



Judy Y. Jenkins
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May 22, 2017

Kansas Corporation Commission
Attn: Amy L. Green, Secretary to Commission
1500 Arrowhead Road
Topeka, Kansas 66604

Re: In the Matter of the Kansas Gas Service Compliance Docket No. 11-KGSG-820-CPL, as Established in Docket No. 06-GIMX-181-GIV.

Dear Ms. Green

In accordance with the Commission's order in Docket No. 06-GIMX-181-GIV, KGS is confirming that for 2016, no changes have been made to the cost allocation manual previously filed with the Kansas Corporation Commission.

The documents and information filed in this docket at this time are not classified as confidential, but as additional filings are made in this docket to address periodic filing requirements or informational requests, Kansas Gas Service reserves the right to classify information that is confidential in nature under the designation "CONFIDENTIAL."

In accordance with the Report of the Commission Staff and the Active Participating Utilities dated October 27, 2010 and the Commission's Order of December 3, 2010, in Docket No. 06-GIMX- 181-GIV, Kansas Gas Service files the following documents:

- A.1. Cost Allocation Manual (CAM).
- A.2. Not applicable.
- B.1. Corporate Organization Chart
- B.2. List of Associated Companies and Descriptions
- B.3. List of Officers and Directors
- B.4. Summaries of Debt Agreements.
- B.5. Balance Sheet and Income Statement for Consolidated Utility Operations
- B.6. Financial Ratios for consolidated Utility Operations
- C.1. Not applicable.
- C.2. Not applicable
- C.3. List of Equity and Credit Analysts following ONE Gas, Inc., whose reports are proprietary and not subject to distribution.

Please accept the filing as being made subject to the procedures set forth in the Report of the Commission Staff and the Active Participating Utilities in Docket No. 06-GIMX- 181-GIV. If you have any questions or concerns please feel free to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Judy Jenkins". The signature is fluid and cursive, with the first name "Judy" being more prominent than the last name "Jenkins".

Judy Jenkins
Managing Attorney

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Kansas Gas Service Compliance) Docket No. 11-KGSG-820-CPL
Docket as Established in Docket No. 06-GIMX-181-GIV.)

KCC Requirement:

- A. To ensure proper allocation or assignment of joint or common costs for non-power goods and services, so a regulated utility bears only its fair share of costs, the public utility shall submit the following information on an annual basis by May 31st:
1. A Cost Allocation Manual (CAM) on a calendar year basis that:
 - a. Explains the methodology used for all costs allocated or assigned for non-power goods and services provided by: (i) the regulated utility, (ii) a holding company, or (iii) a centralized corporate services subsidiary to any associate company that is a jurisdictional public utility;
 - b. Demonstrates that all costs are allocated or assigned justly and reasonably and that the allocation or assignment of costs is not unduly discriminatory or preferential; and,
 - c. If a fully distributed cost methodology is not used, an explanation supporting use of the alternative method of allocation.

With respect to the CAM, it should be filed in the individual utility compliance docket, but if no changes are made to the CAM, a letter in place of the CAM indicating no changes have been made may be filed by the May 31st annual filing date. If the annual filing reflects changes made in the CAM, those changes should be noted and fully described.

2. Any centralized corporate services subsidiary, within a holding company that includes a jurisdictional public utility, required to file FERC Form No. 60, shall file a copy with the Commission by May 31st of the calendar year following the year subject of the report.

KGS Response

A.

1. The Cost Allocation Manual (CAM) submitted within Docket No. 11-KCPD-533-CPL is incorporated herein, by reference, since there have been no changes to the Manual.
2. Not Applicable

KCC Requirement

- B. Each jurisdictional public utility shall provide annually by May 31st the following information using diagrams, schedules or narrative discussion as may be appropriate:

1. A complete detailed organization chart identifying each regulated utility and each associate company;
2. A detailed description of the activities and business conducted at each non-utility associate company;
3. An organizational chart of personnel that includes a list of all directors, corporate officers, and other key personnel shared by any jurisdictional public utility and any non-utility associate company or holding company, if any, along with a description of each person's duties and responsibilities to each entity;
4. Summaries of each mortgage, loan document and debt agreement, including a discussion of the type of collateral or security pledged to support the debt. The utility will also describe any loan or debt agreement taken out to finance an unregulated affiliate that encumbers utility property or cash-flow for security;
5. To the extent financial separations are maintained for either legal or financial accounting purposes and at a level in which financial statements are reasonably capable of being produced by the utility's accounting system, each jurisdictional public utility shall file income statements, balance sheets and cash flow statements for (1) consolidated utility operations; (2) consolidated non-regulated operations; and (3) consolidated corporate financials; (this information is confidential) and
6. To the extent financial separations are maintained for either legal or financial accounting purposes and at a level in which financial statements are reasonably capable of being produced by the utility's accounting system, each jurisdictional public utility shall file a summary of financial ratios as of the end of the last completed fiscal year, as described by way of example in the attachment to these rules and consistent with the method used to report such information to the principal bond rating agency or Standard & Poors for (1) consolidated utility operations; (2) consolidated non-regulated operations; and (3) consolidated corporate financials (this information is confidential).

KGS Response

B.

1. Please see the attached organization chart, containing KGS associated companies within ONE Gas as of December 31, 2016.
2. Please see the attached description of associated companies.
3. Please see the attached list of Officers and Directors.
4. Please see the attached summary of debt agreements. There is no utility debt that encumbers utility property used to finance unregulated affiliates.
5. Please see the attached income statements and balance sheet information for ONE Gas which was included in the Fiscal 2016 10-K filing.
6. Please see the attached financial ratios for the consolidated utility operation.

KCC Requirement

- C. Each jurisdictional public utility shall provide to the Director of Utilities and the Chief of Accounting and Financial Analysis at the Commission concurrent with the filing of 8-K disclosures the following:
1. Written or verbal notice of any affiliate of the jurisdictional public utility or holding company, if any, that has an affiliate that has defaulted on a material obligation or debt for the purpose of 8-K reporting.
 2. Written or verbal notice of any requests by any jurisdictional public utility or holding company, if any, for material waivers or amendments as provided for the purpose of 8-K reporting to debt agreements that secure, encumber, or finance any jurisdictional public utility's assets.
 3. Each jurisdictional public utility shall file reports published by credit rating agencies and equity analysts regarding the utility's regulated and unregulated business within 10 days after publication of the report and its receipt by the utility. A public utility shall not be required to file reports that the utility has not received, or reports that cannot be disseminated or reproduced because of copyright or contractual restrictions.
 4. A summary of any debt secured or encumbered, in any way, by the assets of any jurisdictional public utility on behalf of a non-utility affiliate or holding company, if any.

KGS Response

C.

1. KGS will provide written or verbal notice concurrently, in the event that any affiliate defaults on a material obligation or debt for the purpose of 8-K reporting. Neither ONE Gas, nor any of its affiliates, has defaulted on a material obligation or debt.
2. KGS will provide written or verbal notice of any requests by a jurisdictional public utility or holding company if it seeks a material waiver or amendments as provided for the purpose of 8-K reporting to debt agreements that secure, encumber, or finance any jurisdictional public utility's assets. No such requests have been made.
3. ONE Gas receives credit rating and equity analyst reports under an agreement with an outside vendor. According to the terms of the agreement, ONE Gas is prohibited from releasing these reports to third parties.

Equity analysts covering ONE Gas include:

Bank of America Merrill Lynch
Edward Jones
Evercore ISI
Gabelli & Co.
Hilliard Lyons
Jefferies
Ladenburg Thalmann
Morgan Stanley
Seaport Global
UBS

U. S. Capital Advisors
Wells Fargo

Credit analysts reporting on ONE Gas debt include:

Moody's
S&P

4. ONE Gas does not have any debt issuances that are secured or encumbered with the assets of KGS.



**Kansas
Gas Service™**

A Division of ONE Gas

7421 W 129th St.

Overland Park, KS 66213

913-319-8696 • kansasgasservice.com

May 15, 2017

Amy L. Green, Secretary to Commission
Kansas Corporation Commission
1500 Arrowhead Road
Topeka, Kansas 66604

Re: Docket No. 06-GIMX-181-GIV and Docket No. 11-KGSG-820-CPL

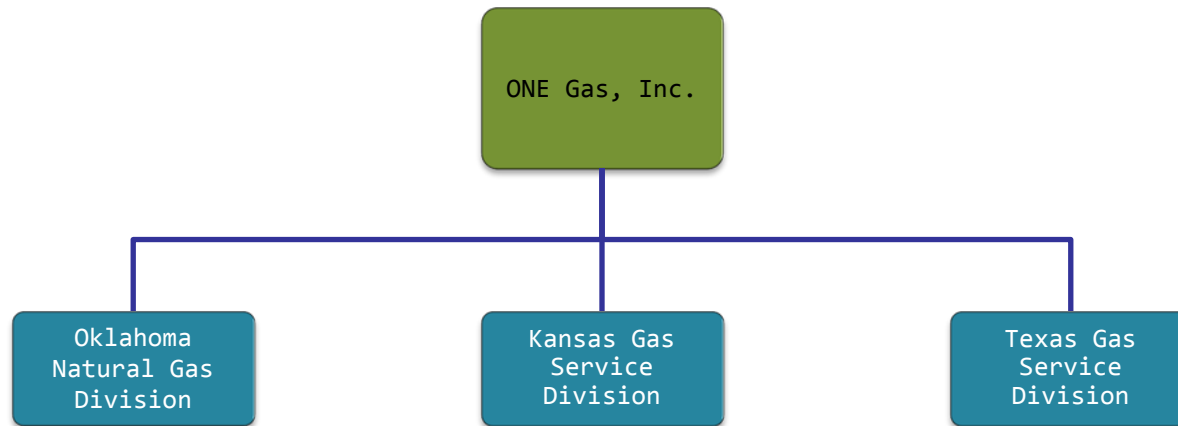
Dear Ms. Green

In accordance with the Commission's order in Docket No. 06-GIMX-181-GIV, KGS is confirming that for 2016, no changes have been made to the cost allocation manual previously filed with the Kansas Corporation Commission.

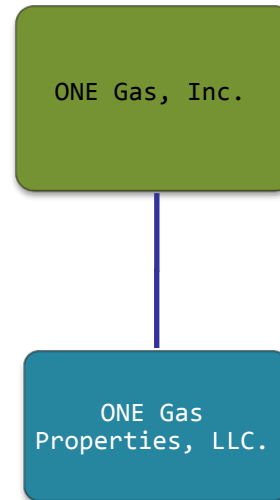
Sincerely,

Lorna Eaton
Manager, Rates and Regulatory Analysis

ONE Gas, Inc. Regulated Operating Divisions



ONE Gas, Inc. Associated Companies



ONE Gas, Inc.
Associated Company Descriptions

December 31, 2016

ONE Gas Properties, L.L.C. is an Oklahoma limited liability company. The entity owns intellectual property including the ONE Gas logo and the trade names Kansas Gas Service, Oklahoma Natural Gas and Texas Gas Service. ONE Gas Properties, L.L.C. charges ONG, KGS and TGS a monthly royalty fee for the use of the intellectual properties it owns.

ONE Gas Foundation, Inc. is an Oklahoma not-for-profit corporation. The entity is a charitable foundation exempt under Section 501(c)(3) of the Internal Revenue Code.

Directors and Officers:**ONE Gas, Inc.** (Oklahoma)
(Formed 8/30/13)**Directors**

John W. Gibson, Chairman
 Pierce H. Norton II
 Robert B. Evans
 Michael G. Hutchinson
 Pattye L. Moore
 Eduardo A. Rodriguez
 Douglas H. Yaeger

Positions Appointed by OGS Board

| | |
|---------------------|---|
| Pierce H. Norton II | President and Chief Executive Officer |
| Curtis L. Dinan | Senior Vice President, Chief Financial Officer and Treasurer |
| Joseph L. McCormick | Senior Vice President, General Counsel and Assistant Secretary |
| Caron A. Lawhorn | Senior Vice President, Commercial |
| Robert S. McAnnally | Senior Vice President, Operations |
| Mark A. Bender | Senior Vice President, Administration and Chief Information Officer |
| Andrew J. Ziola | Vice President, Investor Relations and Public Affairs |
| Brian K. Shore | Vice President, Associate General Counsel and Secretary |

Positions Appointed by OGS CEO

| | |
|-----------------------|--|
| W. Kent Shortridge | Vice President, Operations, Oklahoma Natural Gas |
| Jim Jarrett | Vice President, Operations, Texas Gas Service |
| Dennis J. Okenfuss | Vice President, Operations, Kansas Gas Service |
| Rick A. Grundman | Vice President, Government Affairs and Community Relations |
| David Scalf | Vice President, Rates and Regulatory Affairs |
| Ronald D. Bridgewater | Vice President, System Integrity |
| Teryl C. Rose | Vice President, Environmental, Safety & Health |
| Scott Gentry | Vice President, Natural Gas Supply |
| Greg A. Phillips | Vice President, Commercial |
| Brian Burke | Vice President, Customer Service |
| Jeff Johns | Vice President, Resource Management |
| Rhonda Mayhan | Vice President, Inclusion and Diversity, Executive Director-ONE Gas Foundation |
| James E. Langster | Vice President, Information Technology |
| Mark W. Smith | Vice President – Treasury |

ONE GAS PROPERTIES, L.L.C.

(Oklahoma limited liability company, Formed 10/30/13, OGS Sole Member)

| | |
|---------------------|--|
| Pierce H. Norton II | Chairman, President and Chief Executive Officer |
| Curtis L. Dinan | Senior Vice President, Chief Financial Officer and Treasurer |

| | |
|---------------------|---|
| Joseph L. McCormick | Senior Vice President, General Counsel and Assistant Secretary |
| Caron A. Lawhorn | Senior Vice President, Commercial |
| Robert S. McAnnally | Senior Vice President, Operations |
| Mark A. Bender | Senior Vice President, Administration and Chief Information Officer |
| Mark W. Smith | Vice President, Treasury |
| Andrew J. Ziola | Vice President, Investor Relations and Public Affairs |
| Brian K. Shore | Vice President, Associate General Counsel and Secretary |

ONE Gas, Inc.

| Maturity | 2019 | 2024 | 2044 | 5-Year Credit Agreement | Indenture - US Bank |
|--|--|--|---|---|---|
| Issue Date | 1/27/14 | 1/27/14 | 1/27/14 | 1/31/14 | 1/27/14 |
| Maturity Date | 2/1/19 | 2/1/24 | 2/1/44 | 1/2019 | - |
| Rate | 2.07% | 3.61% | 4.66% | Eurodollar plus 1%, Prime, or Fed Funds plus 0.5% | - |
| Principal | \$300,000,000 | \$300,000,000 | \$600,000,000 | \$700,000,000 | - |
| Annual Interest | \$6,210,000 | \$10,830,000 | \$27,948,000 | \$560,000 (Facility Fee) | - |
| Payments | 2/1, 8/1 | 2/1, 8/1 | 2/1, 8/1 | - | - |
| CUSIP | 68235PAD0 | 68235PAE8 | 68235PAF5 | | - |
| Trustee | US Bank | US Bank | US Bank | BOA (Administrative Agent) | - |
| Lead Bank(s) | Morgan Stanley JPM / BOA / RBS | Morgan Stanley JPM / BOA / RBS | Morgan Stanley JPM / BOA / RBS | RBS JPMorgan | US Bank |
| Callable | anytime prior to 1/1/2019 | anytime prior to 11/1/2023 | anytime prior to 8/1/2043 | - | - |
| Premium | None | None | None | - | - |
| Indenture | 1/27/14 | 1/27/14 | 1/27/14 | - | - |
| Filing | Same as Indenture (Annual compliance cert) | Same as Indenture (Annual compliance cert) | Same as Indenture (Annual compliance cert) | Compliance Certificates | Comp Certificates Certain SEC filings |
| Events of Def | Fail to pay Int/Princ/Prem Interest: 30 days Covenants: 90 days Def on Agmt>\$100MM Bankruptcy, Reorganization | Fail to pay Int/Princ/Prem Interest: 30 days Covenants: 90 days Def on Agmt>\$100MM Bankruptcy, Reorganization | Fail to pay Int/Princ/Prem 30 days notice: Int Covenants: 90 days Def on Agmt>\$15MM Bankruptcy, Reorganization | CF Events of Default (Sec 8.01) | See Indenture Events of Default |
| Limitations on Liens | Liens Language 1 | Liens Language 1 | Liens Language 1 | See CF Covenants (Sec 7.01) | See Indenture Limitation on Liens |
| Lim on S/L | S/L Language 1 | S/L Language 1 | S/L Language 1 | None | See Indenture Limitation on Sale/Leaseback |
| Amendments, Supplements and Waivers | ASW 1 | ASW 1 | ASW 1 | None | See each note |
| Defeasance | Defeasance Language 1 | Defeasance Language 1 | Defeasance Language 1 | None | See each note |
| Covenants | See Covenants 1 | See Covenants 1 | See Covenants 1 | See CF Covenants (Sec 6.01 - 7.09) | See Indenture Covenants |

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATAReport of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of ONE Gas, Inc.:

In our opinion, the accompanying balance sheets and the related statements of income, comprehensive income, equity and cash flows present fairly, in all material respects, the financial position of ONE Gas, Inc. (the Company) at December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Tulsa, Oklahoma
February 23, 2017

ONE Gas, Inc.
STATEMENTS OF INCOME

| | Years Ended December 31, | | |
|--|---|-------------------|-------------------|
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars, except per share amounts)</i> | | |
| Revenues | \$ 1,427,232 | \$ 1,547,692 | \$ 1,818,906 |
| Cost of natural gas | 541,797 | 705,959 | 991,949 |
| Net margin | 885,435 | 841,733 | 826,957 |
| Operating expenses | | | |
| Operations and maintenance | 417,142 | 414,476 | 420,686 |
| Depreciation and amortization | 143,829 | 133,023 | 125,722 |
| General taxes | 55,344 | 55,105 | 55,255 |
| Total operating expenses | 616,315 | 602,604 | 601,663 |
| Operating income | 269,120 | 239,129 | 225,294 |
| Other income | 1,447 | 263 | 1,625 |
| Other expense | (1,490) | (2,813) | (2,949) |
| Interest expense, net | (43,739) | (44,570) | (45,842) |
| Income before income taxes | 225,338 | 192,009 | 178,128 |
| Income taxes | (85,243) | (72,979) | (68,338) |
| Net income | \$ 140,095 | \$ 119,030 | \$ 109,790 |
| Earnings per share | | | |
| Basic | \$ 2.67 | \$ 2.26 | \$ 2.10 |
| Diluted | \$ 2.65 | \$ 2.24 | \$ 2.07 |
| Average shares (thousands) | | | |
| Basic | 52,453 | 52,578 | 52,364 |
| Diluted | 52,963 | 53,254 | 52,946 |
| Dividends declared per share of stock | \$ 1.40 | \$ 1.20 | \$ 0.84 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.

STATEMENTS OF COMPREHENSIVE INCOME

| | Years Ended December 31, | | |
|---|---------------------------------|-------------------|-------------------|
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Net income | \$ 140,095 | \$ 119,030 | \$ 109,790 |
| Other comprehensive income (loss), net of tax | | | |
| Change in pension and other postemployment benefit plans liability, net of tax of \$197, \$(483), and \$1,244, respectively | (314) | 773 | (1,781) |
| Total other comprehensive income (loss), net of tax | (314) | 773 | (1,781) |
| Comprehensive income | \$ 139,781 | \$ 119,803 | \$ 108,009 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.
BALANCE SHEETS

| | December 31, 2016 | December 31, 2015 |
|---|----------------------|----------------------|
| <i>(Thousands of dollars)</i> | | |
| Assets | | |
| Property, plant and equipment | | |
| Property, plant and equipment | \$ 5,404,168 | \$ 5,132,682 |
| Accumulated depreciation and amortization | 1,672,548 | 1,620,771 |
| Net property, plant and equipment | 3,731,620 | 3,511,911 |
| Current assets | | |
| Cash and cash equivalents | 14,663 | 2,433 |
| Accounts receivable, net | 290,944 | 216,343 |
| Materials and supplies | 34,084 | 33,325 |
| Income tax receivable | 1,397 | 38,877 |
| Natural gas in storage | 125,432 | 142,153 |
| Regulatory assets | 83,146 | 32,925 |
| Other current assets | 19,257 | 16,789 |
| Total current assets | 568,923 | 482,845 |
| Goodwill and other assets | | |
| Regulatory assets | 440,522 | 435,863 |
| Goodwill | 157,953 | 157,953 |
| Other assets | 43,773 | 46,193 |
| Total goodwill and other assets | 642,248 | 640,009 |
| Total assets | \$ 4,942,791 | \$ 4,634,765 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.
BALANCE SHEETS
(Continued)

| | December 31, 2016 | December 31, 2015 |
|--|----------------------|----------------------|
| <i>(Thousands of dollars)</i> | | |
| Equity and Liabilities | | |
| Equity and long-term debt | | |
| Common stock, \$0.01 par value: authorized 250,000,000 shares; issued 52,598,005 shares and outstanding 52,283,260 shares at December 31, 2016; issued 52,598,005 shares and outstanding 52,259,224 shares at December 31, 2015 | \$ 526 | \$ 526 |
| Paid-in capital | 1,749,574 | 1,764,875 |
| Retained earnings | 161,021 | 95,046 |
| Accumulated other comprehensive income (loss) | (4,715) | (4,401) |
| Treasury stock, at cost: 314,745 shares at December 31, 2016 and 338,781 shares at December 31, 2015 | (18,126) | (14,491) |
| Total equity | 1,888,280 | 1,841,555 |
| Long-term debt, excluding current maturities, and net of issuance costs of \$8,851 and \$9,645, respectively | 1,192,446 | 1,191,660 |
| Total equity and long-term debt | 3,080,726 | 3,033,215 |
| Current liabilities | | |
| Current maturities of long-term debt | 7 | 7 |
| Notes payable | 145,000 | 12,500 |
| Accounts payable | 131,988 | 107,482 |
| Accrued interest | 18,854 | 18,873 |
| Accrued taxes other than income | 42,571 | 37,249 |
| Accrued liabilities | 22,931 | 31,470 |
| Customer deposits | 61,209 | 60,325 |
| Regulatory liabilities | 11,922 | 24,615 |
| Other current liabilities | 9,451 | 11,700 |
| Total current liabilities | 443,933 | 304,221 |
| Deferred credits and other liabilities | | |
| Deferred income taxes | 1,038,568 | 951,785 |
| Employee benefit obligations | 303,507 | 272,309 |
| Other deferred credits | 76,057 | 73,235 |
| Total deferred credits and other liabilities | 1,418,132 | 1,297,329 |
| Commitments and contingencies | | |
| Total liabilities and equity | \$ 4,942,791 | \$ 4,634,765 |

See accompanying Notes to Financial Statements.

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ONE Gas, Inc.
STATEMENTS OF CASH FLOWS

| | Years Ended December 31, | | |
|---|---------------------------------|------------|-------------|
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Operating activities | | | |
| Net income | \$ 140,095 | \$ 119,030 | \$ 109,790 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 143,829 | 133,023 | 125,722 |
| Deferred income taxes | 86,788 | 63,789 | 49,935 |
| Share-based compensation expense | 11,219 | 9,187 | 7,613 |
| Provision for doubtful accounts | 5,427 | 4,520 | 7,195 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (80,028) | 105,886 | 23,044 |
| Materials and supplies | (759) | (5,814) | 10,868 |
| Income tax receivable | 37,480 | 4,923 | (43,800) |
| Natural gas in storage | 16,721 | 43,147 | (19,172) |
| Asset removal costs | (53,430) | (51,608) | (47,125) |
| Accounts payable | 27,596 | (59,635) | (6,881) |
| Accrued interest | (19) | 1 | 18,743 |
| Accrued taxes other than income | 5,322 | (7,493) | 12,316 |
| Accrued liabilities | (8,539) | 5,451 | 21,228 |
| Customer deposits | 884 | 322 | 2,643 |
| Regulatory assets and liabilities | (49,472) | 50,658 | 30,067 |
| Employee benefit obligation | (25,666) | (15,033) | (10,102) |
| Other assets and liabilities | 24,119 | (6,147) | (45,421) |
| Cash provided by operating activities | 281,567 | 394,207 | 246,663 |
| Investing activities | | | |
| Capital expenditures | (309,071) | (294,320) | (297,103) |
| Other | 492 | — | — |
| Cash used in investing activities | (308,579) | (294,320) | (297,103) |
| Financing activities | | | |
| Borrowings (repayment) on notes payable, net | 132,500 | (29,500) | 42,000 |
| Repurchase of common stock | (24,066) | (24,122) | — |
| Issuance of debt, net of discounts | — | — | 1,199,994 |
| Long-term debt financing costs | — | — | (11,087) |
| Cash payment to ONEOK upon separation | — | — | (1,130,000) |
| Issuance of common stock | 4,017 | 7,051 | 2,001 |
| Dividends paid | (73,209) | (62,826) | (43,696) |
| Cash provided by (used in) financing activities | 39,242 | (109,397) | 59,212 |
| Change in cash and cash equivalents | 12,230 | (9,510) | 8,772 |
| Cash and cash equivalents at beginning of period | 2,433 | 11,943 | 3,171 |
| Cash and cash equivalents at end of period | \$ 14,663 | \$ 2,433 | \$ 11,943 |
| Supplemental cash flow information: | | | |
| Cash paid for interest, net of amounts capitalized | \$ 42,129 | \$ 42,980 | \$ 21,066 |
| Cash (received) paid for income taxes, net | \$ (35,702) | \$ (5,423) | \$ 44,603 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.

STATEMENTS OF EQUITY

| | Common Stock Issued | Common Stock | Paid-in Capital | Retained Earnings |
|---|------------------------|--------------|---------------------------------|-------------------|
| | <i>(Shares)</i> | | <i>(Thousands of dollars)</i> | |
| January 1, 2014 | 100 | \$ — | \$ — | \$ — |
| Net income | — | — | — | 84,214 |
| Other comprehensive loss | — | — | — | — |
| Net transfers from ONEOK | — | — | — | — |
| Reclassification of Owner's net investment to paid-in capital | — | — | 1,749,078 | — |
| Issuance of common stock at the separation | 51,941,136 | 520 | (520) | — |
| Common stock issued | 142,623 | 1 | 9,614 | — |
| Common stock dividends - \$0.84 per share | — | — | 624 | (44,320) |
| December 31, 2014 | 52,083,859 | 521 | 1,758,796 | 39,894 |
| Net income | — | — | — | 119,030 |
| Other comprehensive loss | — | — | — | — |
| Repurchase of common stock | — | — | — | — |
| Common stock issued | 514,146 | 5 | 5,027 | — |
| Common stock dividends - \$1.20 per share | — | — | 1,052 | (63,878) |
| December 31, 2015 | 52,598,005 | 526 | 1,764,875 | 95,046 |
| Net income | — | — | — | 140,095 |
| Other comprehensive income | — | — | — | — |
| Repurchase of common stock | — | — | — | — |
| Common stock issued and other | — | — | (16,212) | — |
| Common stock dividends - \$1.40 per share | — | — | 911 | (74,120) |
| December 31, 2016 | 52,598,005 | \$ 526 | \$ 1,749,574 | \$ 161,021 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.
STATEMENTS OF EQUITY
(Continued)

| | Treasury Stock | Owner's Net Investment | Accumulated Other Comprehensive Income (Loss) | Total Equity |
|---|---------------------------------|---------------------------|---|--------------|
| | <i>(Thousands of dollars)</i> | | | |
| January 1, 2014 | \$ — | \$ 1,239,023 | \$ — | \$ 1,239,023 |
| Net income | — | 25,576 | — | 109,790 |
| Other comprehensive loss | — | — | (1,781) | (1,781) |
| Net transfers from ONEOK | — | 484,479 | (3,393) | 481,086 |
| Reclassification of Owner's net investment to paid-in capital | — | (1,749,078) | — | — |
| Issuance of common stock at the separation | — | — | — | — |
| Common stock issued | — | — | — | 9,615 |
| Common stock dividends - \$0.84 per share | — | — | — | (43,696) |
| December 31, 2014 | — | — | (5,174) | 1,794,037 |
| Net income | — | — | — | 119,030 |
| Other comprehensive loss | — | — | 773 | 773 |
| Repurchase of common stock | (24,122) | — | — | (24,122) |
| Common stock issued | 9,631 | — | — | 14,663 |
| Common stock dividends - \$1.20 per share | — | — | — | (62,826) |
| December 31, 2015 | (14,491) | — | (4,401) | 1,841,555 |
| Net income | — | — | — | 140,095 |
| Other comprehensive income | — | — | (314) | (314) |
| Repurchase of common stock | (24,066) | — | — | (24,066) |
| Common stock issued and other | 20,431 | — | — | 4,219 |
| Common stock dividends - \$1.40 per share | — | — | — | (73,209) |
| December 31, 2016 | \$ (18,126) | \$ — | \$ (4,715) | \$ 1,888,280 |

See accompanying Notes to Financial Statements.

ONE Gas, Inc.
NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations - Prior to January 31, 2014, ONE Gas was a wholly owned subsidiary of ONEOK and comprised its former natural gas distribution business. On January 31, 2014, ONEOK distributed one share of our common stock for every four shares of ONEOK common stock held by ONEOK shareholders of record as of the close of business on January 21, 2014, the record date of the distribution. At the close of business on January 31, 2014, we became an independent, publicly traded company as a result of the distribution. Our common stock began trading “regular-way” under the ticker symbol “OGS” on the NYSE on February 3, 2014.

We provide natural gas distribution services to more than 2 million customers through our divisions in Oklahoma, Kansas and Texas through Oklahoma Natural Gas, Kansas Gas Service and Texas Gas Service, respectively. We serve residential, commercial, industrial and transportation customers in all three states. In addition, we also provide natural gas distribution services to wholesale and public authority customers.

Basis of Presentation - Prior to our separation from ONEOK, our financial statements were derived from ONEOK’s financial statements, which included its natural gas distribution business as if we, for accounting purposes, had been a separate company for all periods presented. The assets and liabilities in the financial statements have been reflected on a historical basis. The financial statements for the period prior to the separation also includes expense allocations for certain corporate functions historically performed by ONEOK, including allocations of general corporate expenses related to executive oversight, accounting, treasury, tax, legal, information technology and other services. We believe our assumptions underlying the financial statements, including the assumptions regarding the allocation of general corporate expenses from ONEOK, are reasonable. However, the financial statements may not include all of the actual expenses that would have been incurred by us and may not reflect our results of operations, financial position and cash flows had we been a separate publicly traded company during the period presented prior to the separation.

All financial information presented after the separation represents the results of operations, financial position and cash flows of ONE Gas. Accordingly:

- Our Statements of Income and Comprehensive Income for the year ended December 31, 2014 , consist of the results of ONE Gas for the eleven months ended December 31, 2014 , and the results of ONE Gas Predecessor for the one month ended January 31, 2014.
- Our Statement of Cash Flows for the year ended December 31, 2014 , consists of the results of ONE Gas for the eleven months ended December 31, 2014 , and the results of ONE Gas Predecessor for the one month ended January 31, 2014.
- Our Statement of Equity for the year ended December 31, 2014 , consists of both the activity for ONE Gas Predecessor prior to January 31, 2014, and the activity for ONE Gas completed in connection with, and subsequent to, the separation on January 31, 2014.

The financial statements include the accounts of the natural gas distribution business as set forth in “Organization and Nature of Operations” above. All significant balances and transactions between our divisions have been eliminated.

Use of Estimates - The preparation of our financial statements and related disclosures in accordance with GAAP requires us to make estimates and assumptions with respect to values or conditions that cannot be known with certainty that affect the reported amount of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect the reported amounts of revenue and expenses during the reporting period. Items that may be estimated include, but are not limited to, the economic useful life of assets, fair value of assets and liabilities, provisions for doubtful accounts receivable, unbilled revenues for natural gas delivered but for which meters have not been read, natural gas purchased but for which no invoice has been received, provision for income taxes, including any deferred tax valuation allowances, the results of litigation and various other recorded or disclosed amounts.

We evaluate these estimates on an ongoing basis using historical experience and other methods we consider reasonable based on the particular circumstances. Nevertheless, actual results may differ significantly from the estimates. Any effects on our financial position or results of operations from revisions to these estimates are recorded in the period when the facts that give rise to the revision become known.

Fair Value Measurements - We define fair value as the price that would be received from the sale of an asset or the transfer of a liability in an orderly transaction between market participants at the measurement date. We use the market and income

approaches to determine the fair value of our assets and liabilities and consider the markets in which the transactions are executed. We measure the fair value of a group of financial assets and liabilities consistent with how a market participant would price the net risk exposure at the measurement date.

Fair Value Hierarchy - At each balance sheet date, we utilize a fair value hierarchy to classify fair value amounts recognized or disclosed in our financial statements based on the observability of inputs used to estimate such fair value. The levels of the hierarchy are described below:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Significant observable pricing inputs other than quoted prices included within Level 1 that are, either directly or indirectly, observable as of the reporting date. Essentially, this represents inputs that are derived principally from or corroborated by observable market data; and
- Level 3 - May include one or more unobservable inputs that are significant in establishing a fair value estimate. These unobservable inputs are developed based on the best information available and may include our own internal data.

We recognize transfers into and out of the levels as of the end of each reporting period.

Determining the appropriate classification of our fair value measurements within the fair value hierarchy requires management's judgment regarding the degree to which market data is observable or corroborated by observable market data. We categorize derivatives for which fair value is determined using multiple inputs within a single level, based on the lowest level input that is significant to the fair value measurement in its entirety. See Note 7 for additional information regarding our fair value measurements.

Cash and Cash Equivalents - Cash equivalents consist of highly liquid investments, which are readily convertible into cash and have original maturities of three months or less.

Revenue Recognition - For regulated deliveries of natural gas, we read meters and bill customers on a monthly cycle. We recognize revenues upon the delivery of the natural gas commodity or services rendered to customers. The billing cycles for customers do not necessarily coincide with the accounting periods used for financial reporting purposes. Revenues are accrued for natural gas delivered and services rendered to customers, but not yet billed. Accrued unbilled revenue is based on a percentage estimate of amounts unbilled each month, which is dependent upon a number of factors, some of which require management's judgment. These factors include customer consumption patterns and the impact of weather on usage. The amounts of accrued unbilled natural gas sales revenues at December 31, 2016 and 2015, were \$143.2 million and \$109.6 million, respectively.

We collect and remit other taxes on behalf of governmental authorities, and we record these amounts in accrued taxes other than income in our Balance Sheets on a net basis.

Cost of Natural Gas - Net margin is comprised of total revenues less cost of natural gas. Cost of natural gas includes commodity purchases, fuel, storage, transportation and other gas purchase costs recovered through our cost of natural gas regulatory mechanisms and does not include an allocation of general operating costs or depreciation and amortization. In addition, our cost of natural gas regulatory mechanisms provide a method of recovering natural gas costs on an ongoing basis without a profit. Therefore, although our revenues will fluctuate with the cost of gas that we purchase, net margin is not affected by fluctuations in the cost of natural gas. See Note 8 regulatory assets and liabilities for additional discussion of purchased gas cost recoveries.

Accounts Receivable - Accounts receivable represent valid claims against nonaffiliated customers for natural gas sold or services rendered, net of allowances for doubtful accounts. We assess the creditworthiness of our customers. Those customers who do not meet minimum standards are required to provide security, including deposits and other forms of collateral, when appropriate. With more than 2 million customers across three states, we are not exposed materially to a concentration of credit risk. We maintain an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends, consideration of the current credit environment and other information. In Oklahoma, Kansas and most jurisdictions we serve in Texas, we are able to recover natural gas costs related to doubtful accounts through purchased-gas cost adjustment mechanisms. At December 31, 2016 and 2015, our allowance for doubtful accounts was \$4.2 million and \$3.5 million, respectively.

Inventories - Natural gas in storage is maintained on the basis of weighted-average cost. Natural gas inventories that are injected into storage are recorded in inventory based on actual purchase costs, including storage and transportation costs.

Natural gas inventories that are withdrawn from storage are accounted for in our purchased-gas cost adjustment mechanisms at the weighted-average inventory cost.

Materials and supplies inventories are stated at the lower of weighted-average cost or net realizable value.

Derivatives and Risk Management Activities - We record all derivative instruments at fair value, with the exception of normal purchases and normal sales that are expected to result in physical delivery. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it, or if regulatory rulings require a different accounting treatment.

If certain conditions are met, we may elect to designate a derivative instrument as a hedge of exposure to changes in fair values or cash flows.

The table below summarizes the various ways in which we account for our derivative instruments and the impact on our financial statements:

| Accounting Treatment | Recognition and Measurement | |
|-----------------------------------|-----------------------------|---|
| | Balance Sheet | Income Statement |
| Normal purchases and normal sales | - Fair value not recorded | - Change in fair value not recognized in earnings |
| Mark-to-market | - Recorded at fair value | - Change in fair value recognized in, and recoverable through, the purchased-gas cost adjustment mechanisms |

We have not elected to formally designate any of our derivative instruments as hedges. Gains or losses associated with the fair value of commodity derivative instruments entered into by us are included in, and recoverable through, the purchased-gas cost adjustment mechanisms.

See Note 7 for additional information regarding our fair value measurements and hedging activities using derivatives.

Property, Plant and Equipment - Our properties are stated at cost, which includes direct construction costs such as direct labor, materials, burden and AFUDC. Generally, the cost of our property retired or sold, plus removal costs, less salvage, is charged to accumulated depreciation. Gains and losses from sales or retirement of an entire operating unit or system of our properties are recognized in income. Maintenance and repairs are charged directly to expense.

AFUDC represents the cost of borrowed funds used to finance construction activities. We capitalize interest costs during the construction or upgrade of qualifying assets. Capitalized interest is recorded as a reduction to interest expense.

Our properties are depreciated using the straight-line method over their estimated useful lives. Generally, we apply composite depreciation rates to functional groups of property having similar economic circumstances. We periodically conduct depreciation studies to assess the economic lives of our assets. These depreciation studies are completed as a part of our regulatory proceedings, and the changes in economic lives, if applicable, are implemented prospectively when the new rates are effective. Changes in the estimated economic lives of our property, plant and equipment could have a material effect on our financial position, results of operations or cash flows.

Property, plant and equipment on our Balance Sheets includes construction work in process for capital projects that have not yet been placed in service and therefore are not being depreciated. Assets are transferred out of construction work in process when they are substantially complete and ready for their intended use.

See Note 9 for additional information regarding our property, plant and equipment.

Impairment of Goodwill and Long-Lived Assets - We assess our goodwill for impairment at least annually as of July 1. Our goodwill impairment analysis performed in 2016, 2015 and 2014, utilized a qualitative assessment and did not result in any impairment indicators. Subsequent to July 1, 2016, no event has occurred indicating that it is more likely than not that our fair value is less than our carrying value of our net assets.

As part of our goodwill impairment test, we first assess qualitative factors (including macroeconomic conditions, industry and market considerations, cost factors and overall financial performance) to determine whether it is more likely than not that our fair value is less than our carrying amount. If further testing is necessary, we perform a two-step impairment test for goodwill.

In the first step, an initial assessment is made by comparing our fair value with our book value, including goodwill. If the fair value is less than the book value, an impairment is indicated, and we must perform a second test to measure the amount of the impairment. In the second test, we calculate the implied fair value of the goodwill by deducting the fair value of all tangible and intangible net assets from the fair value determined in step one of the assessment. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, we will record an impairment charge.

To estimate our fair value, we use two generally accepted valuation approaches, an income approach and a market approach, using assumptions consistent with a market participant's perspective. Under the income approach, we use anticipated cash flows over a period of years plus a terminal value and discount these amounts to their present value using appropriate discount rates. Under the market approach, we apply acquisition multiples to forecasted cash flows. The acquisition multiples used are consistent with historical market transactions. The forecasted cash flows are based on average forecasted cash flows over a period of years.

We assess our long-lived assets for impairment whenever events or changes in circumstances indicate that an asset's carrying amount may not be recoverable. An impairment is indicated if the carrying amount of a long-lived asset exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of the asset. If an impairment is indicated, we record an impairment loss equal to the difference between the carrying value and the fair value of the long-lived asset. We determined that there were no asset impairments in 2016, 2015 or 2014 .

Regulation - We are subject to the rate regulation and accounting requirements of the OCC, KCC, RRC and various municipalities in Texas. We follow the accounting and reporting guidance for regulated operations. During the ratemaking process, regulatory authorities set the framework for what we can charge customers for our services and establish the manner that our costs are accounted for, including allowing us to defer recognition of certain costs and permitting recovery of the amounts through rates over time, as opposed to expensing such costs as incurred. Examples include weather normalization, unrecovered purchased-gas costs, pension and postemployment benefit costs and ad-valorem taxes. This allows us to stabilize rates over time rather than passing such costs on to the customer for immediate recovery. Actions by regulatory authorities could have an effect on the amount recovered from rate payers. Any difference in the amount recoverable and the amount deferred is recorded as income or expense at the time of the regulatory action. A write-off of regulatory assets and costs not recovered may be required if all or a portion of the regulated operations have rates that are no longer:

- established by independent regulators;
- designed to recover the specific entity's costs of providing regulated services; and
- set at levels that will recover our costs when considering the demand and competition for our services.

See Note 8 for additional information regarding our regulatory assets and liabilities disclosures.

Pension and Other Postemployment Employee Benefits - We have defined benefit retirement plans covering eligible employees. We also sponsor welfare plans that provide other postemployment medical and life insurance benefits to eligible employees who retire with at least five years of service. To calculate the costs and liabilities related to our plans, we utilize an outside actuarial consultant, which uses statistical and other factors to anticipate future events. These factors include assumptions about the discount rate, expected return on plan assets, rate of future compensation increases, age and mortality and employment periods. In determining the projected benefit obligations and costs, assumptions can change from period to period and may result in material changes in the cost and liabilities we recognize.

Income Taxes - Deferred income taxes are recorded for the difference between the financial statement and income tax basis of assets and liabilities and carryforward items, based on income tax laws and rates existing at the time the temporary differences are expected to reverse. The effect on deferred taxes of a change in tax rates is deferred and amortized for operations regulated by the OCC, KCC, RRC and various municipalities in Texas, if, as a result of an action by a regulator, it is probable that the effect of the change in tax rates will be recovered from or returned to customers through future rates. We continue to amortize previously deferred investment tax credits for ratemaking purposes over the periods prescribed by our regulators.

A valuation allowance for deferred tax assets is recognized when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized. To assess that likelihood, we use estimates and judgment regarding our future taxable income, as well as the jurisdiction in which such taxable income is generated, to determine whether a valuation allowance is required. Such evidence can include our current financial position, our results of operations, both actual and forecasted, the reversal of deferred tax liabilities, as well as the current and forecasted business economics of our industry. We had no valuation allowance at December 31, 2016 and 2015 .

We utilize a more-likely-than-not recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position that is taken or expected to be taken in a tax return. We reflect penalties and interest as part of income tax expense as they become applicable for tax provisions that do not meet the more-likely-than-not recognition threshold and measurement attribute. There were no material uncertain tax positions at December 31, 2016 and 2015. See Note 12 for additional information regarding income taxes.

Asset Retirement Obligations - Asset retirement obligations represent legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. Certain long-lived assets that comprise our natural gas distribution systems, primarily our pipeline assets, are subject to agreements or regulations that give rise to an asset retirement obligation for removal or other disposition costs associated with retiring the assets in place upon the discontinued use of the natural gas distribution system. We recognize the fair value of a liability for an asset retirement obligation in the period when it is incurred if a reasonable estimate of the fair value can be made. We are not able to estimate reasonably the fair value of the asset retirement obligations for portions of our assets because the settlement dates are indeterminable given our expected continued use of the assets with proper maintenance. We expect our natural gas distribution systems will continue in operation as long as natural gas supply and demand for natural gas distribution service exists. Based on the widespread use of natural gas for heating and cooking activities by residential and commercial customers in our service areas, management expects supply and demand to exist for the foreseeable future.

In accordance with long-standing regulatory treatment, we collect through rates the estimated costs of removal on certain regulated properties through depreciation expense, with a corresponding credit to accumulated depreciation and amortization. These removal costs collected through our rates include costs attributable to legal and nonlegal removal obligations; however, the amounts collected that are in excess of these nonlegal asset-removal costs incurred are accounted for as a regulatory liability for financial reporting purposes. Historically, with the exception of the regulatory authority in Kansas, the regulatory authorities that have jurisdiction over our regulated operations have not required us to quantify or disclose this amount; rather, these costs are addressed prospectively in depreciation rates and are set in each general rate order. We have made an estimate of our regulatory liability using current rates since the last general rate order in each of our jurisdictions if the removal costs collected have exceeded our removal cost incurred; however, for financial reporting purposes, significant uncertainty exists regarding the future disposition of this regulatory liability, pending, among other issues, clarification of regulatory intent. We continue to monitor the regulatory requirements, and the liability may be adjusted as more information is obtained. We record the estimated asset removal obligation in noncurrent liabilities in other deferred credits on our Balance Sheets. To the extent this estimated liability is adjusted, such amounts will be reclassified between accumulated depreciation and amortization and other deferred credits and therefore will not have an impact on earnings.

Contingencies - Our accounting for contingencies covers a variety of business activities, including contingencies for legal and environmental exposures. We accrue these contingencies when our assessments indicate that it is probable that a liability has been incurred or an asset will not be recovered and an amount can be estimated reasonably. We expense legal fees as incurred and base our legal liability estimates on currently available facts and our estimates of the ultimate outcome or resolution. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than the completion of a remediation feasibility study. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable. Actual results may differ from our estimates resulting in an impact, positive or negative, on earnings. See Note 13 for additional information regarding contingencies.

Share-Based Payments - We expense the fair value of share-based payments net of estimated forfeitures. We estimate forfeiture rates based on historical forfeitures under our share-based payment plans.

Earnings per share - Basic EPS is based on net income and is calculated based upon the daily weighted-average number of common shares outstanding during the periods presented. Also, this calculation includes fully vested stock awards that have not yet been issued as common stock. Diluted EPS includes the above, plus unvested stock awards granted under our compensation plans, but only to the extent these instruments dilute earnings per share.

Segments - We operate in one reportable business segment: regulated public utilities that deliver natural gas to residential, commercial, industrial, wholesale, public authority and transportation customers. We define reportable business segments as components of an organization for which discrete financial information is available and operating results are evaluated on a regular basis by the chief operating decision maker (CODM) in order to assess performance and allocate resources. Our CODM is our Chief Executive Officer (CEO). Characteristics of our organization that were relied upon in making this determination include the similar nature of services we provide, the functional alignment of our organizational structure, and the reports that are regularly reviewed by the CODM for the purpose of assessing performance and allocating resources. Our management is functionally aligned and centralized, with performance evaluated based upon results of the entire distribution

business. Capital allocation decisions are driven by asset integrity management, operating efficiency, growth opportunities and government relocations, not geographic location or regulatory jurisdiction.

In 2016, 2015 and 2014, we had no single external customer from which we received 10 percent or more of our gross revenues.

Treasury Stock - We record treasury stock purchases at cost, which includes incremental direct transaction costs. Amounts are recorded as reductions in equity in our Balance Sheets. We record the reissuance of treasury stock at our weighted average cost of treasury shares recorded in equity in our Balance Sheets.

Recently Issued Accounting Standards Update - In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 of the goodwill test, where the measurement of a goodwill impairment loss was determined by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Upon adoption, a goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This new guidance is required for our interim and annual reports for periods beginning after December 15, 2019, and early adoption is permitted. We do not expect this guidance to have a material impact on our financial statements and will adjust our goodwill testing procedures accordingly upon adoption.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," which includes various new aspects to simplify how share-based payments are accounted for and presented in the financial statements. The new standard modifies several aspects of the accounting and reporting for employee share-based payments and related tax accounting impacts, including the presentation in the statements of operations and cash flows. We will adopt this new guidance in the first quarter of 2017. Prospectively, we will record excess tax expenses or benefits in income tax expense. We will record a cumulative-effect increase of \$11.0 million to retained earnings, with an offset to a deferred tax asset, as of the beginning of the reporting period in 2017 for excess tax benefits earned prior to January 1, 2017. We will continue our use of the estimation method to account for share unit awards forfeitures rather than actual forfeitures. We will adopt the classification of cash flows for changes in excess tax benefits prospectively in operating activities, and employer withholding shares for tax-withholding purposes for employees retrospectively in investing activities in our statement of cash flows.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which prescribes recognizing lease assets and liabilities on the balance sheet and includes disclosure of key information about leasing arrangements. A modified retrospective transition approach is required for leases existing at the time of adoption. We are evaluating our population of leases, analyzing lease agreements, and holding meetings with cross-divisional teams to determine the potential impact of this accounting standard on our financial position or results of operations and the transition approach we will utilize. This new guidance is required for our interim and annual reports for periods beginning after December 15, 2018, and early adoption is permitted.

In October 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes," to simplify reporting of deferred taxes. The new guidance requires all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. This guidance is required to be adopted for our interim and annual reports for periods beginning after December 15, 2016, but early adoption is permitted. We have adopted this guidance early to simplify our financial reporting process, have applied it prospectively for the period beginning October 1, 2015, and it did not have a material impact on our financial statements. Prior periods were not retrospectively adjusted.

In August 2015, the FASB issued ASU 2015-15, "Interest-Imputation of Interest (Subtopic 835-30)," which specifically addresses the presentation and subsequent measurement of debt issuance costs associated with line of credit arrangements. We adopted this guidance in the first quarter 2016, and it did not have an impact on our financial position or results of operations.

In April 2015, the FASB issued ASU 2015-03, "Interest-Imputation of Interest," which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. We adopted this guidance in the first quarter of 2016, and have applied the changes retrospectively to all periods presented. We have presented such amounts as a direct deduction from the face amount of our long-term debt, rather than in other assets as a deferred charge in our Balance Sheets. Amortization of the debt issuance costs continues to be reported as interest expense in our Statements of Income.

In April 2015, the FASB issued ASU 2015-05, "Intangibles-Goodwill and Other-Internal-Use Software," which helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement. We adopted this guidance prospectively in the first quarter of 2016, and it did not have a material impact on our financial position or results of operations.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which clarifies and converges the revenue recognition principles under GAAP and International Financial Reporting Standards. In July 2015, FASB delayed the effective date for one year. We have substantially completed evaluating all of our sources of revenue to determine the potential effect on our financial position, results of operations and cash flows. We continue to monitor accounting task forces and the FASB for additional implementation guidance related to: (1) the accounting for funds received from third parties to partially or fully reimburse the cost of construction of an asset; (2) the evaluation of collectability from customers if a utility has regulatory mechanisms to help assure recovery of uncollected accounts from ratepayers; and (3) the accounting for alternative revenue programs, such as performance-based ratemaking, that may impact the final conclusions of our evaluation. Until these items are resolved, we cannot determine the effect the new guidance will have on our financial position, results of operations, cash flows, business processes or the transition method we will utilize to adopt the new guidance. We are required to adopt this new guidance for our interim and annual reports beginning with the first quarter 2018.

2. CREDIT FACILITY AND SHORT-TERM NOTES PAYABLE

The ONE Gas Credit Agreement contains certain financial, operational and legal covenants. Among other things, these covenants include maintaining ONE Gas' total debt-to-capital ratio of no more than 70 percent at the end of any calendar quarter. The ONE Gas Credit Agreement also contains customary affirmative and negative covenants, including covenants relating to liens, indebtedness of subsidiaries, investments, changes in the nature of business, fundamental changes, transactions with affiliates, burdensome agreements, and use of proceeds. In the event of a breach of certain covenants by ONE Gas, amounts outstanding under the ONE Gas Credit Agreement may become due and payable immediately. At December 31, 2016, our total debt-to-capital ratio was 41 percent and we were in compliance with all covenants under the ONE Gas Credit Agreement.

The ONE Gas Credit Agreement includes a \$50 million sublimit for the issuance of standby letters of credit and also features an option to request an increase in the size of the facility to an aggregate of \$1.2 billion from \$700 million by either commitments from new lenders or increased commitments from existing lenders. Borrowings made under the facility are available for general corporate purposes. The ONE Gas Credit Agreement contains provisions for an applicable margin rate and an annual facility fee, both of which adjust with changes in our credit rating. Based on our current credit ratings, borrowings, if any, will accrue interest at LIBOR plus 79.5 basis points, and the annual facility fee is 8 basis points.

We have a commercial paper program under which we may issue unsecured commercial paper up to a maximum amount of \$700 million to fund short-term borrowing needs. The maturities of the commercial paper notes may vary but may not exceed 270 days from the date of issue. The commercial paper notes are sold generally at par less a discount representing an interest factor.

The ONE Gas Credit Agreement is available to repay the commercial paper notes, if necessary. Amounts outstanding under the commercial paper program reduce the borrowing capacity under the ONE Gas Credit Agreement.

At December 31, 2016, we had \$145.0 million of commercial paper and \$1.5 million in letters of credit issued under the ONE Gas Credit Agreement, with no borrowings and \$553.5 million of remaining credit available under the ONE Gas Credit Agreement. The weighted-average interest rate on our commercial paper was 0.95 percent and 0.70 percent at December 31, 2016 and 2015, respectively.

3. LONG-TERM DEBT

In January 2014, we issued senior notes, consisting of \$300 million of 2.07 percent senior notes due 2019, \$300 million of 3.61 percent senior notes due 2024 and \$600 million of 4.658 percent senior notes due 2044. The indenture governing our Senior Notes includes an event of default upon the acceleration of other indebtedness of \$100 million or more. Such events of default would entitle the trustee or the holders of 25 percent in the aggregate principal amount of the outstanding Senior Notes to declare those senior notes immediately due and payable in full.

We may redeem our Senior Notes at par, plus accrued and unpaid interest to the redemption date, starting one month, three months, and six months, respectively, before their maturity dates. Prior to these dates, we may redeem these Senior Notes, in whole or in part, at a redemption price equal to the principal amount, plus accrued and unpaid interest and a make-whole premium. The redemption price will never be less than 100 percent of the principal amount of the respective note plus accrued and unpaid interest to the redemption date. Our Senior Notes are senior unsecured obligations, ranking equally in right of payment with all of our existing and future unsecured senior indebtedness.

4. EQUITY

Preferred Stock - At December 31, 2016, we had 50 million, \$0.01 par value, authorized shares of preferred stock available. We have not issued or established any classes or series of shares of preferred stock.

Common Stock - At December 31, 2016, we had approximately 197.7 million shares of authorized common stock available for issuance.

Treasury Shares - We purchase treasury shares to be used to offset shares issued under our employee and non-employee director equity compensation and employee stock purchase plans. Our Board of Directors established an annual limit of \$20 million of treasury stock purchases, exclusive of funds received through the dividend reinvestment and employee stock purchase plans. Stock purchases may be made in the open market or in private transactions at times, and in amounts that we deem appropriate. There is no guarantee as to the exact number of shares that we purchase, and we can terminate or limit the program at any time.

Dividends Declared - In January 2017, we declared a dividend of \$0.42 per share (\$1.68 per share on an annualized basis) for shareholders of record on February 24, 2017, payable March 10, 2017.

5. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table sets forth the balance in accumulated other comprehensive income (loss) for the period indicated:

| | Accumulated Other Comprehensive Income (Loss) |
|--|--|
| | <i>(Thousands of dollars)</i> |
| January 1, 2015 | \$ (5,174) |
| Pension and other postemployment benefit plans obligations | |
| Other comprehensive income (loss) before reclassification, net of tax of \$(130) | 209 |
| Amounts reclassified from accumulated other comprehensive income (loss), net of tax of \$(353) | 564 |
| Other comprehensive income (loss) | 773 |
| December 31, 2015 | (4,401) |
| Pension and other postemployment benefit plans obligations | |
| Other comprehensive income (loss) before reclassification, net of tax of \$486 | (776) |
| Amounts reclassified from accumulated other comprehensive income (loss), net of tax of \$(289) | 462 |
| Other comprehensive income (loss) | (314) |
| December 31, 2016 | \$ (4,715) |

The following table sets forth the effect of reclassifications from accumulated other comprehensive income (loss) on our Statements of Income for the period indicated:

| Details about Accumulated Other Comprehensive Income (Loss) Components | Year Ended December 31, | | | Affected Line Item in the Statements of Income |
|---|---------------------------------|-------------|-------------|---|
| | 2016 | 2015 | 2014 | |
| | <i>(Thousands of dollars)</i> | | | |
| Pension and other postemployment benefit plan obligations (a) | | | | |
| Amortization of net loss | \$ 40,912 | \$ 47,494 | \$ 34,169 | |
| Amortization of unrecognized prior service cost | (3,316) | (1,962) | (1,211) | |
| | <u>37,596</u> | 45,532 | 32,958 | |
| Regulatory adjustments (b) | <u>(36,845)</u> | (44,615) | (32,445) | |
| | 751 | 917 | 513 | Income before income taxes |
| | <u>(289)</u> | (353) | (198) | Income tax expense |
| Total reclassifications for the period | \$ 462 | \$ 564 | \$ 315 | Net income |

(a) These components of accumulated other comprehensive income (loss) are included in the computation of net periodic benefit cost. See Note 11 for additional information regarding our net periodic benefit cost.

(b) Regulatory adjustments represent pension and other postemployment benefit costs expected to be recovered through rates and are deferred as part of our regulatory assets. See Note 8 for additional information regarding our regulatory assets and liabilities.

6. EARNINGS PER SHARE

The following tables set forth the computation of basic and diluted EPS from continuing operations for the periods indicated:

| Year Ended December 31, 2016 | | | |
|--|------------|--------|------------------|
| | Income | Shares | Per Share Amount |
| <i>(Thousands, except per share amounts)</i> | | | |
| Basic EPS Calculation | | | |
| Net income available for common stock | \$ 140,095 | 52,453 | \$ 2.67 |
| Diluted EPS Calculation | | | |
| Effect of dilutive securities | — | 510 | |
| Net income available for common stock and common stock equivalents | \$ 140,095 | 52,963 | \$ 2.65 |

| Year Ended December 31, 2015 | | | |
|--|------------|--------|------------------|
| | Income | Shares | Per Share Amount |
| <i>(Thousands, except per share amounts)</i> | | | |
| Basic EPS Calculation | | | |
| Net income available for common stock | \$ 119,030 | 52,578 | \$ 2.26 |
| Diluted EPS Calculation | | | |
| Effect of dilutive securities | — | 676 | |
| Net income available for common stock and common stock equivalents | \$ 119,030 | 53,254 | \$ 2.24 |

| Year Ended December 31, 2014 | | | |
|--|------------|--------|------------------|
| | Income | Shares | Per Share Amount |
| <i>(Thousands, except per share amounts)</i> | | | |
| Basic EPS Calculation | | | |
| Net income available for common stock | \$ 109,790 | 52,364 | \$ 2.10 |
| Diluted EPS Calculation | | | |
| Effect of dilutive securities | — | 582 | |
| Net income available for common stock and common stock equivalents | \$ 109,790 | 52,946 | \$ 2.07 |

7. DERIVATIVE FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Derivative Instruments - At December 31, 2016, we held purchased natural gas call options for the heating season ending March 2017, with total notional amounts of 14.3 Bcf, for which we paid premiums of \$5.4 million, and which had a fair value of \$6.5 million. At December 31, 2015, we held purchased natural gas call options for the heating season ended March 2016, with total notional amounts of 17.0 Bcf, for which we paid premiums of \$5.8 million, and which had a fair value of \$0.4 million. The premiums paid and any cash settlements received are recorded as part of our unrecovered purchased-gas costs in current regulatory assets as these contracts are included in, and recoverable through, the purchased-gas cost adjustment mechanisms. Additionally, changes in fair value associated with these contracts are deferred as part of our unrecovered purchased-gas costs in our Balance Sheets. Our natural gas call options are classified as Level 1 as fair value amounts are based on unadjusted quoted prices in active markets including NYMEX-settled prices. There were no transfers between levels for the periods presented.

Other Financial Instruments - The approximate fair value of cash and cash equivalents, accounts receivable and accounts payable is equal to book value, due to the short-term nature of these items. Our cash and cash equivalents are comprised of bank and money market accounts, and are classified as Level 1.

Short-term notes payable and commercial paper are due upon demand and, therefore, the carrying amounts approximate fair value and are classified as Level 1. The book value of our long-term debt, including current maturities, was \$1.2 billion at both December 31, 2016 and 2015. The estimated fair value of our long-term debt, including current maturities, was \$1.2 billion at

both December 31, 2016 and 2015. The estimated fair value of our Senior Notes was determined using quoted market prices, and are considered Level 2.

8. REGULATORY ASSETS AND LIABILITIES

The table below presents a summary of regulatory assets, net of amortization, and liabilities for the periods indicated:

| | Remaining Recovery Period | December 31, 2016 | | |
|--|------------------------------|-------------------|------------|------------|
| | | Current | Noncurrent | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Under-recovered purchased-gas costs | 1 year | \$ 29,901 | \$ — | \$ 29,901 |
| Pension and other postemployment benefit costs | See Note 11 | 31,498 | 427,448 | 458,946 |
| Weather normalization | 1 year | 17,661 | — | 17,661 |
| Reacquired debt costs | 11 years | 812 | 8,108 | 8,920 |
| Other | 1 to 22 years | 3,274 | 4,966 | 8,240 |
| Total regulatory assets, net of amortization | | 83,146 | 440,522 | 523,668 |
| Over-recovered purchased-gas costs | 1 year | (10,154) | — | (10,154) |
| Ad-valorem tax | 1 year | (1,768) | — | (1,768) |
| Total regulatory liabilities | | (11,922) | — | (11,922) |
| Net regulatory assets and liabilities | | \$ 71,224 | \$ 440,522 | \$ 511,746 |

| | Remaining Recovery Period | December 31, 2015 | | |
|--|------------------------------|-------------------|------------|------------|
| | | Current | Noncurrent | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Under-recovered purchased-gas costs | 1 year | \$ 13,336 | \$ — | \$ 13,336 |
| Pension and other postemployment benefit costs | See Note 11 | 15,670 | 425,175 | 440,845 |
| Weather normalization | 1 year | 2,198 | — | 2,198 |
| Reacquired debt costs | 12 years | 812 | 8,919 | 9,731 |
| Other | 1 to 23 years | 909 | 1,769 | 2,678 |
| Total regulatory assets, net of amortization | | 32,925 | 435,863 | 468,788 |
| Accumulated removal costs (a) | up to 50 years | — | (9,032) | (9,032) |
| Over-recovered purchased-gas costs | 1 year | (22,884) | — | (22,884) |
| Ad-valorem tax | 1 year | (1,731) | — | (1,731) |
| Total regulatory liabilities | | (24,615) | (9,032) | (33,647) |
| Net regulatory assets and liabilities | | \$ 8,310 | \$ 426,831 | \$ 435,141 |

(a) Included in other deferred credits in our Balance Sheets.

Regulatory assets on our Balance Sheets, as authorized by the various regulatory authorities, are probable of recovery. Base rates are designed to provide a recovery of cost during the period rates are in effect but do not generally provide for a return on investment for amounts we have deferred as regulatory assets. All of our regulatory assets recoverable through base rates are subject to review by the respective regulatory authorities during future rate proceedings. We are not aware of any evidence that these costs will not be recoverable through either rate riders or base rates, and we believe that we will be able to recover such costs, consistent with our historical recoveries.

Purchased-gas costs represent the natural gas costs that have been over- or under-recovered from customers through the purchased-gas cost adjustment mechanisms, and includes natural gas utilized in our operations and premiums paid and any cash settlements received from our purchased natural gas call options.

We amortize reacquired debt costs in accordance with the accounting guidelines prescribed by the OCC and KCC.

Weather normalization represents revenue over- or under-recovered through the WNA rider in Kansas. This amount is deferred as a regulatory asset or liability for a 12-month period. Kansas Gas Service then applies an adjustment to the customers' bills for 12 months to refund the over-collected revenue or bill the under-collected revenue.

Ad-valorem tax represents an increase or decrease in Kansas Gas Service's taxes above or below the amount approved in a rate case. This amount is deferred as a regulatory asset or liability for a 12-month period. Kansas Gas Service then applies an adjustment to the customers' bills for 12 months to refund the over-collected revenue or bill the under-collected revenue.

Recovery through rates resulted in amortization of regulatory assets of approximately \$3.8 million, \$1.6 million and \$6.4 million for the years ended December 31, 2016, 2015 and 2014, respectively.

We collect, through our rates, the estimated costs of removal on certain regulated properties through depreciation expense, with a corresponding credit to accumulated depreciation and amortization. These removal costs are nonlegal obligations; however, the amounts collected that are in excess of these nonlegal asset-removal costs incurred are accounted for as a regulatory liability. We have made an estimate of our regulatory liability using current rates since the last general rate order in each of our jurisdictions if the removal costs collected have exceeded our removal costs incurred. We record the estimated nonlegal asset-removal obligation in noncurrent liabilities in other deferred credits on our Balance Sheets.

In January 2016, as a result of our rate case in Oklahoma, we recorded a regulatory asset of \$2.4 million to recover certain information technology costs incurred as a result of our separation from ONEOK in 2014, which will be recovered over four years.

9. PROPERTY, PLANT AND EQUIPMENT

The following table sets forth our property, plant and equipment by property type, for the periods indicated:

| | December 31, 2016 | December 31, 2015 |
|--|-------------------------------|----------------------|
| | <i>(Thousands of dollars)</i> | |
| Natural gas distribution pipelines and related equipment | \$ 4,321,429 | \$ 4,114,090 |
| Natural gas transmission pipelines and related equipment | 481,953 | 462,654 |
| General plant and other | 530,459 | 498,906 |
| Construction work in process | 70,327 | 57,032 |
| Property, plant and equipment | 5,404,168 | 5,132,682 |
| Accumulated depreciation and amortization | (1,672,548) | (1,620,771) |
| Net property, plant and equipment | \$ 3,731,620 | \$ 3,511,911 |

We compute depreciation expense by applying composite, straight-line rates of 2.0 percent to 3.0 percent that were approved by various regulatory authorities.

We recorded capitalized interest of \$3.6 million, \$2.6 million and \$2.5 million for the years ended December 31, 2016, 2015 and 2014, respectively. We incurred liabilities for construction work in process and asset removal costs that had not been paid at December 31, 2016, 2015 and 2014 of \$11.9 million, \$15.0 million and \$7.0 million, respectively. Such amounts are not included in capital expenditures on the Statements of Cash Flows.

10. SHARE-BASED PAYMENTS

The ONE Gas Equity Compensation Plan (ECP) provides for the granting of stock-based compensation, including incentive stock options, nonstatutory stock options, stock bonus awards, restricted stock awards, restricted stock unit awards, performance stock awards and performance unit awards to eligible employees and the granting of stock awards to nonemployee directors. We have reserved 2.8 million shares of common stock for issuance under the ECP. At December 31, 2016, we had approximately 1.1 million shares available for issuance under the ECP, which reflect shares issued and estimated shares expected to be issued upon vesting of outstanding awards granted under the plan, less forfeitures. The plan allows for the deferral of awards granted in stock or cash, in accordance with Internal Revenue Code section 409A requirements.

Compensation cost expensed for our share-based payment plans was \$7.0 million, net of tax benefits of \$4.3 million, for 2016, \$5.7 million, net of tax benefits of \$3.5 million, for 2015, and \$7.0 million, net of tax benefits of \$4.4 million, for 2014.

Restricted Stock Unit Awards - We have granted restricted stock unit awards to key employees that vest over a service period of generally three years and entitle the grantee to receive shares of our common stock. Restricted stock unit awards granted accrue dividend equivalents in the form of additional restricted stock units prior to vesting. Restricted stock unit awards are measured at fair value as if they were vested and issued on the grant date, reduced by expected dividend payments for awards.

that do not accrue dividends and adjusted for estimated forfeitures. Compensation expense is recognized on a straight-line basis over the vesting period of the award. A forfeiture rate of 3 percent per year based on historical forfeitures under our share-based payment plans is used.

Performance Stock Unit Awards - We have granted performance stock unit awards to key employees. The shares of common stock underlying the performance stock units vest at the expiration of a service period of generally three years if certain performance criteria are met by us as determined by the Executive Compensation Committee of the Board of Directors. Upon vesting, a holder of performance stock units is entitled to receive a number of shares of common stock equal to a percentage (0 percent to 200 percent) of the performance stock units granted, based on our total shareholder return over the vesting period, compared with the total shareholder return of a peer group of other utilities over the same period.

If paid, the outstanding performance stock unit awards entitle the grantee to receive shares of our common stock. The outstanding performance stock unit awards are equity awards with a market-based condition, which results in the compensation expense for these awards being recognized on a straight-line basis over the requisite service period, provided that the requisite service period is fulfilled, regardless of when, if ever, the market condition is satisfied. The performance stock unit awards granted accrue dividend equivalents in the form of additional performance stock units prior to vesting. The fair value of these performance stock units was estimated on the grant date based on a Monte Carlo model. The compensation expense on these awards will only be adjusted for changes in forfeitures. A forfeiture rate of 3 percent per year based on historical forfeitures under our share-based payment plans was used.

Restricted Stock Unit Award Activity

As of December 31, 2016, there was \$2.8 million of total unrecognized compensation costs related to the nonvested restricted stock unit awards, which is expected to be recognized over a weighted-average period of 1.7 years. The following tables set forth activity and various statistics for restricted stock unit awards outstanding under the respective plans for the period indicated:

| | Number of Units | Weighted- Average Price |
|-----------------------------|--------------------|----------------------------|
| Nonvested December 31, 2015 | 231,258 | \$ 32.59 |
| Granted | 42,935 | \$ 58.30 |
| Vested | (77,033) | \$ 23.76 |
| Forfeited | (2,260) | \$ 38.04 |
| Nonvested December 31, 2016 | 194,900 | \$ 41.68 |

| | 2016 | 2015 | 2014 |
|---|----------|----------|----------|
| Weighted-average grant date fair value (per share) | \$ 58.30 | \$ 41.40 | \$ 33.19 |
| Fair value of shares granted (thousands of dollars) | \$ 2,503 | \$ 3,141 | \$ 3,149 |

The fair value of restricted stock vested was \$4.5 million and \$6.5 million in 2016 and 2015, respectively.

Performance Stock Unit Award Activity

As of December 31, 2016, there was \$4.8 million of total unrecognized compensation cost related to the nonvested performance stock unit awards, which is expected to be recognized over a weighted-average period of 1.7 years. The following tables set forth activity and various statistics related to our performance stock unit awards and the assumptions used by us in the valuations of the 2016, 2015 and 2014 grants at the grant date:

| | Number of Units | Weighted- Average Price |
|-----------------------------|--------------------|----------------------------|
| Nonvested December 31, 2015 | 439,250 | \$ 27.35 |
| Granted | 74,395 | \$ 64.06 |
| Vested | (221,882) | \$ 15.11 |
| Forfeited | (2,952) | \$ 41.44 |
| Nonvested December 31, 2016 | 288,811 | \$ 46.06 |

| | 2016 | 2015 | 2014 |
|-------------------------|--------|--------|--------|
| Volatility (a) | 18.20% | 15.90% | 18.40% |
| Dividend yield | 2.40% | 2.90% | 3.37% |
| Risk-free interest rate | 0.91% | 1.10% | 0.67% |

(a) - Volatility based on historical volatility over three years using daily stock price observations of our peer utilities.

| | 2016 | 2015 | 2014 |
|---|----------|----------|----------|
| Weighted-average grant date fair value (per share) | \$ 64.06 | \$ 44.48 | \$ 35.98 |
| Fair value of shares granted (thousands of dollars) | \$ 4,766 | \$ 4,486 | \$ 4,462 |

The fair value of performance stock vested was \$19.5 million and \$23.5 million in 2016 and 2015, respectively.

Employee Stock Purchase Plan

We have reserved a total of 700 thousand shares of common stock for issuance under our Employee Stock Purchase Plan (the ESPP). Subject to certain exclusions, all employees who work at least 20 hours per week are eligible to participate in the ESPP. Employees can choose to have up to 10 percent of their annual base pay withheld to purchase our common stock, subject to terms and limitations of the plan. The purchase price of the stock is 85 percent of the lower of the average market price of our common stock on the grant date or exercise date. Approximately 41 percent, 40 percent and 36 percent of employees participated in the plan in 2016, 2015 and 2014, respectively, and purchased 83,431 shares at \$54.51 in 2016, 51,092 shares at \$36.15 in 2015, and 51,418 shares at \$32.29 in 2014. Compensation expense, before taxes, was \$1.4 million, \$1.3 million and \$0.4 million in 2016, 2015 and 2014, respectively.

Employee Stock Award Program

Under the Employee Stock Award Program, we issue, for no monetary consideration, one share of our common stock to all eligible employees when the per-share closing price of our common stock on the NYSE closes for the first time at or above each \$1.00 increment above \$34. The total number of shares of our common stock authorized for issuance under this program is 125,000. Shares issued to employees under this program during 2016, 2015 and 2014 totaled 50,573, 23,506 and 35,324, respectively, leaving 15,603 shares for future awards. Compensation expense, before taxes, related to the Employee Stock Award Program was \$3.0 million, \$1.1 million and \$2.5 million for 2016, 2015 and 2014, respectively.

11. EMPLOYEE BENEFIT PLANS

Retirement and Other Postemployment Benefit Plans

Retirement Plans - We have a defined benefit pension plan covering nonbargaining-unit employees hired before January 1, 2005, and certain bargaining-unit employees hired before December 15, 2011. Nonbargaining unit employees hired after December 31, 2004; employees represented by Local No. 304 of the International Brotherhood of Electrical Workers (IBEW) hired on or after July 1, 2010; employees represented by the United Steelworkers hired on or after December 15, 2011; and employees who accepted a one-time opportunity to opt out of the defined benefit pension plan are covered by a profit-sharing plan. Certain employees of the Texas Gas Service division are entitled to benefits under a frozen cash-balance pension plan. In addition, we have a supplemental executive retirement plan for the benefit of certain officers. No new participants in the supplemental executive retirement plan have been approved since 2005, and it was formally closed to new participants as of January 1, 2014. We fund our defined benefit pension costs at a level needed to maintain or exceed the minimum funding levels required by the Employee Retirement Income Security Act of 1974, as amended, and the Pension Protection Act of 2006. Pension expense was \$32.0 million, \$38.0 million and \$27.1 million in 2016, 2015 and 2014, respectively.

Other Postemployment Benefit Plans - We sponsor health and welfare plans that provide postemployment medical and life insurance benefits to certain employees who retire with at least five years of service. The postemployment medical plan is contributory based on hire date, age and years of service, with retiree contributions adjusted periodically, and contains other cost-sharing features such as deductibles and coinsurance. Other postemployment benefit expense was \$2.6 million, \$5.0 million and \$5.9 million in 2016, 2015 and 2014, respectively, prior to regulatory deferrals.

Plan Amendments - In October 2015, we announced to certain pre-65 participants in our postemployment medical plans a change from a self-insured postemployment medical plan to a plan providing participants an annual benefit that would allow them to select coverage on a healthcare exchange beginning January 1, 2017. As a result, we remeasured the respective plan

assets and liabilities, which resulted in a reduction in benefit obligations of our postemployment benefit plan of \$11.9 million in the fourth quarter of 2015.

In September 2016, due to uncertain market conditions with health insurance exchange providers, we elected not to move the eligible pre-65 participants in our postemployment medical plans to a healthcare exchange. As a result, we remeasured the respective plan assets and benefit obligations, effective September 30, 2016. In the fourth quarter of 2016, we further amended our other postemployment medical plan to allow certain participants access to reimbursable retirement accounts. The net impact of these plan amendments in 2016 was a \$483 thousand increase in our other postemployment benefit plan obligation.

Actuarial Assumptions - The following table sets forth the weighted-average assumptions used to determine benefit obligations for pension and postemployment benefits for the periods indicated:

| | December 31, | |
|--|---------------|---------------|
| | 2016 | 2015 |
| Discount rate - pension plans | 4.30% | 4.75% |
| Discount rate - other postemployment plans | 4.20% | 4.75% |
| Compensation increase rate | 3.25% - 3.40% | 3.35% - 3.40% |

The following table sets forth the weighted-average assumptions used by us to determine the periodic benefit costs for the periods indicated:

| | Nine Months Ended September 30, 2016 | Three Months Ended December 31, 2016 | Years Ended December 31, | |
|---|--|--|--------------------------|---------------|
| | | | 2015 | 2014 |
| Discount rate - pension plans | 4.75% | 4.75% | 4.25%/4.75% | (a) 5.25% |
| Discount rate - other postemployment plans | 4.75% | 3.75% | 4.25%/4.75% | (a) 5.00% |
| Expected long-term return on plan assets - pension plans | 7.75% | 7.75% | 7.75% | 7.75% |
| Expected long-term return on plan assets - other postemployment plans | 8.00% | 7.75% | 7.75% | 7.75% |
| Compensation increase rate | 3.35% - 3.40% | 3.35% - 3.40% | 3.30% - 3.50% | 3.35% - 3.50% |

(a) Discount rate for the nine months ended September 30, 2015, and three months ended December 31, 2015, respectively.

We determine our overall expected long-term rate of return on plan assets, based on our review of historical returns and economic growth models. At December 31, 2016, we updated our assumed mortality rates to incorporate the new set of mortality tables issued by the Society of Actuaries in October 2016.

We determine our discount rates annually. We estimate our discount rate based upon a comparison of the expected cash flows associated with our future payments under our defined benefit pension and other postemployment obligations to a hypothetical bond portfolio created using high-quality bonds that closely match expected cash flows. Bond portfolios are developed by selecting a bond for each of the next 60 years based on the maturity dates of the bonds. Bonds selected to be included in the portfolios are only those rated by Moody's as AA- or better and exclude callable bonds, bonds with less than a minimum issue size, yield outliers and other filtering criteria to remove unsuitable bonds.

Regulatory Treatment - The OCC, KCC and regulatory authorities in Texas have approved the recovery of pension costs and other postemployment benefits costs through rates for Oklahoma Natural Gas, Kansas Gas Service and Texas Gas Service, respectively. The costs recovered through rates are based on current funding requirements and the net periodic benefit cost for defined benefit pension and other postemployment costs. Differences, if any, between the expense and the amount recovered through rates would be reflected in earnings, net of authorized deferrals.

We historically have recovered defined benefit pension and other postemployment benefit costs through rates. We believe it is probable that regulators will continue to include the net periodic pension and other postemployment benefit costs in our cost of service.

Obligations and Funded Status - The following table sets forth our defined benefit pension and other postemployment benefit plans, benefit obligations and fair value of plan assets for the periods indicated:

| | Pension Benefits | | Other Postemployment Benefits | |
|--|-------------------------------|--------------|-------------------------------|-------------|
| | December 31, | | December 31, | |
| | 2016 | 2015 | 2016 | 2015 |
| Changes in Benefit Obligation | | | | |
| | <i>(Thousands of dollars)</i> | | | |
| Benefit obligation, beginning of period | \$ 985,624 | \$ 1,028,171 | \$ 228,253 | \$ 257,688 |
| Service cost | 12,055 | 13,660 | 2,675 | 3,257 |
| Interest cost | 45,550 | 43,542 | 10,235 | 10,628 |
| Plan participants' contributions | — | — | 3,043 | 2,915 |
| Actuarial loss (gain) | 25,886 | (47,607) | 14,309 | (19,702) |
| Benefits paid | (71,066) | (52,142) | (15,450) | (14,632) |
| Plan amendment | — | — | 483 | (11,901) |
| Settlements | (31,518) | — | — | — |
| Benefit obligation, end of period | 966,531 | 985,624 | 243,548 | 228,253 |
| Change in Plan Assets | | | | |
| Fair value of plan assets, beginning of period | 785,161 | 845,396 | 155,495 | 151,777 |
| Actual return on plan assets | 48,768 | (9,026) | 9,733 | 1,335 |
| Employer contributions | 12,441 | 933 | 13,225 | 14,100 |
| Plan participants' contributions | — | — | 3,043 | 2,915 |
| Benefits paid | (71,066) | (52,142) | (15,450) | (14,632) |
| Settlements | (35,718) | — | — | — |
| Fair value of assets, end of period | 739,586 | 785,161 | 166,046 | 155,495 |
| Balance at December 31 | \$ (226,945) | \$ (200,463) | \$ (77,502) | \$ (72,758) |
| Current liabilities | \$ (941) | \$ (912) | \$ — | \$ — |
| Noncurrent liabilities | (226,004) | (199,551) | (77,502) | (72,758) |
| Balance at December 31 | \$ (226,945) | \$ (200,463) | \$ (77,502) | \$ (72,758) |

In the fourth quarter of 2016, we settled a portion of our benefit obligation with the purchase of annuities. Benefits paid reflects \$18.1 million of lump sum payments to certain terminated vested participants. The accumulated benefit obligation for our defined benefit pension plans was \$912.4 million and \$934.3 million at December 31, 2016 and 2015, respectively.

There are no plan assets expected to be withdrawn and returned to us in 2017.

Components of Net Periodic Benefit Cost - The following tables set forth the components of net periodic benefit cost for our defined benefit pension and other postemployment benefit plans for the period indicated:

| | Pension Benefits | | |
|---|--------------------------------|-------------|-------------|
| | Year Ended December 31, | | |
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Components of net periodic benefit cost | | | |
| Service cost | \$ 12,055 | \$ 13,660 | \$ 11,620 |
| Interest cost | 45,550 | 43,542 | 43,791 |
| Expected return on assets | (61,183) | (61,769) | (59,862) |
| Amortization of unrecognized prior service cost | — | 266 | 549 |
| Amortization of net loss | 35,543 | 42,226 | 30,200 |
| Settlements | — | 27 | 773 |
| Net periodic benefit cost | \$ 31,965 | \$ 37,952 | \$ 27,071 |

| | Other Postemployment Benefits | | |
|---|--------------------------------------|-------------|-------------|
| | Year Ended December 31, | | |
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Components of net periodic benefit cost | | | |
| Service cost | \$ 2,675 | \$ 3,257 | \$ 3,468 |
| Interest cost | 10,235 | 10,628 | 11,605 |
| Expected return on assets | (12,370) | (11,892) | (11,393) |
| Amortization of unrecognized prior service cost | (3,316) | (2,228) | (1,760) |
| Amortization of net loss | 5,369 | 5,268 | 3,969 |
| Net periodic benefit cost | \$ 2,593 | \$ 5,033 | \$ 5,889 |

Other Comprehensive Income (Loss) - The following table sets forth the amounts recognized in other comprehensive income (loss) related to our defined benefit pension benefits for the period indicated:

| | Pension Benefits | | |
|---|--------------------------------|-------------|-------------|
| | Year Ended December 31, | | |
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Net gain (loss) arising during the period | \$ (1,262) | \$ 339 | \$ (3,543) |
| Amortization of loss | 751 | 917 | 518 |
| Deferred income taxes | 197 | (483) | 1,244 |
| Total recognized in other comprehensive income (loss) | \$ (314) | \$ 773 | \$ (1,781) |

There were no amounts recognized in other comprehensive income (loss) related to our other postemployment benefits for the periods presented.

The tables below set forth the amounts in accumulated other comprehensive income (loss) that had not yet been recognized as components of net periodic benefit expense for the periods indicated:

| | Pension Benefits | |
|---|-------------------------------|-------------|
| | December 31, | |
| | 2016 | 2015 |
| | <i>(Thousands of dollars)</i> | |
| Prior service credit (cost) | \$ — | \$ — |
| Accumulated loss | (414,757) | (407,798) |
| Accumulated other comprehensive loss before regulatory assets | (414,757) | (407,798) |
| Regulatory asset for regulated entities | 407,073 | 400,625 |
| Accumulated other comprehensive loss after regulatory assets | (7,684) | (7,173) |
| Deferred income taxes | 2,969 | 2,772 |
| Accumulated other comprehensive loss, net of tax | \$ (4,715) | \$ (4,401) |

| | Other Postemployment Benefits | |
|---|--------------------------------------|-------------|
| | December 31, | |
| | 2016 | 2015 |
| | <i>(Thousands of dollars)</i> | |
| Prior service credit (cost) | \$ 10,211 | \$ 14,010 |
| Accumulated loss | (62,084) | (50,447) |
| Accumulated other comprehensive loss before regulatory assets | (51,873) | (36,437) |
| Regulatory asset for regulated entities | 51,873 | 36,437 |
| Accumulated other comprehensive loss after regulatory assets | — | — |
| Deferred income taxes | — | — |
| Accumulated other comprehensive loss, net of tax | \$ — | \$ — |

The following table sets forth the amounts recognized in either accumulated comprehensive income (loss) or regulatory assets expected to be recognized as components of net periodic benefit expense in the next fiscal year:

| | Pension Benefits | Other Postemployment Benefits |
|---|-------------------------------|--------------------------------------|
| Amounts to be recognized in 2017 | <i>(Thousands of dollars)</i> | |
| Prior service credit (cost) | \$ — | \$ (4,597) |
| Actuarial net loss | \$ 36,107 | \$ 6,484 |

Health Care Cost Trend Rates - The following table sets forth the assumed health care cost-trend rates for the periods indicated:

| | 2016 | 2015 |
|---|-------------|---------------|
| Health care cost-trend rate assumed for next year | 7.25% | 4.00% - 7.50% |
| Rate to which the cost-trend rate is assumed to decline (the ultimate trend rate) | 5.00% | 4.00% - 5.00% |
| Year that the rate reaches the ultimate trend rate | 2022 | 2022 |

Assumed health care cost-trend rates have a significant effect on the amounts reported for our health care plans. A one percentage point change in assumed health care cost-trend rates would have the following effects:

| | One Percentage Point Increase | One Percentage Point Decrease |
|---|--|--|
| | <i>(Thousands of dollars)</i> | |
| Effect on total of service and interest cost | \$ 233 | \$ (232) |
| Effect on other postemployment benefit obligation | \$ 3,937 | \$ (3,991) |

Plan Assets - Our investment strategy is to invest plan assets in accordance with sound investment practices that emphasize long-term fundamentals. The goal of this strategy is to maximize investment returns while managing risk in order to meet the plan's current and projected financial obligations. To achieve this strategy, we have established a liability-driven investment strategy to change the allocations as the plan reaches certain funded status. The plan's investments include a diverse blend of various domestic and international equities, investment-grade debt securities which mirror the cash flows of our liability, insurance contracts and alternative investments. The current target allocation for the assets of our defined benefit pension plan is as follows:

| | |
|--------------------------------------|-------|
| U.S. large-cap equities | 37.4% |
| Investment-grade bonds | 30.0% |
| Developed foreign large-cap equities | 10.6% |
| Alternative investments | 7.7% |
| Mid-cap equities | 5.6% |
| Emerging markets equities | 5.0% |
| Small-cap equities | 3.7% |
| Total | 100% |

As part of our risk management for the plans, minimums and maximums have been set for each of the asset classes listed above. All investment managers for the plan are subject to certain restrictions on the securities they purchase and, with the exception of indexing purposes, are prohibited from owning our stock.

The current target allocation for the assets of our other postemployment benefits plan is 30 percent fixed income securities and 70 percent equity securities.

The following tables set forth our pension benefits and other postemployment benefits plan assets by fair value category as of the measurement date:

| Asset Category | Pension Benefits December 31, 2016 | | | |
|---|---------------------------------------|-------------------|-------------------|-------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Investments: | | | | |
| Equity securities (a) | \$ 371,655 | \$ 58,987 | \$ — | \$ 430,642 |
| Government obligations | — | 47,445 | — | 47,445 |
| Corporate obligations (b) | — | 129,036 | — | 129,036 |
| Cash and money market funds (c) | 13,786 | 16,114 | — | 29,900 |
| Insurance contracts and group annuity contracts | — | — | 45,140 | 45,140 |
| Other investments (d) | — | 71 | 57,352 | 57,423 |
| Total assets | \$ 385,441 | \$ 251,653 | \$ 102,492 | \$ 739,586 |

(a) - This category represents securities of the various market sectors from diverse industries.

(b) - This category represents bonds from diverse industries.

(c) - This category is primarily money market funds.

(d) - This category represents alternative investments such as hedge funds and other financial instruments.

| Asset Category | Pension Benefits December 31, 2015 | | | |
|---|---------------------------------------|-------------------|-------------------|-------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Investments: | | | | |
| Equity securities (a) | \$ 405,935 | \$ 62,150 | \$ — | \$ 468,085 |
| Government obligations | — | 44,651 | — | 44,651 |
| Corporate obligations (b) | — | 139,396 | — | 139,396 |
| Cash and money market funds (c) | 5,429 | 10,279 | — | 15,708 |
| Insurance contracts and group annuity contracts | — | — | 56,465 | 56,465 |
| Other investments (d) | 2,884 | — | 57,972 | 60,856 |
| Total assets | \$ 414,248 | \$ 256,476 | \$ 114,437 | \$ 785,161 |

(a) - This category represents securities of the various market sectors from diverse industries.

(b) - This category represents bonds from diverse industries.

(c) - This category is primarily money market funds.

(d) - This category represents alternative investments such as hedge funds and other financial instruments.

| Other Postemployment Benefits | | | | |
|---|------------------|-------------------|----------------|-------------------|
| December 31, 2016 | | | | |
| Asset Category | Level 1 | Level 2 | Level 3 | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Investments: | | | | |
| Equity securities (a) | \$ 39,817 | \$ 7,323 | \$ — | \$ 47,140 |
| Government obligations | — | 75 | — | 75 |
| Corporate obligations (b) | — | 19,948 | — | 19,948 |
| Cash and money market funds (c) | 74 | 16,989 | — | 17,063 |
| Insurance contracts and group annuity contracts | — | 81,820 | — | 81,820 |
| Total assets | \$ 39,891 | \$ 126,155 | \$ — | \$ 166,046 |

(a) - This category represents securities of the various market sectors from diverse industries.

(b) - This category represents bonds from diverse industries.

(c) - This category is primarily money market funds.

| Other Postemployment Benefits | | | | |
|---|------------------|-------------------|----------------|-------------------|
| December 31, 2015 | | | | |
| Asset Category | Level 1 | Level 2 | Level 3 | Total |
| <i>(Thousands of dollars)</i> | | | | |
| Investments: | | | | |
| Equity securities (a) | \$ 54,560 | \$ 7,498 | \$ — | \$ 62,058 |
| Government obligations | — | 64 | — | 64 |
| Corporate obligations (b) | — | 200 | — | 200 |
| Cash and money market funds (c) | 233 | 13,322 | — | 13,555 |
| Insurance contracts and group annuity contracts | — | 79,531 | — | 79,531 |
| Other investments (d) | 4 | — | 83 | 87 |
| Total assets | \$ 54,797 | \$ 100,615 | \$ 83 | \$ 155,495 |

(a) - This category represents securities of the various market sectors from diverse industries.

(b) - This category represents bonds from diverse industries.

(c) - This category is primarily money market funds.

(d) - This category represents alternative investments such as hedge funds.

The following table sets forth the reconciliation of Level 3 fair value measurements of our pension plans for the periods indicated:

| | Pension Benefits | | |
|--|----------------------------|--------------------------|-------------------|
| | Insurance Contracts | Other Investments | Total |
| <i>(Thousands of dollars)</i> | | | |
| January 1, 2015 | \$ 59,877 | \$ 57,914 | \$ 117,791 |
| Net realized and unrealized gains (losses) | 2,188 | 58 | 2,246 |
| Settlements | (5,600) | — | (5,600) |
| December 31, 2015 | \$ 56,465 | \$ 57,972 | \$ 114,437 |
| Net realized and unrealized gains (losses) | 4,518 | (620) | 3,898 |
| Sales and settlements | (15,843) | — | (15,843) |
| December 31, 2016 | \$ 45,140 | \$ 57,352 | \$ 102,492 |

Contributions - During 2016 , we contributed \$12.4 million to our defined benefit pension plans and we contributed \$13.2 million to our other postemployment benefit plans. In 2017 , we expect to contribute \$1.0 million to our defined benefit pension plans and expect to contribute \$3.1 million to our other postemployment benefit plans.

Pension and Other Postemployment Benefit Payments - Benefit payments for our defined benefit pension and other postemployment benefit plans for the period ended December 31, 2016 were \$71.1 million and \$15.5 million , respectively. The following table sets forth the pension benefits and other postemployment benefits payments expected to be paid in 2017-2026:

| | Pension Benefits | Other Postemployment Benefits |
|--------------------------------|-------------------------------|--|
| Benefits to be paid in: | <i>(Thousands of dollars)</i> | |
| 2017 | \$ 51,539 | \$ 16,165 |
| 2018 | \$ 52,660 | \$ 16,815 |
| 2019 | \$ 53,450 | \$ 17,073 |
| 2020 | \$ 54,812 | \$ 17,379 |
| 2021 | \$ 56,033 | \$ 17,401 |
| 2022 through 2026 | \$ 294,519 | \$ 86,559 |

The expected benefits to be paid are based on the same assumptions used to measure our benefit obligation at December 31, 2016 , and include estimated future employee service.

Other Employee Benefit Plans

401(k) Plan - We have a 401(k) Plan which covers all full-time employees, and employee contributions are discretionary. We match 100 percent of each participant's eligible contribution up to 6 percent of eligible compensation, subject to certain limits. Our contributions made to the plan were \$10.8 million , \$10.2 million and \$9.7 million in 2016, 2015 and 2014 , respectively.

Profit-Sharing Plan - We have a profit-sharing plan for all employees that do not participate in our defined benefit pension plan. We plan to make a contribution to the profit-sharing plan each quarter equal to 1 percent of each participant's eligible compensation during the quarter. Additional discretionary employer contributions may be made at the end of each year. Employee contributions are not allowed under the plan. Our contributions made to the plan were \$6.0 million , \$6.5 million and \$4.0 million in 2016, 2015 and 2014 , respectively.

Employee Deferred Compensation Plan - Our Nonqualified Deferred Compensation Plan provides select employees with the option to defer portions of their compensation and provides nonqualified deferred compensation benefits that are not available due to limitations on employer and employee contributions to qualified defined contribution plans under the federal tax laws. Contributions made to the plan were not material in 2016, 2015 and 2014 .

12. INCOME TAXES

The following table sets forth our provision for income taxes for the periods indicated:

| | Years Ended December 31, | | |
|-------------------------------------|---------------------------------|------------------|------------------|
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Current income tax provision | | | |
| Federal | \$ (2,016) | \$ 7,135 | \$ 17,006 |
| State | 471 | 2,055 | 1,397 |
| Total current income tax provision | (1,545) | 9,190 | 18,403 |
| Deferred income tax provision | | | |
| Federal | 76,247 | 56,440 | 42,024 |
| State | 10,541 | 7,349 | 7,911 |
| Total deferred income tax provision | 86,788 | 63,789 | 49,935 |
| Total provision for income taxes | \$ 85,243 | \$ 72,979 | \$ 68,338 |

The following table is a reconciliation of our income tax provision for the periods indicated:

| | Years Ended December 31, | | |
|--|---------------------------------|------------------|------------------|
| | 2016 | 2015 | 2014 |
| | <i>(Thousands of dollars)</i> | | |
| Income before income taxes | \$ 225,338 | \$ 192,009 | \$ 178,128 |
| Federal statutory income tax rate | 35% | 35% | 35% |
| Provision for federal income taxes | 78,868 | 67,203 | 62,345 |
| State income taxes, net of federal tax benefit | 7,158 | 6,114 | 6,051 |
| Other, net | (783) | (338) | (58) |
| Total provision for income taxes | \$ 85,243 | \$ 72,979 | \$ 68,338 |

The following table sets forth the tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and liabilities for the periods indicated:

| | December 31, | |
|---|---------------------------------|-------------------|
| | 2016 | 2015 |
| | <i>(Thousands of dollars)</i> | |
| Deferred tax assets | | |
| Employee benefits and other accrued liabilities | \$ 123,333 | \$ 110,148 |
| Net operating loss | 23,094 | — |
| Other | 5,716 | 7,848 |
| Total deferred tax assets | 152,143 | 117,996 |
| Deferred tax liabilities | | |
| Excess of tax over book depreciation | 990,682 | 897,667 |
| Purchased-gas cost adjustment | 13,822 | 3,999 |
| Other regulatory assets and liabilities, net | 186,207 | 168,115 |
| Total deferred tax liabilities | 1,190,711 | 1,069,781 |
| Net deferred tax liabilities | \$ 1,038,568 | \$ 951,785 |

As of December 31, 2016, we have federal and state income tax net operating loss (NOL) carryforwards of \$63.0 million and \$21.0 million, respectively, which will expire at various dates from 2024 through 2036. We believe that it is more likely than not that the tax benefits of the NOL carryforwards will be utilized prior to their expirations; therefore, no valuation allowance is necessary.

Deferred tax assets related to tax benefits of employee share-based compensation have been reduced for performance share units and restricted share units that vested in periods in which we were in an NOL position. This vesting resulted in tax

deductions in excess of previously recorded benefits based on the performance share unit and restricted share unit value at the time of grant. Although these additional tax benefits are reflected in NOL carryforwards in the tax return, the additional tax benefit is not recognized until the deduction reduces taxes payable. A portion of the tax benefit does not reduce our current taxes payable due to NOL carryforwards; accordingly, these tax benefits are not reflected in our NOLs in deferred tax assets. Cumulative tax benefits included in NOL carryforwards but not reflected in deferred tax assets were \$11.0 million as of December 31, 2016.

We have filed our consolidated federal and state tax returns for years 2014 and 2015.

13. COMMITMENTS AND CONTINGENCIES

Commitments - Operating leases represent future minimum lease payments under noncancelable leases covering office space, facilities and information technology hardware and software. Rental expense was \$8.6 million in 2016 and \$5.0 million in each of 2015 and 2014. The following table sets forth our operating lease payments for the periods indicated:

| Operating Leases | |
|--------------------------------|----------------|
| <i>(Millions of dollars)</i> | |
| 2017 | \$ 5.6 |
| 2018 | 5.2 |
| 2019 | 4.4 |
| 2020 | 3.6 |
| 2021 | 3.2 |
| Thereafter | 4.4 |
| Total | \$ 26.4 |

Environmental Matters - We are subject to multiple historical, wildlife preservation and environmental laws and/or regulations, which affect many aspects of our present and future operations. Regulated activities include, but are not limited to, those involving air emissions, storm water and wastewater discharges, handling and disposal of solid and hazardous wastes, wetland preservation, hazardous materials transportation, and pipeline and facility construction. These laws and regulations require us to obtain and/or comply with a wide variety of environmental clearances, registrations, licenses, permits and other approvals. Failure to comply with these laws, regulations, licenses and permits may expose us to fines, penalties and/or interruptions in our operations that could be material to our results of operations. In addition, emission controls and/or other regulatory or permitting mandates under the Clean Air Act and other similar federal and state laws could require unexpected capital expenditures. We cannot assure that existing environmental statutes and regulations will not be revised or that new regulations will not be adopted or become applicable to us. Revised or additional statutes or regulations that result in increased compliance costs or additional operating restrictions could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We own or retain legal responsibility for the environmental conditions at 12 former manufactured natural gas sites in Kansas. These sites contain potentially harmful materials that are subject to control or remediation under various environmental laws and regulations. A consent agreement with the KDHE governs all work at these sites. The terms of the consent agreement require us to investigate these sites and set remediation activities based upon the results of the investigations and risk analysis. Remediation typically involves the management of contaminated soils and may involve removal of structures and monitoring and/or remediation of groundwater.

We have completed or addressed removal of the source of soil contamination at 11 of the 12 sites, and continue to monitor groundwater at eight of the 12 sites according to plans approved by the KDHE. Regulatory closure has been achieved at three of the sites, subject to any future regulatory remediation requirements that may require additional costs. During 2016, we completed a site assessment at the twelfth site where no active soil remediation has occurred. We have submitted a work plan to the KDHE for approval to remove contaminated soil at this site. Costs associated with the remediation at this site are not expected to be material to our results of operations or financial position.

With regard to one of our other former manufactured natural gas sites, recent results from periodic monitoring and a 2016 interim site investigation indicated elevated levels of potentially harmful materials at the site. In response to the results of the interim site investigation, during the fourth quarter of 2016, potential investigation and remediation alternatives were developed. We have estimated the potential costs associated with additional investigation and remediation to be in the range of \$4.0 million to \$7.0 million. Additional testing and work plan development will be conducted in 2017 to determine a remediation work plan to present to the KDHE for approval and could impact our estimates of the cost of remediation at this

site. A single reliable estimate of the remediation costs is not feasible due to the amount of uncertainty in the ultimate remediation approach that will be utilized. Accordingly, in the fourth quarter of 2016, we recorded a reserve of \$4.0 million for this site.

Our expenditures for environmental evaluation, mitigation, remediation and compliance to date have not been significant in relation to our financial position, results of operations or cash flows, and our expenditures related to environmental matters had no material effects on earnings or cash flows during 2016, 2015 and 2014. A number of environmental issues may exist with respect to manufactured gas plants that are unknown to us. Accordingly, future costs are dependent on the final determination and regulatory approval of any remedial actions, the complexity of the site, level of remediation required, changing technology and governmental regulations, and to the extent not recovered by insurance or recoverable in rates from our customers, could be material to our financial condition, results of operations or cash flows.

With the trend toward stricter standards, greater regulation and more extensive permit requirements for the types of assets operated by us that are subject to environmental regulation, our environmental expenditures could increase in the future, and such expenditures may not be fully recovered by insurance or recoverable in rates from our customers, and those costs may adversely affect our financial condition, results of operations and cash flows. We do not expect expenditures for these matters to have a material adverse effect on our financial condition, results of operations or cash flows.

Pipeline Safety - We are subject to PHMSA regulations, including integrity-management regulations. PHMSA regulations require pipeline companies operating high-pressure transmission pipelines to perform integrity assessments on pipeline segments that pass through densely populated areas or near specifically designated high-consequence areas. In January 2012, the Pipeline Safety, Regulatory Certainty and Job Creation Act was signed into law. The law increased maximum penalties for violating federal pipeline safety regulations and directs the DOT and the Secretary of Transportation to conduct further review or studies on issues that may or may not be material to us. These issues include, but are not limited to, the following:

- an evaluation of whether natural gas pipeline integrity-management requirements should be expanded beyond current high-consequence areas;
- a verification of records for pipelines in class 3 and 4 locations and high-consequence areas to confirm maximum allowable operating pressures; and
- a requirement to test previously untested pipelines operating above 30 percent yield strength in high-consequence areas.

In April 2016, PHMSA published a NPRM, the Safety of Gas Transmission & Gathering Lines Rule, in the Federal Register to revise pipeline safety regulations applicable to the safety of onshore natural gas transmission and gathering pipelines. Proposals include changes to pipeline integrity management requirements and other safety-related requirements. The NPRM comment period ended July 7, 2016, and comments are under review by PHMSA. The potential capital and operating expenditures associated with the NPRM are currently being evaluated and could be significant depending on the final regulations.

Legal Proceedings - We are a party to various litigation matters and claims that have arisen in the normal course of our operations. While the results of litigation and claims cannot be predicted with certainty, we believe the reasonably possible losses from such matters, individually and in the aggregate, are not material. Additionally, we believe the probable final outcome of such matters will not have a material adverse effect on our results of operations, financial position or cash flows.

14. QUARTERLY FINANCIAL DATA (UNAUDITED)

| Year Ended December 31, 2016 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|------------------------------|---------------------------------|-------------------|------------------|-------------------|
| | <i>(Thousands of dollars)</i> | | | |
| Revenues | \$ 508,364 | \$ 245,923 | \$ 232,191 | \$ 440,754 |
| Operating income | \$ 116,073 | \$ 43,621 | \$ 30,892 | \$ 78,534 |
| Net income | \$ 64,743 | \$ 20,300 | \$ 12,737 | \$ 42,315 |
| Earnings per share | | | | |
| Basic | \$ 1.23 | \$ 0.39 | \$ 0.24 | \$ 0.81 |
| Diluted | \$ 1.22 | \$ 0.38 | \$ 0.24 | \$ 0.80 |

| Year Ended December 31, 2015 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|------------------------------|---------------------------------|-------------------|------------------|-------------------|
| | <i>(Thousands of dollars)</i> | | | |
| Revenues | \$ 676,531 | \$ 256,786 | \$ 225,226 | \$ 389,149 |
| Operating income | \$ 109,005 | \$ 31,270 | \$ 24,951 | \$ 73,903 |
| Net income | \$ 60,381 | \$ 12,076 | \$ 7,371 | \$ 39,202 |
| Earnings per share | | | | |
| Basic | \$ 1.15 | \$ 0.23 | \$ 0.14 | \$ 0.75 |
| Diluted | \$ 1.13 | \$ 0.23 | \$ 0.14 | \$ 0.74 |

ONE Gas, Inc.
Financial Ratios
For the Year Ended December 31, 2016

Attachment B-6

| | <u>Utility Operations</u> |
|---|-------------------------------|
| <u>Total debt to total capitalization</u> | |
| Notes payable (includes commercial paper) | 145,000 |
| Current maturities of long-term debt | 7 |
| Current portion of capitalized lease obligations | - |
| Long-term debt | 1,201,297 |
| Capitalized lease obligation | - |
| Total off balance sheet debt | <u>1,346,304</u> |
| Notes payable (includes commercial paper) | 145,000 |
| Current maturities of long-term debt | 7 |
| Current portion of capitalized lease obligations | - |
| Long-term debt | 1,201,297 |
| Capitalized lease obligation | - |
| Total equity | <u>1,888,280</u> |
| Total capitalization | <u>3,234,584</u> |
| Total debt to total capitalization | 42% |
| <u>Funds from operations interest coverage</u> | |
| Net income from continuing operations | 140,095 |
| Depreciation & amortization | 143,829 |
| Deferred income taxes (excluding investment tax credit) | 86,788 |
| Investment tax credit | - |
| Allowance for debt funds used during construction | (3,601) |
| Allowance for equity funds used during construction | - |
| Equity earnings from investments | - |
| Distributions received | - |
| Gain (loss) on sale of assets | - |
| Deferred income tax adjustment | - |
| | <u>367,111</u> |
| Cash paid for interest, net of amounts capitalized | 42,129 |
| Allowance for debt funds used during construction | 3,601 |
| Interest expense adjustment | - |
| Interest on off balance sheet debt | - |
| | <u>45,730</u> |
| | 412,841 |
| Interest expense, net | 43,739 |
| Interest expense adjustment | - |
| Allowance for debt funds used during construction | 3,601 |
| Interest on off balance sheet debt | - |
| | <u>47,340</u> |
| Funds from operations interest coverage | 8.72 |
| <u>Funds from operations as a percentage of total debt</u> | |
| Net income from continuing operations | 140,095 |
| Depreciation & amortization | 143,829 |
| Deferred income taxes (excluding investment tax credit) | 86,788 |
| Investment tax credit | - |
| Allowance for equity funds used during construction | - |
| Allowance for debt funds used during construction | (3,601) |
| Equity earnings from investments | - |
| Distributions received | - |
| Gain (loss) on sale of assets | - |
| Deferred income tax adjustment | - |
| | <u>367,111</u> |
| Depreciation adj for operating leases | - |
| Notes payable (includes commercial paper) | 145,000 |
| Current maturities of long-term debt | 7 |
| Current portion of capitalized lease obligations | - |
| Long-term debt | 1,201,297 |
| Capitalized lease obligations | - |
| Total off balance sheet debt | <u>1,346,304</u> |
| Funds from operations as a percentage of total debt | 27% |