ARIZONA CORPORATION COMMISSION
UTILITIES DIVISION

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ANNUAL REPORT MAILING LABEL – MAKE CHANGES AS NECESSARY

G-04204A
UNS Gas, Inc.
Attn: Melissa Morales
P.O. Box 711, Mailstop HQE910
Tucson, Arizona 85702

ANNUAL REPORT
Gas

FOR YEAR ENDING

12	31	2018

FOR COMMISSION USE

ANN 02	18

5-20-19

COMPANY INFORMATION

Company Name (Business Name): UNS, Gas, Inc.

Mailing Address: P.O. Box 711, Mailstop HQE910
(Street)

Tucson (City) | Arizona (State) | 85702 (Zip)

(520) 884-3650 — Telephone No. (Include Area Code)
(520) 884-3601 — Fax No. (Include Area Code)
N/A — Cell No. (Include Area Code)

Email Address: JoSmith@uns.com

Local Office Mailing Address: P.O. Box 711, Mailstop HQE910
(Street)

Tucson (City) | Arizona (State) | 85702 (Zip)

(520) 884-3650 — Local Office Telephone No. (Include Area Code)
(520) 884-3601 — Fax No. (Include Area Code)
N/A — Cell No. (Include Area Code)

Email Address: JoSmith@uns.com

MANAGEMENT INFORMATION

☒ **Regulatory Contact:**

☒ **Management Contact:** Jo Smith (Name) — Director, Regulatory Services (Title)

P.O. Box 711, Mailstop HQE910 (Street) | Tucson (City) | Arizona (State) | 85702 (Zip)

(520) 884-3650 — Telephone No. (Include Area Code)
(520) 884-3601 — Fax No. (Include Area Code)
N/A — Cell No. (Include Area Code)

Email Address: JoSmith@uns.com

On Site Manager: Nathan Shelley
(Name)

2901 W. Shamrell Blvd., Suite 110 (Street) | Flagstaff (City) | Arizona (State) | 86001 (Zip)

(928) 226-2266 — Telephone No. (Include Area Code)
(520) 779-5338 — Fax No. (Include Area Code)
N/A — Cell No. (Include Area Code)

Email Address: nshelley@uesaz.com

Statutory Agent: Linda Kennedy
(Name)

P.O. Box 711, Mailstop HQE910	Tucson	Arizona	85702
(Street)	(City)	(State)	(Zip)
(520) 884-3604	(520) 884-3601	N/A	
Telephone No. (Include Area Code)	Fax No. (Include Area Code	Cell No. (Include Area Code)	

Attorney: Todd C. Hixon
(Name)

P.O. Box 711, Mailstop HQE910	Tucson	Arizona	85702
(Street)	(City)	(State)	(Zip)
(520) 884-3667	(520) 884-3601	N/A	
Telephone No. (Include Area Code)	Fax No. (Include Area Code)	Cell No. (Include Area Code)	

Email Address: THixon@tep.com

OWNERSHIP INFORMATION

Check the following box that applies to your company:

- ☐ **Sole Proprietor (S)**
- ☒ **C Corporation (C) (Other than Association/Co-op)**
- ☐ **Partnership (P)**
- ☐ **Subchapter S Corporation (Z)**
- ☐ **Bankruptcy (B)**
- ☐ **Association/Co-op (A)**
- ☐ **Receivership (R)**
- ☐ **Limited Liability Company**
- ☐ **Other (Describe)**__________

COUNTIES SERVED

Check the box below for the county/ies in which you are certificated to provide service:

☒ **APACHE**	☐ **COCHISE**	☒ **COCONINO**
☐ **GILA**	☐ **GRAHAM**	☐ **GREENLEE**
☐ **LA PAZ**	☐ **MARICOPA**	☒ **MOHAVE**
☒ **NAVAJO**	☐ **PIMA**	☐ **PINAL**
☒ **SANTA CRUZ**	☒ **YAVAPAI**	☐ **YUMA**
☐ **STATEWIDE**		

SERVICES AUTHORIZED TO PROVIDE

Check the following box(es) for the services that you are authorized to provide:

☒ **Gas**

- ☒ Natural Gas
- ☐ Propane

☐ **Other** (Specify)______________________________

STATISTICAL INFORMATION

GAS UTILITIES ONLY

Total number of customers	157,807	
Residential	145,031	
Commercial	12,729	
Industrial	42	*
Irrigation	5	
Resale	0	
Total therms sold	133,277,945 Therms	
Residential	74,353,904	
Commercial	36,497,503	
Industrial	22,403,753	*
Irrigation	22,785	
Resale	0	

*Includes NSP customers.

COMPANY NAME: UNS Gas, Inc.

UTILITY SHUTOFFS / DISCONNECTS

MONTH		Termination without Notice R14-2-311.B	Termination with Notice R14-2-311.C	OTHER
JANUARY		0	249	0
FEBRUARY		0	248	0
MARCH		0	306	0
APRIL		0	402	0
MAY		0	357	0
JUNE		0	256	0
JULY		0	193	0
AUGUST		0	166	0
SEPTEMBER		0	95	0
OCTOBER		0	137	0
NOVEMBER		0	73	0
DECEMBER		0	114	0
TOTALS ⟶		0	2596	0

OTHER (description):

VERIFICATION
AND
SWORN STATEMENT
Intrastate Revenues Only

VERIFICATION

STATE OF Arizona	COUNTY OF (COUNTY NAME) Pima
I, THE UNDERSIGNED	NAME (OWNER OR OFFICIAL) TITLE Frank P. Marino Sr. Vice President & Chief Financial Officer
OF THE	COMPANY NAME UNS Gas Inc.

DO SAY THAT THIS ANNUAL UTILITY REPORT TO THE ARIZONA CORPORATION COMMISSION

FOR THE YEAR ENDING	MONTH	DAY	YEAR
	12	31	2018

HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

SWORN STATEMENT

IN ACCORDANCE WITH THE REQUIREMENT OF TITLE 40, ARTICLE 8, SECTION 40-401, ARIZONA REVISED STATUTES, IT IS HEREIN REPORTED THAT THE GROSS OPERATING REVENUE OF SAID UTILITY DERIVED FROM ARIZONA INTRASTATE UTILITY OPERATIONS DURING CALENDAR YEAR 2018 WAS:

Arizona Intrastate Gross Operating Revenues Only ($)
$ 117,838,609

(THE AMOUNT IN BOX ABOVE INCLUDES $10,405,719 IN SALES TAXES BILLED, OR COLLECTED)

**REVENUE REPORTED ON THIS PAGE MUST INCLUDE SALES TAXES BILLED OR COLLECTED. IF FOR ANY OTHER REASON, THE REVENUE REPORTED ABOVE DOES NOT AGREE WITH TOTAL OPERATING REVENUES ELSEWHERE REPORTED, ATTACH THOSE STATEMENTS THAT RECONCILE THE DIFFERENCE. (EXPLAIN IN DETAIL)

Frank P. Marino
SIGNATURE OF OWNER OR OFFICIAL

520-745-3448
TELEPHONE NUMBER

SUBSCRIBED AND SWORN TO BEFORE ME

A NOTARY PUBLIC IN AND FOR THE COUNTY OF | COUNTY NAME Santa Cruz

THIS 16th DAY OF | MONTH May, 2019

(SEAL) ANGELA STYCZYKOWSKI
Notary Public - Arizona
Santa Cruz County
My Comm. Expires Jun 25, 2019

MY COMMISSION EXPIRES

Angela Styczykowski
SIGNATURE OF NOTARY PUBLIC

VERIFICATION
AND
SWORN STATEMENT
RESIDENTIAL REVENUE
INTRASTATE REVENUES ONLY

STATE OF ARIZONA	COUNTY OF (COUNTY NAME) Pima
I, THE UNDERSIGNED	NAME (OWNER OR OFFICIAL) Frank P. Marino — TITLE Sr. V.P. & CFO
OF THE	COMPANY NAME UNS Gas Inc.

DO SAY THAT THIS ANNUAL UTILITY REPORT TO THE ARIZONA CORPORATION COMMISSION

FOR THE YEAR ENDING	MONTH	DAY	YEAR
	12	31	2018

HAS BEEN PREPARED UNDER MY DIRECTION, FROM THE ORIGINAL BOOKS, PAPERS AND RECORDS OF SAID UTILITY; THAT I HAVE CAREFULLY EXAMINED THE SAME, AND DECLARE THE SAME TO BE A COMPLETE AND CORRECT STATEMENT OF BUSINESS AND AFFAIRS OF SAID UTILITY FOR THE PERIOD COVERED BY THIS REPORT IN RESPECT TO EACH AND EVERY MATTER AND THING SET FORTH, TO THE BEST OF MY KNOWLEDGE, INFORMATION AND BELIEF.

SWORN STATEMENT

IN ACCORDANCE WITH THE REQUIREMENTS OF TITLE 40, ARTICLE 8, SECTION 40-401.01, ARIZONA REVISED STATUTES, IT IS HEREIN REPORTED THAT THE GROSS OPERATING REVENUE OF SAID UTILITY DERIVED FROM ARIZONA INTRASTATE UTILITY OPERATIONS RECEIVED FROM RESIDENTIAL CUSTOMERS DURING CALENDAR YEAR 2018 WAS:

ARIZONA INTRASTATE GROSS OPERATING REVENUES

$70,324,267

(THE AMOUNT IN BOX AT LEFT INCLUDES $6,209,973 IN SALES TAXES BILLED, OR COLLECTED

*RESIDENTIAL REVENUE REPORTED ON THIS PAGE MUST INCLUDE SALES TAXES BILLED.

[signature]
SIGNATURE OF OWNER OR OFFICIAL

520-745-3448
TELEPHONE NUMBER

SUBSCRIBED AND SWORN TO BEFORE ME

A NOTARY PUBLIC IN AND FOR THE COUNTY OF

THIS 11th DAY OF

(SEAL)

MY COMMISSION EXPIRES

ANGELA STYCZYKOWSKI
Notary Public - Arizona
Santa Cruz County
My Comm. Expires Jun 25, 2019

NOTARY PUBLIC NAME ANGELA STYCZYKOWSKI
COUNTY NAME Santa Cruz
MONTH May 2019

[signature]
SIGNATURE OF NOTARY PUBLIC

FINANCIAL INFORMATION

Attach to this annual report a copy of the companies' year-end (Calendar Year 2018) financial statements. If you do not compile these reports, the Utilities Division will supply you with blank financial statements for completion and filing. **ALL INFORMATION MUST BE ARIZONA-SPECIFIC AND REFLECT OPERATING RESULTS IN ARIZONA.**

UNS Gas, Inc.
FINANCIAL STATEMENTS

December 31, 2018

UniSourceEnergy
SERVICES

Deloitte

Deloitte & Touche LLP
2901 North Central Avenue
Suite 1200
Phoenix, AZ 85012-2799
USA

Tel: +1 602 234 5100
Fax: +1 602 234 5186
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Stockholder and the Board of Directors of
UNS Gas, Inc.:

We have audited the accompanying balance sheets of UNS Gas, Inc. (the "Company") as of December 31, 2018 and 2017, the related statements of income, changes in stockholder's equity, and cash flows, for the years then ended, and the related notes (collectively referred to as 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.

Auditors' 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 Company'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 Company'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 the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Phoenix, Arizona
February 22, 2019

UNS GAS, INC.
STATEMENTS OF INCOME
(Amounts in thousands)

	Years Ended December 31, 2018	2017
Operating Revenues	**$ 113,365**	$ 114,113
Operating Expenses		
Purchased Energy	**54,050**	56,014
Decrease to Reflect PGA Recovery Treatment	**(893)**	(1,530)
Total Purchased Energy	**53,157**	54,484
Operations and Maintenance	**26,981**	25,901
Depreciation	**11,537**	11,082
Amortization	**(953)**	(757)
Taxes Other Than Income Taxes	**4,467**	4,281
Total Operating Expenses	**95,189**	94,991
Operating Income	**18,176**	19,122
Other Income (Expense)		
Interest Expense	**(4,828)**	(4,718)
Allowance For Borrowed Funds	**19**	22
Allowance For Equity Funds	**27**	46
Other, Net	**99**	(132)
Total Other Income (Expense)	**(4,683)**	(4,782)
Income Before Income Tax Expense	**13,493**	14,340
Income Tax Expense	**3,190**	4,511
Net Income	**$ 10,303**	$ 9,829

The accompanying notes are an integral part of these financial statements.

UNS GAS, INC.
STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	Years Ended December 31, 2018	2017
Cash Flows from Operating Activities		
Net Income	$ **10,303**	$ 9,829
Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:		
Depreciation Expense	**11,537**	11,082
Amortization Expense	**(953)**	(757)
Amortization of Debt Issuance Costs	**90**	89
Deferred Income Taxes	**1,336**	4,256
Pension and Other Postretirement Benefits Expense	**1,016**	1,098
Pension and Other Postretirement Benefits Funding	**(1,032)**	(1,521)
Allowance For Equity Funds Used During Construction	**(27)**	(46)
Changes in Current Assets and Current Liabilities:		
Accounts Receivable	**303**	(2,006)
Materials and Supplies	**(1,255)**	365
Income Taxes Payable Adjustment	**—**	(1,500)
Accounts Payable and Accrued Charges	**1,605**	(1,319)
Regulatory Liabilities	**(2,236)**	(2,856)
Other, Net	**(9)**	2,018
Net Cash Flows—Operating Activities	**20,678**	18,732
Cash Flows from Investing Activities		
Capital Expenditures	**(21,679)**	(23,226)
Contributions in Aid of Construction	**2,370**	3,755
Net Cash Flows—Investing Activities	**(19,309)**	(19,471)
Cash Flows from Financing Activities		
Dividend Paid to Parent	**(8,000)**	(8,000)
Other, Net	**1,403**	255
Net Cash Flows—Financing Activities	**(6,597)**	(7,745)
Net Decrease in Cash and Cash Equivalents	**(5,228)**	(8,484)
Cash and Cash Equivalents, Beginning of Period	**12,858**	21,342
Cash and Cash Equivalents, End of Period	$ **7,630**	$ 12,858

The accompanying notes are an integral part of these financial statements.

UNS GAS, INC.
BALANCE SHEETS
(Amounts in thousands, except share data)

	December 31, 2018	December 31, 2017
ASSETS		
Utility Plant		
Plant in Service	$ 371,691	$ 354,240
Construction Work in Progress	1,615	3,455
Total Utility Plant	373,306	357,695
Accumulated Depreciation and Amortization	(75,966)	(70,210)
Total Utility Plant, Net	297,340	287,485
Current Assets		
Cash and Cash Equivalents	7,630	12,858
Accounts Receivable, Net	19,140	19,581
Materials and Supplies	2,576	1,321
Regulatory Assets	2,890	3,992
Derivative Instruments	1,232	30
Other	572	631
Total Current Assets	34,040	38,413
Regulatory and Other Assets		
Regulatory Assets	8,387	10,631
Derivative Instruments	412	66
Other	455	599
Total Regulatory and Other Assets	9,254	11,296
Total Assets	$ 340,634	$ 337,194

The accompanying notes are an integral part of these financial statements.

(Continued)

UNS GAS, INC.
BALANCE SHEETS
(Amounts in thousands, except share data)

	December 31, 2018		December 31, 2017
CAPITALIZATION AND OTHER LIABILITIES			
Capitalization			
Common Stock Equity:			
Common Stock (No Par Value, 1,000 Shares Authorized, 1,000 Shares Outstanding as of December 31, 2018 and 2017)	**$ 67,978**	$	67,978
Retained Earnings	**37,043**		34,740
Total Common Stock Equity	**105,021**		102,718
Long-Term Debt, Net	**94,403**		94,361
Total Capitalization	**199,424**		197,079
Current Liabilities			
Accounts Payable	**14,321**		12,557
Accrued Taxes Other than Income Taxes	**4,371**		4,275
Accrued Employee Expenses	**1,660**		1,720
Accrued Interest	**1,791**		1,774
Regulatory Liabilities	**6,936**		8,801
Customer Deposits	**2,333**		2,445
Derivative Instruments	**3,230**		3,453
Other	**2,619**		2,703
Total Current Liabilities	**37,261**		37,728
Regulatory and Other Liabilities			
Deferred Income Taxes, Net	**30,560**		29,134
Regulatory Liabilities	**63,300**		62,680
Customer Advances for Construction	**4,863**		3,600
Pension and Other Postretirement Benefits	**3,790**		4,524
Derivative Instruments	**1,436**		2,449
Total Regulatory and Other Liabilities	**103,949**		102,387
Commitments and Contingencies			
Total Capitalization and Other Liabilities	**$ 340,634**	$	337,194

The accompanying notes are an integral part of these financial statements.

(Concluded)

UNS GAS, INC.
STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY
(Amounts in thousands)

	Common Stock	Retained Earnings	Total Stockholder's Equity
Balances as of December 31, 2016	**$ 67,978**	**$ 32,911**	**$ 100,889**
Net Income		9,829	9,829
Dividend Declared to Parent		(8,000)	(8,000)
Balances as of December 31, 2017	**$ 67,978**	**$ 34,740**	**$ 102,718**
Net Income		10,303	10,303
Dividend Declared to Parent		(8,000)	(8,000)
Balances as of December 31, 2018	**$ 67,978**	**$ 37,043**	**$ 105,021**

The accompanying notes are an integral part of these financial statements.

NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

UNS Gas, Inc. (UNS Gas) is a regulated natural gas distribution company which services approximately 158,000 retail customers in Mohave, Yavapai, Coconino, and Santa Cruz counties in Arizona. UNS Gas is a wholly owned subsidiary of UniSource Energy Services, Inc. (UES), an intermediate holding company that is wholly owned by UNS Energy Corporation (UNS Energy). UNS Energy, a utility services holding company, is an indirect wholly owned subsidiary of Fortis Inc. (Fortis).

BASIS OF PRESENTATION

UNS Gas' financial statements and disclosures are presented in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America, including specific accounting guidance for regulated operations.

Certain amounts from prior periods have been reclassified to conform to the current year presentation. Most notably, UNS Gas combined captions on the Statements of Income by reclassifying similar line items into a single line item as follows:

	As Filed	Amount Reclassified	As Reclassified
(in thousands)	Year Ended December 31, 2017		
Other Income (Deductions)			
Interest Income	$ 93	$ (93)	$ —
Other Income	46	(46)	—
Other Expense	(225)	225	—
Allowance For Equity Funds	—	46	46
Other, Net	—	(132)	(132)
Interest Expense			
Long-Term Debt	4,584	(4,584)	—
Other Interest Expense	134	(134)	—
Interest Capitalized	(22)	22	—
Allowance For Borrowed Funds	—	(22)	(22)
Interest Expense	—	4,718	4,718

Accounting for Regulated Operations

UNS Gas applies accounting standards that recognize the economic effects of rate regulation. As a result, UNS Gas capitalizes certain costs that would be recorded as expense or in Accumulated Other Comprehensive Income (AOCI) by unregulated companies. Regulatory assets represent incurred costs that have been deferred because they are probable of future recovery in rates designed to allow a regulated utility recovery of its costs of providing services and an opportunity to earn a reasonable return on its investment (Retail Rates) charged to retail customers or in rates charged to wholesale customers through transmission tariffs. Regulatory liabilities generally represent expected future costs that have already been collected from customers or amounts that are expected to be returned to customers through billing reductions in future periods.

Estimates of recovering deferred costs and returning deferred credits are based on specific ratemaking decisions or precedent for each item. Regulatory assets and liabilities are amortized consistent with the treatment in the rate setting process. UNS Gas evaluates regulatory assets and liabilities each period and believes future recovery or settlement is probable. If future recovery of costs ceases to be probable, the assets would be written off as a charge to current period earnings or AOCI. See Note 2 for additional information regarding regulatory matters.

UNS Gas applies regulatory accounting as the following conditions exist:

- An independent regulator sets rates;
- The regulator sets the rates to recover the specific enterprise's costs of providing service; and
- Rates are set at levels that will recover the entity's costs and can be charged to and collected from ratepayers.

NEW ACCOUNTING STANDARDS ISSUED AND ADOPTED

The following new authoritative accounting guidance issued by the Financial Accounting Standards Board (FASB) has been adopted as of January 1, 2018. Unless otherwise indicated, adoption of the new guidance in each instance had an insignificant impact on UNS Gas' financial position, results of operations, cash flows, and disclosures.

Revenue from Contracts with Customers

UNS Gas early adopted accounting guidance that requires recognition of revenue when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the company expects to be entitled. The Company continues to recognize revenue for tariff-based sales to retail customers, which represent UNS Gas' primary source of revenue, as gas is delivered. UNS Gas adopted the new guidance using the modified retrospective approach. There was no adjustment identified or recorded to the opening balance of retained earnings on adoption. The Company applied the new revenue guidance to contracts with customers that were not completed at the date of initial application, January 1, 2018. The new guidance requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. See Note 4 for additional disclosure related to UNS Gas' operating revenues.

Compensation—Retirement Benefits

UNS Gas early adopted accounting guidance that requires an employer to disaggregate the service cost component from the other components of net periodic benefit cost. UNS Gas no longer capitalizes the non-service cost components of net periodic benefit cost as part of inventory or plant in service and presents non-service costs in Other, Net on the Statements of Income.

Derivatives and Hedging

UNS Gas early adopted accounting guidance that simplifies the application of hedge accounting through changes to both the designation and measurement guidance and is intended to enable the Company to better portray the economics of its risk management activities in its financial statements.

NEW ACCOUNTING STANDARDS ISSUED AND NOT YET ADOPTED

The following new authoritative accounting guidance issued by the FASB has not yet been adopted and reflected in UNS Gas' financial statements as of December 31, 2018. Unless otherwise indicated, UNS Gas is currently assessing the impacts such guidance may have (which could be material) on UNS Gas' financial position, results of operations, cash flows, and disclosures, as well as the potential to early adopt where applicable. Updates not listed below were assessed and either determined to not be applicable or are expected to have an insignificant impact on UNS Gas' financial position, results of operations, cash flows, and disclosures.

Leases

In February 2016, the FASB issued an Accounting Standard Update (ASU) that requires lessees to recognize a lease liability, initially measured at the present value of future lease payments, and a right-of-use asset for all leases with a lease term greater than 12 months. The new lease standard also requires additional quantitative and qualitative disclosures for both lessees and lessors. The standard is effective for periods beginning January 1, 2020, and may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as an adjustment to retained earnings as of the date of initial application. UNS Gas early adopted this ASU on January 1, 2019, applied the transition provisions of the new standard as of the adoption date, and will not retrospectively adjust prior periods.

UNS Gas elected a package of practical expedients that allowed it to not reassess: (i) whether existing contracts are or contain a lease; (ii) the lease classification of existing leases; or (iii) the initial direct costs for existing leases. In addition, UNS Gas elected a practical expedient that permitted entities to not evaluate existing land easements that were not previously accounted for as leases. The new lease guidance will be applied on a prospective basis to all new or modified land easements after January 1, 2019.

UNS Gas' leasing activities accounted for as operating leases relate to office facilities. Adoption of the ASU resulted in recognition of additional right-of-use assets and lease liabilities of approximately $2.5 million. The Company does not expect the new ASU to affect its results of operations or cash flows.

During the implementation process, UNS Gas planned modifications to its processes and control activities related to gathering contracts and contract review requirements associated with accounting for leases.

Internal-Use Software

In August 2018, the FASB issued an ASU that clarifies accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. Under the new guidance, customers apply the same criteria for capitalizing implementation costs as they would for an arrangement that has a software license. The ASU also provides specific requirements for the classification and presentation of the capitalized implementation costs and the related amortization of those costs. The standard is effective for periods beginning January 1, 2020, and should be applied either retrospectively or prospectively after the date of adoption. UNS Gas early adopted this ASU prospectively effective January 1, 2019.

USE OF ACCOUNTING ESTIMATES

Management uses estimates and assumptions when preparing financial statements according to GAAP. These estimates and assumptions affect:

- assets and liabilities in the balance sheet at the dates of the financial statements;
- disclosures about contingent assets and liabilities at the dates of the financial statements; and
- revenues and expenses in the income statement during the periods presented.

Because these estimates involve judgments based upon management's evaluation of relevant facts and circumstances, actual results may differ from these estimates.

Contingencies

Reserves for specific legal proceedings are established when the likelihood of an unfavorable outcome is probable and the amount of loss can be reasonably estimated. Significant judgment is required in predicting the outcome of these suits and claims, many of which take years to complete. UNS Gas identifies certain other legal matters where the Company believes an unfavorable outcome is reasonably possible or no estimate of possible losses can be made. All contingencies are regularly reviewed to determine whether the likelihood of loss has changed and to assess whether a reasonable estimate of the loss or range of loss can be made.

CASH AND CASH EQUIVALENTS

UNS Gas considers all highly liquid investments with a remaining maturity of three months or less at acquisition to be cash equivalents.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

UNS Gas records an allowance for doubtful accounts to reduce accounts receivable for amounts estimated to be uncollectible. The allowance is determined based on historical bad debt patterns, retail sales, and economic conditions. Accounts receivable are charged-off in the period in which the receivable is deemed uncollectible.

INVENTORY

UNS Gas values materials, supplies, and fuel inventory at the lower of weighted average cost and net realizable value. Materials and supplies consist of generation, transmission, and distribution construction and repair materials. The majority of UNS Gas' inventory will be recovered in rates charged to ratepayers. Handling and procurement costs (such as labor, overhead costs, and transportation costs) are capitalized as part of the cost of the inventory.

UTILITY PLANT

Utility plant includes the business property and equipment that supports natural gas services, consisting primarily of transmission and distribution facilities. Utility plant is reported at original cost. Original cost includes materials and labor, contractor services, construction overhead (when applicable), and an Allowance for Funds Used During Construction (AFUDC), less contributions in aid of construction.

The cost of repairs and maintenance are expensed to Operations and Maintenance Expense on the Statements of Income as costs are incurred.

When UNS Gas retires a unit of regulated property, accumulated depreciation is reduced by the original cost plus removal costs less any salvage value. There is no impact to the income statement.

AFUDC and Capitalized Interest

AFUDC reflects the cost of debt and equity funds used to finance construction and is capitalized as part of the cost of regulated utility plant. AFUDC amounts are capitalized and amortized through depreciation expense as a recoverable cost in Retail Rates. The capitalized interest that relates to debt is recorded in Allowance For Borrowed Funds on the Statements of Income. The capitalized cost for equity funds is recorded in Allowance For Equity Funds on the Statements of Income.

The average AFUDC rates on regulated construction expenditures are included in the table below:

	2018	2017
Average AFUDC Rates	6.58%	7.43%

Depreciation

Depreciation is recorded for owned utility plant on a group method straight-line basis at depreciation rates based on the economic lives of the assets. See Note 3 for additional information regarding utility plant. The ACC approves all depreciation rates. Depreciation rates are based on average useful lives and include estimates for salvage value and removal costs.

Below are the summarized average annual depreciation rates for all utility plant:

	2018	2017
Average Annual Depreciation Rates	2.60%	2.64%

Computer Software and Cloud Computing Costs

Costs incurred to purchase and develop internal use computer software and cloud computing arrangements that include a software license are capitalized and amortized over the estimated economic life of the product. If the associated software is no longer useful or impaired, the carrying value is reduced and recorded as an expense on the income statement.

EVALUATION OF ASSETS FOR IMPAIRMENT

Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that an asset's carrying amount may not be recoverable. If estimated future undiscounted cash flows are less than the carrying amount, the Company estimates the fair value and records an impairment for the amount by which the carrying value exceeds the fair value. For these estimates, UNS Gas may consider data from multiple valuation methods, including data from market participants. The Company exercises judgment to: (i) estimate the future cash flows and the useful lives of long-lived assets; and (ii) determine the Company's intent to use the assets. UNS Gas' intent to use or dispose of assets is subject to re-evaluation and can change over time.

DEFERRED FINANCING COSTS

Costs to issue debt are deferred and amortized to interest expense on a straight-line basis over the life of the debt. Deferred debt issuance costs are presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability. These costs include underwriters' commissions, discounts or premiums, and other costs such as legal, accounting, regulatory fees, and printing costs.

UNS Gas accounts for debt issuance costs related to credit facility arrangements as an asset.

The gains and losses on reacquired debt associated with regulated operations are deferred and amortized to interest expense over the remaining life of the original debt.

OPERATING REVENUES

UNS Gas earns the majority of its revenues from the sale of natural gas to retail customers based on regulator-approved tariff rates. Most of the Company's contracts have a single performance obligation, the delivery of gas. UNS Gas satisfies the performance obligation over time as gas is delivered and control is transferred to the customer. The Company bills for gas sales based on the reading of meters on a systematic basis throughout the month. In general, UNS Gas' contracts have payment terms of 10 to 20 days from the date the bill is rendered. UNS Gas considers any payment not received by the due date delinquent and charges the customer a late payment fee. No component of the transaction price is allocated to unsatisfied performance obligations.

UNS Gas has certain contracts with variable transaction pricing that require it to estimate the resulting variable consideration, the Company estimates the variable consideration at the most likely amount to which the Company expects to be entitled and recognizes a refund liability until UNS Gas is certain that the Company will be entitled to the consideration. The Company includes estimated amounts of variable consideration in the transaction price to the extent it is probable that changes in its estimate will not result in significant reversals of revenue in subsequent periods. See Note 4 for the disaggregation of UNS Gas' Operating Revenues.

PURCHASED GAS ADJUSTMENT CLAUSE

UNS Gas recovers actual gas costs incurred through a Purchased Gas Adjustor (PGA) mechanism that adjusts monthly. Gas cost over-recoveries are deferred as regulatory liabilities and cost under-recoveries are deferred as regulatory assets. See Note 2 for additional information regarding regulatory matters.

ENERGY EFFICIENCY PROGRAMS

UNS Gas is required to implement cost-effective Demand Side Management (DSM) programs to comply with the ACC's Energy Efficiency Standards (EE Standards). The EE Standards provide regulated utilities a DSM surcharge to recover from retail customers the costs to implement DSM programs. The EE Standards require increasing annual targeted retail therm savings equal to 6% by 2020.

The DSM surcharges collected above or below the costs incurred to implement the plans are deferred and reflected in the balance sheet as a regulatory liability or asset. UNS Gas recognizes DSM surcharge revenue in Operating Revenues on the Statements of Income in amounts necessary to offset recognized qualifying expenditures.

TAXES OTHER THAN INCOME TAXES

UNS Gas acts as a conduit or collection agent for sales taxes, utility taxes, franchise fees, and regulatory assessments. Trade receivables are recorded as the Company bills customers for these taxes and assessments. Simultaneously, liabilities payable to governmental agencies are recorded in the balance sheet for these taxes and assessments. These amounts are not reflected in the income statement.

INCOME TAXES

Due to the difference between GAAP and income tax laws, many transactions are treated differently for income tax purposes than for financial statement presentation purposes. Temporary differences are accounted for by recording deferred income tax assets and liabilities on the balance sheet. These assets and liabilities are recorded using enacted income tax rates expected to be in effect when the deferred tax assets and liabilities are realized or settled. UNS Gas reduces deferred tax assets by a valuation allowance when, in the opinion of management, it is more likely than not some portion, or the entire deferred income tax asset, will not be realized.

Tax benefits are recognized when it is more likely than not that a tax position will be sustained upon examination by the tax authorities based on the technical merits of the position. The tax benefit recorded is the largest amount that is more than 50% likely to be realized upon ultimate settlement with the tax authority, assuming full knowledge of the position and all relevant facts. Interest expense accruals relating to income tax obligations are recorded in Interest Expense on the Statements of Income.

UNS Gas records income tax liabilities based on its taxable income as reported in the consolidated tax return of FortisUS Inc., a Fortis intermediate holding company (FortisUS).

PENSION AND OTHER POSTRETIREMENT BENEFITS

UES sponsors a noncontributory, defined benefit pension plan for substantially all employees of UES. Benefits are based on years of service and average compensation. The Company also provides limited healthcare and life insurance benefits for retirees.

UES recognizes the underfunded status of the defined benefit pension plan as a liability in the balance sheet. The underfunded status is measured as the difference between the fair value of the pension plan's assets and the projected benefit obligation for the pension plan. UES recognizes a regulatory asset to the extent these future costs are probable of recovery in the rates charged to retail customers. The Company expects recovery of these costs over the estimated service lives of employees.

Pension and other postretirement benefit expenses are determined by actuarial valuations based on assumptions that the Company evaluates annually. See Note 9 for additional information regarding the employee benefit plan.

FAIR VALUE

As defined under GAAP, fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants in the principal market or in the most advantageous market when no principal market exists. Adjustments to transaction prices or quoted market prices may be required in illiquid or disorderly markets in order to estimate fair value. Different valuation techniques may be appropriate under the circumstances to determine the value that would be received to sell an asset or paid to transfer a liability in an orderly transaction. Market participants are assumed to be independent, knowledgeable, able and willing to transact an exchange, and not under duress. Nonperformance or credit risk is considered in determining fair value. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized in a current or future market exchange. See Note 11 for additional information regarding fair value.

DERIVATIVE INSTRUMENTS

The Company uses various physical and financial derivative instruments, including forward contracts, financial swaps, and call and put options, to: (i) meet forecasted load and reserve requirements; (ii) reduce exposure to energy commodity price volatility; and (iii) hedge interest rate risk exposure. Derivative instruments that do not meet the normal purchase or normal sale scope exception are recognized as either assets or liabilities on the balance sheet and are measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

Commodity derivatives used in normal business operations that are settled by physical delivery, among other criteria, are eligible for, and may be designated as normal purchases or normal sales. Normal purchases or normal sales contracts are not recorded at fair value and settled amounts are recognized as cost of fuel, energy, and capacity on the income statement.

For derivatives designated as hedging contracts, UNS Gas formally assesses, at inception, whether the hedging contract is highly effective in offsetting changes in the hedged item. Also, UNS Gas formally documents hedging activity by transaction type and risk management strategy.

For derivatives not designated as hedging contracts, the settled amount is generally included in regulated rates. Accordingly, the net unrealized gains and losses associated with interim price movements on contracts that are accounted for as derivatives and probable of inclusion in regulated rates are recorded as regulatory assets and liabilities. See Note 11 for additional information regarding derivative instruments.

SUBSEQUENT EVENTS

UNS Gas evaluates events or transactions that occur after the balance sheet date but before the financial statements are issued for potential recognition or disclosure in the financial statements. UNS Gas has evaluated subsequent events through February 22, 2019, the date the financial statements were issued.

NOTE 2. REGULATORY MATTERS

The ACC and the Federal Energy Regulatory Commission (FERC) each regulate portions of utility accounting practices and rates of UNS Gas. The ACC regulates rates charged to retail customers, the issuance of securities, transactions with affiliated parties, and other utility matters. The ACC also enacts other regulations and policies that can affect the Company's business decisions and accounting practices. The FERC regulates terms and prices of wholesale transport and purchases of natural gas.

2012 RATE ORDER

In April 2012, the ACC approved a base rate increase of $2.7 million over adjusted test year revenues (2012 Rate Order). The ACC approved an authorized rate of return of 8.27% on original cost rate base, which included a cost of equity component of 9.75% and a cost of debt component of 6.74%. The new rates became effective in May 2012.

FEDERAL TAX LEGISLATION

In December 2017, the ACC opened a docket requesting that all regulated utilities submit proposals to address passing the benefits of the Tax Cuts and Jobs Act (TCJA) through to customers. In 2018, the ACC approved the proposal submitted by UNS Gas effective June 1, 2018 (ACC Refund Order). The refund represents the reduction in the federal corporate income tax rate and an estimate of Excess Deferred Income Tax (EDIT) amortization trued-up annually for actuals. The refund amount, after the EDIT amortization true-up, totaled $2.9 million. The 2018 bill credit was designed to return the refund amount to customers based on forecasted therm sales for the calendar year 2018. Any under or over collected amounts are deferred to a regulatory asset or liability and will be used to adjust the 2019 bill credit amounts.

The table below summarizes the regulatory asset (liability) balance related to the ACC Refund Order:

(in thousands)	Year Ended December 31, 2018
Beginning of Period	$ —
ACC Approved Refund (Reduction in Operating Revenues)	(2,859)
Amount Returned to Customers Through Bill Credits	3,354
End of Period	$ 495

Customer bill credits are trued-up annually to reflect actuals for therm sales and EDIT amortization. UNS Gas filed an application with the ACC to establish the 2019 customer refund of $2.9 million. The refund will be returned to customers through a combination of a customer bill credit and a regulatory liability in 2019.

See Note 12 for additional information regarding the TCJA.

COST RECOVERY MECHANISMS

UNS Gas has received regulatory decisions that allow for more timely recovery of certain costs through the recovery mechanisms described below.

Purchased Gas Adjustor

The PGA mechanism allows UNS Gas to adjust Retail Rates to recover fluctuations in natural gas costs. UNS Gas records deferrals for recovery or refund to the extent actual natural gas costs vary from the PGA rate. The PGA rate reflects a weighted, 12-month rolling average of the natural gas costs incurred by UNS Gas. The PGA rate automatically adjusts monthly, but is restricted from rising or falling more than $0.15 per therm in a 12-month period. UNS Gas is required to request a credit adjustment if the PGA balance is over-collected by $10.0 million or more.

The table below summarizes the PGA regulatory asset (liability) balance:

(in thousands)	Years Ended December 31, 2018	2017
Beginning of Period	$ (6,688)	$ (8,157)
Deferred Purchased Gas Costs	45,183	47,035
PGA Refunds (Recoveries) [1]	(44,351)	(45,566)
End of Period	$ (5,856)	$ (6,688)

[1] In October 2018, the ACC approved a PGA credit effective November 1, 2018 to April 30, 2019.

Energy Efficiency Standards

Under the EE Standards, the ACC requires gas utilities to implement cost-effective programs to reduce customers' energy consumption. The EE Standards require increasing cumulative annual targeted retail therm savings equal to 6% by 2020. UNS Gas is required to implement cost-effective DSM programs to comply with the ACC's EE Standards. The EE Standards provide regulated utilities a DSM surcharge to recover from retail customers the costs to implement DSM programs.

Lost Fixed Cost Recovery Mechanism

The Lost Fixed Cost Recovery (LFCR) mechanism provides for recovery of certain non-fuel costs that would go unrecovered due to reduced retail therm sales as a result of implementing ACC-approved energy efficiency programs. UNS Gas records a regulatory asset and recognizes LFCR revenues when the amounts are verifiable regardless of when the lost retail therm sales occur. UNS Gas is required to make an annual filing with the ACC requesting recovery of the LFCR revenues recognized in the prior year. The recovery is subject to a year-over-year cap of 1% of UNS Gas' applicable retail revenues.

UNS Gas recorded regulatory assets and recognized LFCR revenues of $0.1 million in 2018 and 2017. LFCR revenues are included in Operating Revenues on the Statements of Income.

REGULATORY ASSETS AND LIABILITIES

Regulatory assets and liabilities recorded in the balance sheet are summarized in the table below:

(in thousands)	December 31, 2018	2017
Regulatory Assets		
Pension and Other Postretirement Benefits (Note 9)	$ 4,423	$ 5,146
Derivatives (Note 11)	3,066	5,807
Income Taxes Recoverable through Future Rates [1]	2,936	3,382
Other Regulatory Assets	852	288
Total Regulatory Assets	11,277	14,623
Less Current Portion	2,890	3,992
Total Non-Current Regulatory Assets	$ 8,387	$ 10,631
Regulatory Liabilities		
Net Cost of Removal [2]	$ 34,145	$ 32,618
Income Taxes Payable through Future Rates [1]	29,556	30,090
Purchased Gas Adjustor	5,856	6,688
Other Regulatory Liabilities	679	2,085
Total Regulatory Liabilities	70,236	71,481
Less Current Portion	6,936	8,801
Total Non-Current Regulatory Liabilities	$ 63,300	$ 62,680

(1) Amortized over the life of the assets. The balances include changes related to the revaluation of tax assets and liabilities as a result of the TCJA. See Note 1 and Note 12 for additional information regarding income taxes.

(2) Represents an estimate of the future cost of retirement net of salvage value. These are amounts collected through revenue for transmission and distribution plant, and general and intangible plant which are not yet expended.

Regulatory assets are either being collected or are expected to be collected through Retail Rates. UNS Gas does not earn a return on regulatory assets. Regulatory liabilities represent items that UNS Gas either expects to pay to customers through billing reductions in future periods or plans to use for the purpose for which they were collected from customers. With the exception of over-recovered PGA costs and Income Taxes Payable through Future Rates related to the EDIT balances, UNS Gas does not pay a return on regulatory liabilities.

IMPACTS OF REGULATORY ACCOUNTING

If UNS Gas determines that it no longer meets the criteria for continued application of regulatory accounting, UNS Gas would be required to write off its regulatory assets and liabilities related to those operations not meeting the regulatory accounting requirements. Discontinuation of regulatory accounting could have a material impact on UNS Gas' financial statements.

NOTE 3. UTILITY PLANT

The following table shows Plant in Service on the Balance Sheets by major class:

($ in thousands)	Annual Depreciation Rate [1]	Average Remaining Life in Years [1]	December 31, 2018	December 31, 2017
Plant in Service				
Distribution Plant	2.37%	48	$ 326,913	$ 310,094
Transmission Plant	1.54%	35	17,542	17,542
General Plant	4.38%	1	26,844	25,178
Intangible Plant, Software Costs, and Other [2]	Various	Various	58	1,092
Plant Held for Future Use	—	—	334	334
Total Plant in Service [3]			$ 371,691	$ 354,240

[1] Represents a composite of the depreciation rates of assets within each major class of gas plant and is based on the 2011 depreciation study available for the major classes of Plant in Service.

[2] Primarily represents miscellaneous intangible assets which are amortized over an average life of either 15 or 25 years.

[3] Includes plant acquisition adjustments of $(48.3) million as of December 31, 2018 and 2017.

NOTE 4. REVENUE

UNS Gas earns the majority of its revenues from the sale of gas to retail customers based on regulator-approved tariff rates. Most of the Company's contracts have a single performance obligation, the delivery of gas.

DISAGGREGATION OF REVENUES

The following table presents the disaggregation of UNS Gas' Operating Revenues on the Statements of Income by type of service:

(in thousands)	Years Ended December 31, 2018	Years Ended December 31, 2017
Retail	$ 108,379	$ 110,296
Other Services	1,805	1,829
Revenues from Contracts with Customers	110,184	112,125
Alternative Revenues	133	120
Other	3,048	1,868
Total Operating Revenues	$ 113,365	$ 114,113

Retail Revenues

UNS Gas' tariff-based sales to residential, commercial, and industrial customers are regulated by the ACC and recognized when gas is delivered at the amount of consideration that the Company expects to receive in exchange. Retail revenues include an estimate for unbilled revenues from service that has been provided but not billed by the end of an accounting period. At the end of the month, amounts of natural gas delivered since the last meter reading are estimated and the corresponding unbilled revenue is calculated using anticipated Retail Rates. Unbilled revenues are dependent upon a number of factors that require management's judgment including estimates of retail sales, customer usage patterns, and pricing. Once the usage is estimated, UNS Gas applies the anticipated rate and records revenue. Unbilled revenues primarily increase during the fall and winter months and decrease during the spring and summer months due to the seasonal fluctuations of UNS Gas' actual load. The timing of revenue recognition, billings, and cash collections results in billed and unbilled accounts receivable balances on the balance sheet. See Note 5 for components of Accounts Receivable, Net on the Balance Sheets.

In January 2018, UNS Gas began to recognize a provision for revenues subject to refund, which reduced operating revenues, and a current regulatory liability for savings expected to be returned to customers from the Company's federal income tax reduction under the TCJA. In May 2018, the ACC approved the ACC Refund Order effective June 1, 2018. As a result of the

ACC Refund Order, the Company returned tax savings to customers through a bill credit. See Note 2 for more information regarding the ACC Refund Order.

Other Services Revenues

Other Services Revenues primarily includes miscellaneous service connection fees.

Alternative Revenues

Alternative revenue programs allow utilities to adjust future rates in response to past activities or completed events if certain criteria are met. UNS Gas charges customers the ACC-authorized tariff price plus separate ACC-authorized surcharges. UNS Gas has identified its LFCR mechanism and DSM performance incentive as alternative revenues. The LFCR mechanism provides for recovery of certain non-fuel costs that would go unrecovered due to reduced therm sales as a result of implementing ACC-approved energy efficiency programs. The LFCR surcharge is assessed as a percentage of the customer's bill. Revenue recognition related to the LFCR mechanism creates a regulatory asset until such time as the revenue is collected. For recovery of the LFCR regulatory asset, UNS Gas is required to file an annual LFCR adjustment request with the ACC for the LFCR revenues recognized in the prior year. The recovery is subject to a year-over-year cap of applicable retail revenues of 1%. See Note 2 for additional information regarding these cost recovery mechanisms.

Other Revenues

Other Revenues primarily includes resale and derivative revenue. See Note 11 for information regarding derivative instruments.

NOTE 5. ACCOUNTS RECEIVABLE

The following table presents the components of Accounts Receivable, Net on the Balance Sheets:

	December 31,	
(in thousands)	2018	2017
Customer	$ 8,735	$ 8,739
Customer, Unbilled	9,638	9,875
Due from Affiliates (Note 6)	1,165	1,370
Allowance for Doubtful Accounts	(398)	(403)
Accounts Receivable, Net	$ 19,140	$ 19,581

NOTE 6. RELATED PARTY TRANSACTIONS

UNS Gas engages in various transactions with Fortis, UNS Energy, and affiliated subsidiaries of UNS Energy including Tucson Electric Power Company (TEP), UNS Electric, Inc. (UNS Electric), and Southwest Energy Solutions, Inc. (SES) (collectively UNS Energy Affiliates). These transactions include: (i) the sale and purchase of natural gas and transportation services; (ii) common cost allocations; and (iii) the provision of corporate and other labor related services.

The following table presents the components of related party balances included in Accounts Receivable, Net and Accounts Payable on the Balance Sheets:

	December 31,	
(in thousands)	2018	2017
Receivables from Related Parties		
UNS Electric	$ 422	$ 236
TEP	741	153
UNS Energy	2	981
Total Due from Related Parties	$ 1,165	$ 1,370
Payables to Related Parties		
UNS Energy	$ 540	$ 17
TEP	1,352	1,565
UNS Electric	157	184
SES	35	3
Total Due to Related Parties	$ 2,084	$ 1,769

The following table presents the components of related party transactions included in the Statements of Income:

	Years Ended December 31,	
(in thousands)	2018	2017
Goods and Services Provided by UNS Gas to Affiliates		
Sale and Transportation of Gas, UNS Electric (1)	$ 3,688	$ 3,607
Capacity Charges, TEP (2)	588	39
Capacity Charges, UNS Electric (2)	196	—
Corporate Services, UNS Energy Affiliates (3)	837	84
Goods and Services Provided by Affiliates to UNS Gas		
Common Costs, TEP (4)	8,535	7,968
Supplemental Workforce, SES (5)	111	26
Corporate Services, UNS Energy (6)	1,209	1,131
Corporate Services, UNS Energy Affiliates (3)	4,075	4,007
Corporate Services, Fortis Affiliates (7)	5	—

(1) UNS Gas charges UNS Electric for natural gas and transportation to Black Mountain Generating Station (BMGS). See Note 8 for details of costs related to the agreements.

(2) UNS Gas charges TEP and UNS Gas for natural gas capacity used to supply BMGS.

(3) Costs for corporate and other administrative services between UNS Energy Affiliates are directly assigned to the benefiting entity at a fully burdened cost when possible.

(4) Common costs (information systems, facilities, etc.) are allocated on a cost-causative basis. The method of allocation is deemed reasonable by management and is reviewed by the ACC as part of the rate case process.

(5) SES provides supplemental workforce and meter-reading services to UNS Gas based on related party service agreements. The charges are based on cost of services performed and deemed reasonable by management.

(6) Costs for corporate services at UNS Energy are allocated to its subsidiaries using the Massachusetts Formula, an industry accepted method of allocating common costs to affiliated entities. UNS Gas' allocation is approximately 7% of UNS Energy's allocated costs. Corporate Services, UNS Energy includes legal, audit, and Fortis management fees.

(7) Fortis affiliates provide non-tariffed goods and services to UNS Energy Affiliates at the higher of fully burdened cost or fair market value.

SHARE-BASED COMPENSATION

2015 Share Unit Plan

The Human Resources and Governance Committee (Committee) of UNS Energy approved and UNS Energy's Board of Directors ratified the 2015 Share Unit Plan (Plan) effective January 2015. Under the Plan, key employees, including executive officers of UNS Energy and its subsidiaries, may be granted long-term incentive awards of performance-based share units (PSUs) and time-based restricted share units (RSUs) annually. Each PSU and RSU granted is valued based on one share of Fortis common stock traded on the Toronto Stock Exchange, converted to U.S. dollars. UNS Energy allocates the obligation and expense for this plan to its subsidiaries based on the Massachusetts Formula.

The following table represents PSUs and RSUs awarded by UNS Energy:

	2018	2017
PSUs	54,426	68,126
RSUs	27,213	34,063

The awards are classified as liability awards based on the cash settlement feature. Liability awards are measured at their fair value at the end of each reporting period and will fluctuate based on the price of Fortis' common stock as well as the level of achievement of the financial performance criteria. The awards are payable on the third anniversary of the grant date. UNS Gas' allocated share of probable payout was $0.7 million as of December 31, 2018 and 2017.

UNS Gas' allocated portion of compensation expense is recognized in Operations and Maintenance Expense on the Statements of Income. Compensation expense associated with unvested PSUs and RSUs is recognized on a straight-line basis over the minimum required service period in an amount equal to the fair value on the measurement date or each reporting period. UNS Gas recorded $0.2 million and $0.3 million in 2018 and 2017, respectively, based on its share of UNS Energy's compensation expense.

NOTE 7. DEBT AND CREDIT FACILITY

DEBT

Long-term debt matures more than one year from the date of the financial statements. The following table presents the components of Long-Term Debt, Net on the Balance Sheets:

($ in thousands)	Interest Rate	Maturity Date	December 31, 2018	December 31, 2017
Notes				
2011 Senior Notes	5.39%	2026	$ 50,000	$ 50,000
2015 Senior Notes	4.00%	2045	45,000	45,000
Total Long-Term Debt [1]			95,000	95,000
Less Debt Issuance Costs			597	639
Total Long-Term Debt, Net			$ 94,403	$ 94,361

(1) As of December 31, 2018, all of UNS Gas' debt is unsecured.

CREDIT FACILITY

The unsecured credit agreement shared by UNS Gas and UNS Electric with a maturity date of October 2022 included in Current Liabilities on the Balance Sheets consists of the following:

(in thousands)	Capacity	Sub-Limit LOC	Borrowed	Available	Weighted Average Interest Rate	Pricing [(2)]
	December 31, 2018					
Credit Facility [(1)]	$ 100	$ 50	$ —	$ 100	—%	LIBOR + 1.000% or ABR + 0.00%
(in thousands)	December 31, 2017					
Credit Facility [(1)]	$ 100	$ 50	$ —	$ 100	—%	LIBOR + 1.000% or ABR + 0.00%

(1) The maximum borrowings outstanding at any one time for UNS Gas or UNS Electric under their shared agreement may not exceed 80% of the aggregate of the commitments and each is liable for only their own individual borrowings.

(2) Interest rates and fees under the credit facilities are based on a pricing grid tied to the respective entity's credit ratings.

UNS Gas expects that amounts borrowed under the credit agreements will be used for working capital and other general corporate purposes. The Company will issue LOCs from time to time to support energy procurement and hedging transactions.

NOTE 8. COMMITMENTS AND CONTINGENCIES

COMMITMENTS

As of December 31, 2018, UNS Gas had the following unconditional, minimum purchase obligations and operating leases:

(in thousands)	2019	2020	2021	2022	2023	Thereafter	Total
Fuel, Including Transportation	$ 15,514	$ 15,913	$ 15,585	$ 15,564	$ 12,212	$ 7,595	$ 82,383
Operating Leases [(1)]	571	512	529	518	402	167	$ 2,699
Land Easements and Rights-of-Ways [(2)]	91	16	37	47	45	2,305	2,541
Total Purchase Commitments	$ 16,176	$ 16,441	$ 16,151	$ 16,129	$ 12,659	$ 10,067	$ 87,623

(1) Primarily represents leases for office facilities with varying terms, provisions, and expiration dates. UNS Gas' operating lease expense totaled $0.8 million in 2018 and 2017.

(2) Agreements contain varying terms, provisions, and expiration dates.

Fuel, Including Transportation

UNS Gas purchases natural gas from various suppliers at market prices and the costs are recoverable from customers through the PGA. UNS Gas' forward gas purchase agreements expire through the first quarter of 2021. Certain of these contracts are at a fixed price per million British thermal units (MMBtu) and others are indexed to natural gas prices. The commitment amounts included in the table are based on projected market prices as of December 31, 2018.

UNS Gas has related party agreements for natural gas supply and pipeline capacity with UNS Electric for BMGS through 2028. As of December 31, 2018, UNS Electric's commitment under these contracts totaled $10.6 million and does not reduce the balance in the table above. Natural gas is supplied as needed to meet UNS Electric's load requirements. See Note 6 for more information on UNS Gas' related party transactions.

UNS Gas has firm transportation agreements with capacity sufficient to meet its load requirements. These contracts expire in various years between 2020 and 2026 as of December 31, 2018.

CONTINGENCIES

UNS Gas is party to a variety of legal actions arising out of the normal course of business. Plaintiffs occasionally seek punitive or exemplary damages. The Company believes such normal and routine litigation will not have a material impact on its operations or consolidated financial results. UNS Gas is also involved in other kinds of legal actions, some of which assert or may assert claims or seek to impose fines, penalties, and other costs in substantial amounts on the Company.

NOTE 9. EMPLOYEE BENEFIT PLANS

PENSION BENEFIT PLAN

UNS Gas does not maintain a separate pension plan. The pension plan maintained by UES covers the majority of UNS Gas' employees. UNS Gas and UNS Electric fund the plan by contributing at least the minimum amount required under Internal Revenue Service (IRS) regulations. UES allocates net periodic benefit cost based on service cost for participating employees. UNS Gas recognizes its share of the underfunded status of the UES defined benefit pension plan as a liability in the balance sheet.

OTHER POSTRETIREMENT BENEFIT PLAN

UNS Gas provides other postretirement medical benefits for certain retirees. UNS Gas' active employees are not eligible for retiree medical benefits.

REGULATORY RECOVERY

UNS Gas records its share of changes in the pension and other postretirement defined benefit plans, not yet reflected in net periodic benefit cost, as a regulatory asset or liability, as such amounts are probable of future recovery or refund in rates charged to retail customers.

The following table presents pension and other postretirement benefit amounts (excluding tax balances) included on the balance sheet:

	Pension Benefits		Other Postretirement Benefits	
	December 31,			
(in thousands)	2018	2017	2018	2017
Regulatory Assets	$ 3,890	$ 4,640	$ 533	$ 506
Accrued Employee Expenses	—	—	(38)	(43)
Pension and Other Postretirement Benefits	(3,457)	(4,152)	(333)	(372)
Net Amount Recognized	$ 433	$ 488	$ 162	$ 91

OBLIGATIONS AND FUNDED STATUS

The Company measured the actuarial present values of all defined benefit pension and other postretirement benefit obligations as of December 31, 2018 and 2017. The table below presents the status of the UES pension plan as a whole and UES' share of the TEP other postretirement benefits plan. The plans have projected benefit obligations in excess of the fair value of plan assets for each period presented:

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,			
(in thousands)	2018	2017	2018	2017
Change in Benefit Obligation				
Beginning of Period	$ 39,339	$ 34,002	$ 817	$ 847
Actuarial Loss	(5,552)	3,635	(15)	88
Interest Cost	1,391	1,335	22	23
Service Cost	2,085	1,855	—	—
Participant Contributions	—	—	33	35
Benefits Paid	(2,900)	(1,488)	(175)	(176)
End of Period	34,363	39,339	682	817
Change in Fair Value of Plan Assets				
Beginning of Period	30,983	25,011	5	7
Actual Return on Plan Assets	(2,526)	4,561	—	—
Benefits Paid	(2,900)	(1,488)	(175)	(176)
Employer Contributions [1]	1,908	2,899	142	139
Participant Contributions	—	—	33	35
End of Period	27,465	30,983	5	5
Funded Status at End of Period	$ (6,898)	$ (8,356)	$ (677)	$ (812)

[1] UNS Gas expects to contribute $1.1 million to the pension plan in 2019.

As of December 31, 2018, UNS Gas' proportionate share of the pension plan's total funded status is approximately 50%.

The following table provides the components of UES' regulatory assets that have not been recognized as components of net periodic benefit cost as of the dates presented:

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,			
(in thousands)	2018	2017	2018	2017
Net Loss	$ 8,996	$ 10,435	$ 977	$ 993
Prior Service Benefit	—	—	(4)	(8)

The pension plan had an accumulated benefit obligation in excess of plan assets as of the dates presented:

	December 31,	
(in thousands)	2018	2017
Accumulated Benefit Obligation	$ 29,062	$ 32,931
Fair Value of Plan Assets	27,465	30,984

The Company measures service and interest costs by applying the specific spot rates along the yield curve to the plans' liability cash flows. UES' net periodic benefit plan cost includes the following components:

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,			
(in thousands)	2018	2017	2018	2017
Service Cost	$ 2,085	$ 1,855	$ —	$ —
Interest Cost	1,391	1,335	22	23
Expected Return on Plan Assets	(2,165)	(1,730)	—	—
Amortization of Prior Service Credit	—	—	(3)	(3)
Amortization of Net Loss	578	611	—	—
Net Periodic Benefit Cost	$ 1,889	$ 2,071	$ 19	$ 20
Percent recognized by UNS Gas based on relative employee participation	53%	53%	40%	41%

The non-service components of net periodic benefit cost are included in Other, Net on the Statements of Income. Approximately 30% of the 2018 service cost, and approximately 36% of the 2017 net periodic benefit cost was capitalized as a cost of construction.

The changes in plan assets and benefit obligations recognized as regulatory assets were as follows:

	Pension Benefits		Other Postretirement Benefits	
(in thousands)	2018	2017	2018	2017
Current Year Actuarial (Gain) Loss	$ (861)	$ 804	$ (15)	$ 88
Amortization of Net Loss	(578)	(611)	—	—
Amortization of Prior Service Credit	—	—	3	3
Total Recognized (Gain) Loss	$ (1,439)	$ 193	$ (12)	$ 91

UNS Gas amortizes prior service costs on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan. Estimated amortization from regulatory assets into net periodic benefit cost for UES in 2019 includes the following:

(in thousands)	Pension Benefits	Other Postretirement Benefits
Net Loss	$ 521	$ —
Prior Service Credit	—	3

Net periodic benefit cost is subject to various assumptions and determinations, such as the discount rate, the rate of compensation increase, and the expected return on plan assets. Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded in the future as net periodic benefit cost.

UNS Gas uses a combination of sources in selecting the expected long-term rate-of-return-on-assets assumption, including an investment return model. The model used provides a "best-estimate" range over 20 years from the 25th percentile to the 75th percentile. The model, used as a guideline for selecting the overall rate-of-return-on-assets assumption, is based on forward-looking return expectations only. The above method is used for all asset classes.

The following table includes the weighted average assumptions used to determine benefit obligations:

	Pension Benefits		Other Postretirement Benefits	
	2018	2017	2018	2017
Discount Rate	4.5%	3.8%	4.3%	3.6%
Rate of Compensation Increase	2.8%	2.8%	N/A	N/A

The following table includes the weighted average assumptions used to determine net periodic benefit costs:

	Pension Benefits		Other Postretirement Benefits	
	2018	2017	2018	2017
Discount Rate, Service Cost	3.8%	4.4%	3.8%	4.3%
Discount Rate, Interest Cost	3.6%	4.0%	3.2%	3.3%
Rate of Compensation Increase	2.8%	2.8%	N/A	N/A
Expected Return on Plan Assets	7.0%	7.0%	N/A	N/A

Healthcare cost trend rates are assumed to decrease gradually from next year to the year the ultimate rate is reached:

	December 31,	
	2018	2017
Next Year (Pre-65)	6.5%	6.5%
Next Year (Post-65)	7.8%	7.6%
Ultimate Rate Assumed (Pre-65 and Post-65)	4.5%	4.5%
Year Ultimate Rate is Reached (Pre-65)	2037	2037
Year Ultimate Rate is Reached (Post-65)	2037	2036

Assumed healthcare cost trend rates significantly affect the amounts reported for healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would not significantly change the benefit cost or obligation as of December 31, 2018.

PENSION PLAN ASSETS

UES calculates the fair value of plan assets on December 31, the measurement date. Pension plan asset allocations, by asset category, on the measurement date were as follows:

	December 31,	
	2018	2017
Asset Category		
Equity Securities	54%	55%
Fixed Income Securities	42%	41%
Real Estate	4%	4%
Total	100%	100%

The following tables present the fair value measurements of UES' pension plan assets by level within the fair value hierarchy:

(in thousands)	Level 1	Level 2	Total
		December 31, 2018	
Asset Category			
Cash Equivalents	$ 26	$ —	$ 26
Equity Securities			
United States Large Cap	—	3,959	3,959
United States Small Cap	—	1,366	1,366
Non-United States	—	5,895	5,895
Global	—	3,564	3,564
Fixed Income	—	11,581	11,581
Real Estate	—	1,074	1,074
Total	$ 26	$ 27,439	$ 27,465

(in thousands)		December 31, 2017	
Asset Category			
Cash Equivalents	$ 19	$ —	$ 19
Equity Securities			
United States Large Cap	—	5,775	5,775
United States Small Cap	—	1,598	1,598
Non-United States	—	6,741	6,741
Global	—	2,791	2,791
Fixed Income	—	12,818	12,818
Real Estate	—	1,241	1,241
Total	$ 19	$ 30,964	$ 30,983

- Level 1 cash equivalents are based on observable market prices and are comprised of the fair value of commercial paper, money market funds, and certificates of deposit.
- Level 2 investments comprise amounts held in commingled equity funds, United States bond funds, and real estate funds. Valuations are based on active market quoted prices for assets held by each respective fund.

Pension Plan Investments

Investment Goals

Asset allocation is the principal method for achieving each pension plan's investment objectives while maintaining appropriate levels of risk. UNS Gas considers the projected impact on benefit security of any proposed changes to the current asset allocation policy. The expected long-term returns and implications for pension plan sponsor funding are reviewed in selecting policies to ensure that current asset pools are projected to be adequate to meet the expected liabilities of the pension plan. UNS Gas expects to use asset allocation policies weighted most heavily to equity and fixed income funds, while maintaining some exposure to real estate and opportunistic funds. Within the fixed income allocation, long-duration funds may be used to partially hedge interest rate risk.

Risk Management

UNS Gas recognizes the difficulty of achieving investment objectives in light of the uncertainties and complexities of the investment markets. The Company recognizes some risk must be assumed to achieve a pension plan's long-term investment objectives. In establishing risk tolerances, the following factors affecting risk tolerance and risk objectives will be considered: (i) plan status; (ii) plan sponsor financial status and profitability; (iii) plan features; and (iv) workforce characteristics. UNS Gas determined that the pension plan can tolerate some interim fluctuations in market value and rates of return in order to achieve long-term objectives. UNS Gas tracks the pension plan's portfolio relative to the benchmark through quarterly investment reviews. The reviews consist of a performance and risk assessment of all investment categories and on the portfolio as a whole. Investment managers for the pension plan may use derivative financial instruments for risk management purposes or as part of their investment strategy. Currency hedges may also be used for defensive purposes.

Relationship between Plan Assets and Benefit Obligations

The overall health of the plan will be monitored by comparing the value of plan obligations (both Accumulated Benefit Obligation and Projected Benefit Obligation) against the fair value of assets and tracking the changes in each. The frequency of this monitoring will depend on the availability of plan data, but will be no less frequent than annually via actuarial valuation.

Target Allocation Percentages

The current target allocation percentages for the major asset categories of the plan follow. The plan allows a variance of +/- 2% from targets before funds are automatically rebalanced.

	December 31, 2018
Equity Securities:	
United States Large Cap	15%
United States Small Cap	5%
Global Equity	31%
Global Infrastructure	3%
Fixed Income	42%
Real Estate	4%
Total	100%

Pension Fund Descriptions

For each type of asset category selected by the Pension Committee, UNS Gas' investment consultant assembles a group of third-party fund managers and allocates a portion of the total investment to each fund manager.

ESTIMATED FUTURE BENEFIT PAYMENTS

UES expects the following benefit payments to be made by the plans, which reflect future service, as appropriate.

(in thousands)	2019	2020	2021	2022	2023	2024-2028
Pension Benefits	$ 1,779	$ 1,986	$ 2,108	$ 2,425	$ 2,476	$ 13,014
Other Postretirement Benefits	81	78	74	70	66	263

DEFINED CONTRIBUTION PLAN

UNS Gas offers a defined contribution savings plan to all eligible employees. The plan meets the IRS required standards for 401(k) qualified plans. Participants direct the investment of contributions to certain funds in their account. The Company matches part of a participant's contributions to the plan. UNS Gas made matching contributions to the plan of $0.3 million in 2018 and 2017.

NOTE 10. SUPPLEMENTAL CASH FLOW INFORMATION

CASH TRANSACTIONS

	Years Ended December 31,	
(in thousands)	2018	2017
Interest, Net of Amounts Capitalized	$ 4,539	$ 4,536
Income Taxes	1,500	1,500

NON-CASH TRANSACTIONS

Other significant non-cash investing and financing activities that affected recognized assets and liabilities but did not result in cash receipts or payments were as follows:

	Years Ended December 31,	
(in thousands)	2018	2017
Accrued Capital Expenditures	$ 1,234	$ 1,409
Net Cost of Removal [1]	1,526	1,694

(1) Represents an accrual for future cost of retirement net of salvage values that does not impact earnings.

NOTE 11. FAIR VALUE MEASUREMENTS AND DERIVATIVE INSTRUMENTS

UNS Gas categorizes financial instruments into the three-level hierarchy based on inputs used to determine the fair value. Level 1 inputs are unadjusted quoted prices for identical assets or liabilities in an active market. Level 2 inputs include quoted prices for similar assets or liabilities, quoted prices in non-active markets, and pricing models whose inputs are observable, directly or indirectly. Level 3 inputs are unobservable and supported by little or no market activity. UNS Gas has no financial instruments categorized as Level 3. Transfers between levels are recorded at the end of a reporting period. There were no transfers between levels in the periods presented.

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE ON A RECURRING BASIS

The following tables present, by level within the fair value hierarchy, UNS Gas' assets and liabilities accounted for at fair value on a recurring basis classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Level 1	Level 2	Total
(in thousands)		December 31, 2018	
Assets			
Cash Equivalents [1]	$ 6,000	$ —	$ 6,000
Energy Derivative Contracts, Regulatory Recovery [2]	—	1,326	1,326
Energy Derivative Contracts, No Regulatory Recovery [2]	—	318	318
Total Assets	6,000	1,644	7,644
Liabilities			
Energy Derivative Contracts, Regulatory Recovery [2]	—	(4,391)	(4,391)
Energy Derivative Contracts, No Regulatory Recovery [2]	—	(275)	(275)
Total Liabilities	—	(4,666)	(4,666)
Total Assets (Liabilities), Net	$ 6,000	$ (3,022)	$ 2,978

(in thousands)		December 31, 2017	
Assets			
Cash Equivalents [1]	$ 10,000	$ —	$ 10,000
Energy Derivative Contracts, Regulatory Recovery [2]	—	96	96
Total Assets	10,000	96	10,096
Liabilities			
Energy Derivative Contracts, Regulatory Recovery [2]	—	(5,902)	(5,902)
Total Liabilities	—	(5,902)	(5,902)
Total Assets (Liabilities), Net	$ 10,000	$ (5,806)	$ 4,194

(1) Cash Equivalents represent amounts held in money market funds valued at cost, including interest, which approximates fair market value. Cash Equivalents are included in Cash and Cash Equivalents on the Balance Sheets.

(2) Energy Derivative Contracts include gas swap agreements (Level 2) entered into to reduce exposure to energy price risk, and certain customer supply contracts (Level 2). These contracts are included in Derivative Instruments on the Balance Sheets.

All energy derivative contracts, other than customer supply contracts, are subject to legally enforceable master netting arrangements to mitigate credit risk. UNS Gas presents derivatives on a gross basis in the balance sheet. The tables below present the potential offset of counterparty netting and cash collateral.

(in thousands)	Gross Amount Recognized in the Balance Sheets	Gross Amount Not Offset in the Balance Sheets: Counterparty Netting of Energy Contracts	Gross Amount Not Offset in the Balance Sheets: Cash Collateral Received/Posted	Net Amount
	December 31, 2018			
Derivative Assets				
Energy Derivative Contracts	$ 1,644	$ 1,394	$ —	$ 250
Derivative Liabilities				
Energy Derivative Contracts	(4,666)	(1,394)	—	(3,272)
(in thousands)	December 31, 2017			
Derivative Assets				
Energy Derivative Contracts	$ 96	$ 96	$ —	$ —
Derivative Liabilities				
Energy Derivative Contracts	(5,902)	(96)	—	(5,806)

DERIVATIVE INSTRUMENTS

UNS Gas enters into various derivative and non-derivative contracts to reduce exposure to energy price risk associated with its natural gas purchase requirements. The objectives for entering into such contracts include: (i) creating price stability; (ii) meeting load and reserve requirements; and (iii) reducing exposure to price volatility that may result from delayed recovery under the PGA mechanism.

The Company primarily applies the market approach for recurring fair value measurements. When UNS Gas has observable inputs for substantially the full term of the asset or liability or uses quoted prices in an inactive market, it categorizes the instrument in Level 2. UNS Gas categorizes derivatives in Level 3 when an aggregate pricing service or published prices that represent a consensus reporting of multiple brokers is used.

For natural gas prices, UNS Gas obtains quotes from brokers, major market participants, exchanges, or industry publications and relies on its own price experience from active transactions in the market. The Company primarily uses one set of quotations and then validates those prices using other sources. UNS Gas believes that the market information provided is reflective of market conditions as of the time and date indicated.

UNS Gas also considers the impact of counterparty credit risk using current and historical default and recovery rates, as well as its own credit risk using credit default swap data.

The inputs and the Company's assessments of the significance of a particular input to the fair value measurements require judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. UNS Gas reviews the assumptions underlying its price curves monthly.

Energy Derivative Contracts, Regulatory Recovery

UNS Gas enters into energy contracts that are considered derivatives and qualify for regulatory recovery. The realized gains and losses on these energy contracts are recovered through the PGA mechanism and the unrealized gains and losses are deferred as a regulatory asset or a regulatory liability. The table below presents the unrealized gains and losses recorded to a regulatory asset or a regulatory liability on the balance sheet:

(in thousands)	Years Ended December 31, 2018	Years Ended December 31, 2017
Unrealized Net Gain (Loss)	$ 2,741	$ (8,302)

Derivative Volumes

As of December 31, 2018, UNS Gas had energy contracts that will settle on various dates through 2021. The following table presents volumes associated with the energy contracts:

	December 31,	
	2018	2017
Gas Contracts BBtu	15,142	14,187

CREDIT RISK

The use of contractual arrangements to manage the risks associated with changes in energy commodity prices creates credit risk exposure resulting from the possibility of non-performance by counterparties pursuant to the terms of their contractual obligations. UNS Gas enters into contracts for the physical delivery of natural gas which contain remedies in the event of non-performance by the supply counterparties. In addition, volatile natural gas prices can create significant credit exposure from natural gas market receivables and subsequent measurements at fair value.

UNS Gas has contractual agreements for energy procurement and hedging activities that contain certain provisions requiring UNS Gas and its counterparties to post collateral under certain circumstances. These circumstances include: (i) exposures in excess of unsecured credit limits; (ii) credit rating downgrades; or (iii) a failure to meet certain financial ratios. In the event that such credit events were to occur, the Company, or its counterparties, would have to provide certain credit enhancements in the form of cash, LOC, or other acceptable security to collateralize exposure beyond the allowed amounts.

UNS Gas considers the effect of counterparty credit risk in determining the fair value of derivative instruments that are in a net asset position, after incorporating collateral posted by counterparties, and then allocates the credit risk adjustment to individual contracts. The Company also considers the impact of its credit risk on instruments that are in a net liability position, after considering the collateral posted, and then allocates the credit risk adjustment to the individual contracts.

The value of all derivative instruments in net liability positions under contracts with credit risk-related contingent features, including contracts under the normal purchase normal sale exception, was $10.4 million as of December 31, 2018, compared with $11.4 million as of December 31, 2017. As of December 31, 2018, UNS Gas had no LOCs as credit enhancements with its counterparties. If the credit risk contingent features were triggered on December 31, 2018, UNS Gas would have been required to post an additional $10.4 million of collateral of which $8.0 million relates to outstanding net payable balances for settled positions.

FINANCIAL INSTRUMENTS NOT CARRIED AT FAIR VALUE

The fair value of a financial instrument is the market price to sell an asset or transfer a liability at the measurement date. Borrowings under revolving credit facilities approximate fair value due to the short-term nature of these financial instruments. These items have been excluded from the table below.

The use of different estimation methods and/or market assumptions may yield different estimated fair value amounts. The following table includes the face value and estimated fair value of UNS Gas' long-term debt:

	Fair Value Hierarchy	Face Value		Fair Value	
		December 31,			
(in thousands)		2018	2017	2018	2017
Liabilities					
Long-Term Debt, including Current Maturities	Level 2	$ 95,000	$ 95,000	$ 98,639	$ 105,625

NOTE 12. INCOME TAXES

Income Tax Expense included on the Statements of Income consists of the following:

(in thousands)	Years Ended December 31, 2018	2017
Current Income Tax Expense		
Federal	$ 1,662	$ 65
State	192	190
Total Current Income Tax Expense	1,854	255
Deferred Income Tax Expense		
Federal	905	3,735
State	431	521
Total Deferred Income Tax Expense	1,336	4,256
Total Federal and State Income Tax Expense	$ 3,190	$ 4,511

On December 22, 2017, the President of the United States of America signed into law the TCJA, which enacted significant changes to the Internal Revenue Code, including a reduction in the U.S. federal corporate income tax rate from a maximum rate of 35% to a flat rate of 21% effective for tax years beginning after 2017. In addition, the TCJA provided modifications to bonus depreciation rules and limitations on the deductibility of interest expense, both of which include carve-outs for regulated utilities.

As a result of the TCJA, the Company was required to revalue its deferred tax assets and liabilities at the new federal corporate income tax rate as of the date of enactment. This resulted in a net decrease to deferred income tax liabilities. Since the Company believes it is probable that a significant portion of the decrease will be returned to customers through future rates, a regulatory liability was established. UNS Gas is amortizing the EDIT balance in accordance with applicable federal income tax laws, which require the amortization of a majority of the balance over the remaining life of the related plant.

In May 2018, the ACC Refund Order was approved requiring UNS Gas to share EDIT amortization of the ACC-jurisdictional assets with customers. Income tax expense decreased by $1.3 million in 2018, compared with the same period in 2017. The EDIT activity related to the effects of the TCJA did not have a material impact on the change.

In August 2018, the IRS proposed regulations on bonus depreciation. The proposed regulation did not change the Company's estimated provision for its 2017 tax year. UNS Gas' accounting for the income tax effects of the bonus depreciation provisions included in the TCJA has been completed as of December 31, 2018.

The significant components of deferred income tax assets and liabilities consist of the following:

(in thousands)	December 31, 2018	December 31, 2017
Gross Deferred Income Tax Assets		
Customer Advances	$ 1,209	$ 889
Contributions in Aid of Construction	3,844	3,661
Compensation and Benefits	425	543
Fortis Acquisition Customer Credits	51	363
Income Taxes Recoverable Through Future Rates	7,350	7,483
Other	111	120
Total Gross Deferred Income Tax Assets	12,990	13,059
Gross Deferred Income Tax Liabilities		
Plant, Net	(42,616)	(41,267)
Income Taxes Payable Through Future Rates	(730)	(841)
Other	(204)	(85)
Total Gross Deferred Income Tax Liabilities	(43,550)	(42,193)
Deferred Income Taxes, Net	$ (30,560)	$ (29,134)

UNS Gas recorded no valuation allowance against deferred income tax assets as of December 31, 2018 and 2017. Management believes that based on the historical pattern of taxable income, UNS Gas will produce sufficient taxable income in the future to realize its deferred tax assets.

Included in Accounts Receivable, Net and Accounts Payable are current income taxes receivable and payable that are due from and to affiliates, respectively. UNS Gas' net intercompany income taxes were a payable of less than $0.5 million and a receivable of less than $1.0 million as of December 31, 2018 and 2017, respectively.

UNS Gas recorded no interest expense in 2018 and 2017. In addition, UNS Gas had no interest payable and no penalties accrued as of December 31, 2018 and 2017.

UNS Gas has been audited by the IRS through tax year 2010. The Company's 2011 to 2018 tax years are open for audit by federal and state tax agencies.