394,400	13,394,400
2018	16,000,000	1,719,400	17,719,400
2019	11,000,000	1,044,400	12,044,400
2020	16,000,000	384,700	16,384,700
Total	65,000,000	<u>\$ 8,478,600</u>	<u>\$ 73,478,600</u>
Unamortized bond premium	2,524,905		
Total per statement of net position	<u>\$ 67,524,905</u>		

The Series A Bonds have fixed interest rates ranging from 3.0% to 5.0%, with an effective rate, including bond premium, of 3.39%.

In December 2008, PGP entered into Advance Payment Agreements (APAs) with the Gas Authority under which the Gas Authority provides funding to PGP. The APAs mature in 2027. Interest expense is charged based on the Gas Authority's actual borrowing costs or contractual line-of-credit costs.

As of June 30, 2015, the weighted-average rate charged to PGP was approximately 1.79%. PGP made interest payments to the Gas Authority totaling \$6,338,209 and \$6,261,941 for fiscal years 2015 and 2014, respectively. The Members are obligated for their participation share of all Pool costs in which they have elected to participate, including related debt, unless such Members have also elected to pay a portion of their share of costs as an Advance Billing.

#### 5. Derivative Instruments

##### Hedging Derivative Instruments

PGP uses derivative instruments to hedge its commodity price risk associated with forecasted oil and gas sales from owned reserves by converting the revenues that PGP will receive from customers from a variable price, based on a spot market price, to a fixed price.

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### **5. Derivative Instruments (continued)**

The derivative agreements require monthly payments to be paid or received based on the difference between the spot market price and the contract strike price on notional volumes. None of PGP's derivatives require a cash payment at inception.

Effective June 30, 2009, PGP, the Gas Authority, and the Bank of Montreal, counterparty to certain of PGP's derivative instruments, entered into a novation agreement whereby the Bank of Montreal transferred, and the Gas Authority accepted, all the rights, liabilities, duties, and obligations with respect to PGP's outstanding derivative contracts with the Bank of Montreal. Accordingly, the Gas Authority has entered into various commodity derivatives to convert forecasted sales by PGP for oil and gas reserves to fixed prices. PGP is obligated to repay all amounts incurred by the Gas Authority under these arrangements in full as required by the Gas Authority. Trades executed on behalf of PGP result in a derivative between the Gas Authority and PGP with a value that corresponds and offsets the value of the derivatives executed by the Gas Authority on PGP's behalf. At June 30, 2015, PGP had no receivable from the Gas Authority as the various commodity derivatives executed prior to the novation agreement settled. At June 30, 2014, PGP had a receivable from the Gas Authority of \$665,132 for the fair value of these contracts. These amounts are reflected within the fair values of derivative instruments on the accompanying statements of net position.

#### **Fair Values of Derivatives**

The fair value estimates reflected on the statements of net position are based on pertinent information available to management at each statement of net position date. The fair value estimates for PGP's derivative instruments represent the present value of the differences of the fixed prices in the related instruments less the NYMEX (gas) or NYMEX – WTI (oil) forward price curve (or, for basis hedges at local delivery points, the forward price curve at that delivery point), multiplied by the corresponding monthly oil or gas volume using the LIBOR forward interest rate curve as a discount rate.

The fair values of option contracts are estimated using option pricing models that consider similar factors and also include an estimate of expected volatility. These estimated fair values may be significantly impacted by changes in underlying oil and natural gas commodity prices or the general interest rate environment. The fair values presented have not been comprehensively revalued for purposes of these financial statements since June 30, 2015, and current estimates of fair value may differ significantly from the amounts presented herein.

The fair value balances of derivative instruments outstanding at June 30, 2015 and 2014, classified by type, and the changes in fair value of such derivative instruments for the years then ended, as reported in the financial statements are as follows (losses and liabilities in parentheses).

Public Gas Partners, Inc.

Notes to Financial Statements (continued)

**5. Derivative Instruments (continued)**

As of and for the year ended June 30, 2015:

	Notional Amount at June 30, 2014*		Fair Value at June 30, 2014		Change in Fair Value		Fair Value at June 30, 2015		Notional Amount at June 30, 2015*
<b>Hedging derivatives</b>									
Henry Hub Swaps – Gas –									
Receive fixed	54,402,600	\$	(432,399)	\$	48,634,648	\$	48,202,249		44,380,000
Henry Hub Options –									
Bought put	1,388,800		2,455,543		(43,241)		2,412,302		807,800
Henry Hub Options –									
Sold call	1,388,800		(41,331)		36,871		(4,460)		807,800
WTI Swaps – Oil –									
Receive fixed	1,275,760		(9,089,900)		28,266,406		19,176,506		884,040
WTI Options –									
Bought put	36,400		7,822		82,287		90,109		6,000
WTI Options –									
Bought put	-		-		146		146		6,000
WTI Options – Sold call	36,400		(388,545)		388,256		(289)		6,000
Basis Swaps – Gas –									
Receive fixed	2,835,500		(323,987)		115,046		(208,941)		2,183,200

As of and for the year ended June 30, 2014:

	Notional Amount at June 30, 2013*		Fair Value at June 30, 2013		Change in Fair Value		Fair Value at June 30, 2014		Notional Amount at June 30, 2014*
<b>Hedging derivatives</b>									
Henry Hub Swaps – Gas –									
Receive fixed	11,724,400	\$	17,306,839	\$	(17,739,238)	\$	(432,399)		54,402,600
Henry Hub Options –									
Bought put	1,497,400		2,780,886		(325,434)		2,455,452		1,388,800
Henry Hub Options –									
Sold call	1,497,400		(66,512)		25,181		(41,331)		1,388,800
WTI Swaps – Oil –									
Receive fixed	1,501,460		577,781		(9,667,681)		(9,089,900)		1,275,760
WTI Options –									
Bought put	66,500		135,627		(127,805)		7,822		36,400
WTI Options – Sold call	66,500		(432,904)		44,359		(388,545)		36,400
Basis Swaps – Gas –									
Receive fixed	2,714,000		(391,095)		67,198		(323,897)		2,835,500

\* Notional amounts are in MMBtu except WTI Swaps, which are in barrels.

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### 5. Derivative Instruments (continued)

Following are key terms of PGP's derivative instruments as of June 30, 2015:

	<b>Effective Dates</b>	<b>Notional Amounts*</b>	<b>Strike Prices</b>
<b>Hedging derivatives</b>			
Henry Hub Swaps – Gas – Receive fixed	2015 – 2023	44,380,000	\$4.00 - \$6.32
Henry Hub Options – Bought put	2015 – 2016	807,800	\$6.00 - \$6.00
Henry Hub Options – Sold call	2015 – 2016	807,800	\$6.85 - \$7.00
WTI Swaps – Oil – Receive fixed	2015 – 2019	884,040	\$80.00 - \$101.03
WTI Options – Bought put	2015 – 2015	6,000	\$75.00 - \$75.00
WTI Options – Bought Call	2015 -- 2015	6,000	\$96.00 - \$96.00
WTI Options – Sold call	2015 – 2015	6,000	\$96.00 - \$96.00
Basis Swaps – Gas – Receive fixed	2015 – 2016	2,183,200	NYMEX minus (\$0.18 - \$0.50)

\* Notional amounts are in MMBtu except WTI Swaps, which are in barrels.

#### **Risks**

##### Basis Risk

The NYMEX-based commodity hedging transactions are subject to locational basis risk. NYMEX-based forward contract transactions are based on pricing at the Henry Hub or WTI delivery points; however, PGP's oil and gas properties produce and deliver at various delivery points. PGP enters into derivative instruments based on pricing at certain local delivery points to mitigate basis risk.

##### Credit Risk

PGP intends to hold all derivative instruments to maturity. PGP is exposed to market price risk in the event of nonperformance by any of its four counterparties; however, PGP does not anticipate nonperformance. The counterparties to these contracts are major financial institutions with credit ratings of at least A with one of the major rating agencies.

Each Pool has entered into netting arrangements whenever it has entered into more than one derivative instrument transaction with a counterparty. Under the terms of those arrangements, should one party become insolvent or otherwise default on its obligations, close-out netting provisions permit the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' fair values so that a single sum will be owed by, or owed to, the non-defaulting party.

Public Gas Partners, Inc.

Notes to Financial Statements (continued)

**5. Derivative Instruments (continued)**

PGP's counterparty credit exposures from derivative transactions and counterparty credit ratings as of June 30, 2015, are as follows:

Counterparty	Counterparty Credit Ratings S&P/Moody's	Fair Market Value of Derivative Instruments June 30, 2015 Asset (Liability)
BP Corporation North America, Inc.	A/Baa1	\$ 881,368
JP Morgan Chase Bank, N.A.	A+/Aa3	\$ 25,347,227
Royal Bank of Canada	AA-/Aa3	\$ 28,107,446
Wells Fargo Bank, N.A.	AA-/Aa3	\$ 15,331,581

Termination Risk

PGP is exposed to termination risk in its commodity derivatives. Termination of certain PGP commodity hedges may occur if PGP's credit ratings fall below BBB and PGP elects not to collateralize the unrealized losses on those transactions with specified cash and securities. No such collateral has been required or posted as of or during the periods presented.

**6. Asset Retirement Obligations (ARO)**

PGP has recorded a liability representing the present value of expected future costs associated with site reclamation, facilities dismantlement, and plugging and abandonment of oil and gas wells at June 30, 2015 and 2014, as follows:

	June 30	
	2015	2014
Balance of ARO – beginning of year	\$ 19,372,713	\$ 11,346,585
Additions from acquisitions and drilling	44,534	8,064,869
Changes in cost estimates	2,778,249	-
Accretion expense	840,757	479,827
ARO settled	(150,772)	(518,568)
Balance of ARO – end of year	\$ 22,885,481	\$ 19,372,713

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### 7. Acquisition of Alabama Coalbed Methane Assets

In October 2013, Pool 3 closed the acquisition of the leases and the related working and royalty interests in approximately 1,155 coalbed methane gas wells in the Black Warrior Basin of Alabama owned and operated by Energen Resources, Inc. In addition, PGP Operating acquired the operational rights to these wells and an additional 260 wells comprising the entirety of the acreage covered by these leases. In addition to these rights and assets, PGP Operating acquired a field office building and related land, vehicles used in the execution of gas field operations, well materials, and certain furniture, fixtures, computers and related equipment.

The total consideration for this acquisition was \$160,000,000, which was funded through an advance from the Gas Authority. This transaction had an effective date of July 1, 2013. In accordance with GASB 69, all revenues and expenses from the effective date through closing were capitalized into the purchase price.

The following table summarizes the allocation of estimated fair values of the net assets acquired as part of this acquisition.

<b>Assets Acquired</b>	<b>Fair Value Acquired</b>
Natural gas properties	\$ 151,069,424
Buildings	1,266,888
Well materials	1,092,649
Vehicles	1,001,632
Land	100,000
<b>Total assets acquired</b>	<b>154,530,593</b>
Net liabilities assumed	517,715
<b>Total net position acquired</b>	<b>\$ 154,012,878</b>
Pre-closing date revenues	9,668,302
Overhead fees and other credits	2,115,015
Pre-closing date expenses	(4,370,045)
Miscellaneous other adjustments	(1,426,150)
<b>Total original purchase price</b>	<b>\$ 160,000,000</b>

#### 8. Related Party Transactions

PGP Operating delivers extracted natural gas in the normal course of operations to several pipelines, marketers and other purchasers, including Municipal Gas Marketing Services (MGMS), a joint venture owned equally by the Gas Authority and The Southeast Alabama Gas District (SEAGD). MGMS delivers volumes to both the Gas Authority and SEAGD. During

## Public Gas Partners, Inc.

### Notes to Financial Statements (continued)

#### **8. Related Party Transactions (continued)**

2015, PGP Operating recognized gross sales of natural gas to MGMS totaling \$18,659,625. On a net working interest basis to Pool 3, this resulted in \$2,885,996 of fiscal 2015 revenues recorded in production sold to customers and Members. As of June 30, 2015, PGP held \$1,255,500 in accounts receivable for amounts owed by MGMS.

#### **9. Litigation**

PGP is subject to various litigation incidental to its ownership interests in oil and gas reserves. While the outcome of such contingencies cannot be predicted with certainty, management does not believe that the resolution of such matters will have a material impact on the results of operations, financial position, or cash flows of PGP.



## Supplemental Schedules

**Public Gas Partners, Inc.**  
**Statement of Net Position**

	<b>June 30, 2015</b>			
	<b>Pool 1</b>	<b>Pool 2</b>	<b>Pool 3</b>	<b>Total</b>
<b>Assets and deferred outflows of resources</b>				
Current assets:				
Cash and cash equivalents	\$ 2,786,867	\$ 1,272,707	\$ 4,995,924	\$ 9,055,498
Restricted cash	7,868,128	25,000	492,959	8,386,087
Accounts receivable	7,365,871	724,305	11,022,565	19,112,741
Fair value of derivative instruments	11,610,798	2,115,211	8,585,403	22,311,412
Other assets	2,053,755	94,711	1,589,649	3,738,115
Interproject receivables (payables)	32,684	(3,533)	(29,151)	-
Total current assets	31,718,103	4,228,401	26,657,349	62,603,853
Noncurrent assets:				
Oil and gas properties – net	109,016,967	12,680,304	130,368,204	252,065,475
Property, plant, and equipment — net	-	-	3,077,950	3,077,950
Investments	-	15,356,366	-	15,356,366
Fair value of derivative instruments	15,200,109	2,736,058	29,420,043	47,356,210
Other assets	-	-	600,000	600,000
Total noncurrent assets	124,217,076	30,772,728	163,466,197	318,456,001
Deferred outflows of resources - costs recoverable/(refundable)	119,741,991	55,877,315	49,228,491	224,847,797
Total assets and deferred outflows of resources	<u>\$275,677,170</u>	<u>\$ 90,878,444</u>	<u>\$239,352,037</u>	<u>\$ 605,907,651</u>
<b>Liabilities, deferred inflows of resources, and net position</b>				
Current liabilities:				
Accounts payable and accrued expenses	\$ 4,665,061	\$ 206,322	\$ 7,517,288	\$ 12,388,671
Advance billings – FMPA	2,814,986	1,150,880	-	3,965,866
Current portion of long-term debt	11,912,385	-	-	11,912,385
Total current liabilities	19,392,432	1,357,202	7,517,288	28,266,922
Noncurrent liabilities:				
Advances from the Gas Authority	107,321,341	61,449,484	185,213,684	353,984,509
Advance billings – FMPA	53,484,729	21,866,719	-	75,351,448
Long-term debt	55,612,520	-	-	55,612,520
Asset retirement obligations	12,957,833	1,312,029	8,615,619	22,885,481
Total noncurrent liabilities	229,376,423	84,628,232	193,829,303	507,833,958
Total liabilities	248,768,855	85,985,434	201,346,591	536,100,880
Deferred inflows of resources - unrealized gain on derivative instruments	26,908,315	4,893,010	38,005,446	69,806,771
Net position	-	-	-	-
Total liabilities, deferred inflows of resources, and net position	<u>\$275,677,170</u>	<u>\$ 90,878,444</u>	<u>\$239,352,037</u>	<u>\$ 605,907,651</u>

Public Gas Partners, Inc.  
Statement of Revenues,  
Expenses, and Changes in Net Position

	Year Ended June 30, 2015			
	Pool 1	Pool 2	Pool 3	Total
Operating revenues:				
Production sold to customers and Members	\$ 55,264,316	\$ 5,435,901	\$ 46,485,676	\$ 107,185,893
Gas acquired and sold to Members	13,913,377	6,415,263	45,029,594	65,358,234
Total operating revenues	69,177,693	11,851,164	91,515,270	172,544,127
Operating expenses:				
Oil and gas operations	25,289,898	2,856,212	18,808,625	46,954,735
Gas supplies delivered to Members	11,440,872	4,818,260	48,636,556	64,895,688
Depletion of oil and gas properties	23,167,091	1,555,665	18,256,097	42,978,853
Impairment of oil and gas properties	24,864,148	11,924,466	26,589,146	63,377,760
Depreciation of property, plant, and equipment	-	-	393,195	393,195
General and administrative	1,438,257	273,114	1,873,568	3,584,939
Total operating expenses	86,200,266	21,427,717	114,557,187	222,185,170
Operating income (loss)	(17,022,573)	(9,576,553)	(23,041,917)	(49,641,043)
Nonoperating income (expense):				
Interest expense and other, net	(4,882,585)	(1,272,521)	(2,649,032)	(8,804,138)
Equity in earnings/(losses) of affiliates	-	(8,560,427)	-	(8,560,427)
Deferred outflows of resources - costs recoverable/(refundable)	21,905,158	19,409,501	25,690,949	67,005,608
Total nonoperating income (expense)	17,022,573	9,576,553	23,041,917	49,641,043
Changes in net position	-	-	-	-
Net position:				
Beginning of year	-	-	-	-
End of year	\$ -	\$ -	\$ -	\$ -

**Public Gas Partners, Inc.**  
**Statement of Cash Flows**

	<b>Year Ended June 30, 2015</b>			
	<b>Pool 1</b>	<b>Pool 2</b>	<b>Pool 3</b>	<b>Total</b>
<b>Operating activities</b>				
Receipts from customers and Members	\$ 61,493,182	\$ 10,186,280	\$ 93,529,746	\$ 165,209,208
Payments to Members	(2,743,416)	(1,793,226)	(7,653,509)	(12,190,151)
Payments to operators and suppliers	(39,817,943)	(7,949,496)	(65,226,533)	(112,993,972)
Payments from (to) oil and gas derivative counterparties, net	11,651,998	2,159,978	3,692,690	17,504,666
Internal activity — payments to other pools	104,557	(11,203)	(93,354)	—
Net cash provided by (used in) operating activities	<u>30,688,378</u>	<u>2,592,333</u>	<u>24,249,040</u>	<u>57,529,751</u>
<b>Capital and related financing activities</b>				
Sale of oil and gas reserves	2,828,833	1,026,560	47,581	3,902,974
Capital expenditures of property, plant, and equipment	—	—	(835,642)	(835,642)
Sale of property, plant, and equipment	—	—	200,418	200,418
Drilling and completion costs, net of refunds	(15,860,096)	(126,353)	(169,885)	(16,156,334)
Repayments of gas revenue bonds	(12,250,000)	—	—	(12,250,000)
Advances from (repayments to) the Gas Authority	(577,192)	(6,110,288)	(19,218,992)	(25,906,472)
Interest payments and debt issuance costs	(6,014,771)	(1,233,924)	(3,278,116)	(10,526,811)
Net cash provided by (used in) capital and related financing activities	<u>(31,873,226)</u>	<u>(6,444,005)</u>	<u>(23,254,636)</u>	<u>(61,571,867)</u>
<b>Investing activities</b>				
Investment distributions/(additions)	(99,056)	4,312,881	38,549	4,252,374
Net cash provided by (used in) investing activities	<u>(99,056)</u>	<u>4,312,881</u>	<u>38,549</u>	<u>4,252,374</u>
Net increase (decrease) in cash equivalents	(1,283,904)	461,209	1,032,953	210,258
Cash and cash equivalents:				
Beginning of period	11,938,899	836,498	4,455,930	17,231,327
End of period	<u>\$ 10,654,995</u>	<u>\$ 1,297,707</u>	<u>\$ 5,488,883</u>	<u>\$ 17,441,585</u>
Reconciliation of revenues in excess of operating expenses to net cash provided by operating activities:				
Operating income (loss)	\$ (17,022,573)	\$ (9,576,553)	\$ (23,041,917)	\$ (49,641,043)
Adjustments to reconcile net cash flows provided by (used in) operating activities:				
Accretion of asset retirement obligation	368,665	67,415	404,677	840,757
Depreciation expense	—	—	393,195	393,195
Depletion of oil and gas properties	23,167,091	1,555,665	18,256,097	42,978,853
Impairment of oil and gas properties	24,864,148	11,924,466	26,589,146	63,377,760
Changes in certain assets and liabilities:				
Accounts receivable	3,967,486	495,094	7,508,574	11,971,154
Other assets	(1,949,494)	148,652	265,731	(1,535,111)
Accounts payable and accrued expenses	(68,085)	(217,977)	(6,033,109)	(6,319,171)
Advance billings — FMPA	(2,743,417)	(1,793,226)	—	(4,536,643)
Interproject receivables (payables)	104,557	(11,203)	(93,354)	—
Net cash provided by operating activities	<u>\$ 30,688,378</u>	<u>\$ 2,592,333</u>	<u>\$ 24,249,040</u>	<u>\$ 57,529,751</u>