



Your Water
Our Business



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Highlights Of 2004

Financial	2004	2003
Service Revenue	\$7,112,000	\$6,503,000
Net Loss	(\$677,040)	(\$1,459,000)
Total Municipal Position	\$1,060,000	\$1,737,000
Operations	2004	2003
Number of Customers	25,956	25,527
Annual Sales (m3)	10,450,470	10,753,931
Peak Daily System Demand (m3)	49,600	65,727

EXCEPT FOR THE AIR WE BREATHE, WATER IS THE SINGLE MOST IMPORTANT ELEMENT IN OUR LIVES AND WE TRUST THAT AN ABUNDANT SUPPLY OF CLEAN, SAFE DRINKING WATER IS ALWAYS THERE WHEN WE NEED IT.



H.J. Brian Curran P.Eng., MBA

President, Public Utilities Commission

To: Mark Howson and Members of the Public Utilities Commission

Water delivered to residents and businesses of Sault Ste. Marie in 2004 met or exceeded the requirements of the Ontario Drinking Water Act.

Water rates increased by 13% but revenues for the year increased by only 6% as water consumption declined by 7%. Operating expenses declined by 3% due in large part to a significant decrease in watermain breaks from 193 in 2003 to 84 in 2004. Last year saw one of the least number of watermain breaks, while 2003 was a record year for breaks. We experienced a loss of \$677,040 after operating and capital expenditures, an improvement from a loss of \$1,459,754 in the previous year.

A 10% increase in water rates was approved for 2005. Despite the increase residents of Sault Ste. Marie will continue to enjoy among the lowest water rates in Ontario. The increase will cost the average residential consumer an additional \$1.54 per month.

Staff responsible for both the water treatment and distribution systems remain vigilant to protect system integrity. Monitoring wells were completed to allow collection and analysis of groundwater samples. Groundwater supplies approximately half of the water consumed by Sault Ste. Marie and its quality must not be allowed to deteriorate.

Water department personnel because they remain alert to any anomalies in the system were able to detect a major leak that was not apparent by surface inspection. When discovered, the force of the water from the break had seriously undermined a roadway in front of a school. If not discovered the road surface would have failed from vehicle traffic and may have caused serious personal injury and property damage.

A handwritten signature in black ink, appearing to read "H.J. Curran", written in a cursive style.

Year in Review

The Public Utilities Commission is responsible for the maintenance and operation of the waterworks for the City of Sault Ste. Marie. The Commission ensures that municipally owned waterworks provide safe, reliable potable water at cost for household use, fire protection, commercial and industrial processes to residential and businesses within the municipal services boundary of Sault Ste. Marie. Potable water is also supplied to an area of the Rankin First Nations Reserve.

The water filtration plant is rated at 40,000 cubic meters/day, but is capable of operating at 60,000 cubic meters/day. The plant has been designed to extend its capacity to 120,000 cubic meters/day when the demand arises at a future date. The water intake is located at Gros Cap and extends 860 meters into Lake Superior at a depth of 17 meters. The Gros Cap Pumping Station pumps water to the Marshall Drive Control Tanks. Raw water then travels by gravity to the inlet of the Water Filtration Plant. The plant uses direct filtration, incorporating chemically assisted coagulation, flocculation and dual media filtration. Water from six deep wells located in the east urban and west urban areas of the City blends in the distribution system with the water from the filtration plant.

The management, maintenance and operation of the waterworks system are carried out by PUC Services Inc. under a 10 year contract.

Water Rates

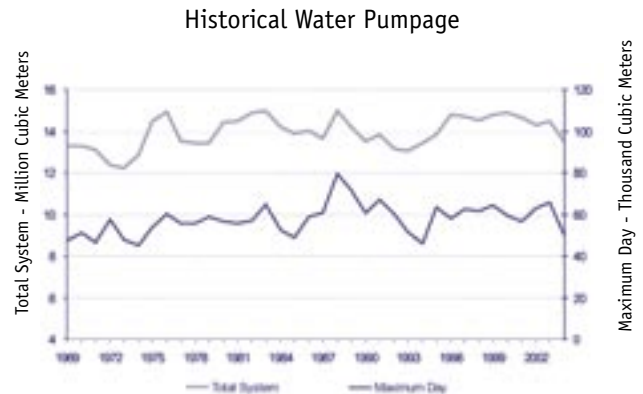
The Commission approved a by-law to establish new water rates effective January 1, 2004 in order to provide sufficient revenues to cover costs for water treatment, distribution, maintenance and capital requirements. The average increase was approximately 13% although individual customers may have experienced higher or lower increases due to their consumption levels, the difference in the monthly fixed charges and the volumetric charge. A further 10% rate increase effective January 1, 2005 was approved by the Commission. Even with the increases, Sault Ste. Marie water rates are still among the lowest in Ontario.

Water Quality

PUC Services Inc. personnel routinely tests both raw and treated water at various points in the treatment and distribution system in accordance with the requirements specified by the Ministry of the Environment (MOE). All test results are available for review by accessing either the PUC website (www.smpuc.com) or the City of Sault Ste. Marie's website (www.city.sault-ste-marie.on.ca/puc/puc_main.htm) or by requesting a copy of the results from the Commission.

System Total Pumpage

Total water production in 2004 was 13.47 million cubic meters compared to 14.48 in 2003. The maximum daily pumpage in the year was 49.6 thousand cubic meters, which occurred in July. The capacity of the supply and treatment system is approximately double present demand. Average consumption has fluctuated around 14 million cubic meters over the past three decades.



Watermain Breaks

There were 84 total breaks the period of November 1, 2003 to October 31, 2004. The past ten year average is 113. The chart below summarizes annual totals since the winter of 1984-85.

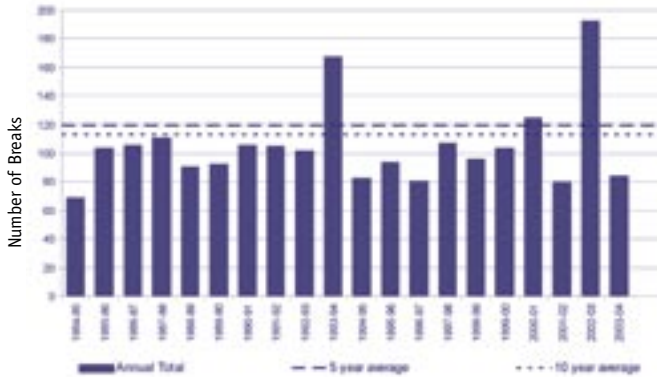
There were 10 breaks recorded in November, 2004. Six of those breaks occurred on November 27th after a power interruption took out power to the Zone Two Booster Station, causing a water hammer in the system. A seventh related break was later discovered on December 30th and had the potential for serious consequences.

December consumption figures were indicating an unusual increase in demand, in the order of 40% above the same period in 2003. The increase did not relate to any obvious customer usage and was traced back to about November 27th, when the water hammer had occurred.

Crews searched for escaping water in areas such as ravines and gullies, or listened to hydrants for noise caused by leakage. The break was finally located on the morning of December 30th when a City Public Works crew reported high flows in the storm sewer on St. Georges Avenue at Grand Boulevard. PUC crews confirmed a break on the 300mm watermain in front of the St. Basil's School entrance.

When the crew started to excavate for the repair, they discovered the high traffic section of the street had been completely undermined with only 5 to 7 inches of asphalt holding the road up. The cavity was 9 to 10

Long-Term Break Summary - Annual Totals



feet deep and about 15 feet square. The potential for a serious accident was imminent.

A conservative estimate of the water lost due to the break is 3,700 cubic meters/day for 32 days. This amounts to 118,400 cubic meters (26,048,000 gallons).

Infrastructure Renewal

Through the 50's and into the early 80's the City experienced significant growth in population and land development. The water distribution system was expanded extensively over those years to meet this growth.

While the City's population has declined over the past 20 years, the system expansion that resulted from those preceding years of growth still exists today. Furthermore, the great majority of that infrastructure is now between 30 and 60 years old and, moving forward, will require more attention.

There are relatively few options available to address the issues of watermain breakage and leakage. Mains can be refurbished with various forms of liners and coatings. But these are limited in application and effectiveness. Replacement is still the only permanent solution. Furthermore there is no option to renew service lines other than replacement.

The replacement of mains has been closely tied to the City's road reconstruction program in order to minimize restoration costs to the water utility. We take advantage of the City's program to replace complete distribution systems, including the mains, services and hydrants. Current capital spending to replace watermains and associated appurtenances is typically about \$1.5 million per year.

In addition to the distribution mains and services, we need to consider the typical useful life of pumping stations, reservoirs and the filtration plant. Based on normal life expectancies for each of these components and the associated replacement costs, the sustaining annual reinvestment required to provide for renewal of this infrastructure has been conservatively estimated

at \$3.5 million. Compared to the current capital spending level, it is clear that increased spending will be required in the future.

Currently, water rates in Sault Ste. Marie are amongst the lowest in the province. Those rates will be significantly affected in order to protect the City's water supply and maintain safe reliable service to its residents.

Operating Requirements

The fallout from Walkerton has and will continue to impose ever greater regulatory control and accountability on distribution activities. MOE Inspectors are encouraging operators to implement utility best practices aimed at improving the security and integrity of their systems. These practices include:

- dead-end flushing program,
- uni-directional flushing,
- watermain swabbing,
- cross-connection program,
- annual hydrant flow checks,
- hydrant flow testing,
- valve maintenance program,
- curb box maintenance program,
- leak detection/water loss program.

The first four items above are related to maintaining acceptable water quality supplied to users. The two hydrant related items are legislated under the Ontario Fire Code. Items related to curb box and valve maintenance are necessary to ensure reliability of the system and adequate level of service to customers. The last item is related to minimizing operating costs by avoiding unbilled water use.

It is important to note that the full implementation of any one of the above noted practices will result in additional work being generated to repair or replace any deficiencies discovered.

At this time, most of the best practice items identified are recommended only. However, it is clear that based on the direction of the Provincial Government since Walkerton, that such practices will eventually be mandated.

Bill 175

As a direct result of the Walkerton Inquiry and Commissioner O'Conner's recommendations, the government passed Bill 175, The Sustainable Water and Sewage Systems Act, 2002, in December of 2002. However, the relevant details and dates concerning implementation of the requirements have not yet been established as there have been no regulations passed to date. It is anticipated regulations will be imposed in 2005.

The Act clearly mandates the Commission to recover the full cost of providing water service to its customers. The Act specifies that full life-cycle costs are to be assessed and rates set accordingly in order to recover the full cost of service.

There are three main undertakings specified under the Act. These include:

- Preparation of a report on the full cost of water service,
- Preparation of a Cost Recovery Plan,
- Implementation of the Cost Recovery Plan.

It is anticipated the Act will drive increased levels of capital spending in the years ahead.

The Drinking Water Quality Management Standard

The Ministry of Environment (MOE), in carrying out the recommendations of Commissioner O’Conner, has engaged the Canadian Standards Association (CSA) to work with municipal stakeholders to develop a Drinking Water Quality Management Standard. A draft Standard was introduced for stakeholder review and input in 2004.

The Standard will outline the mandatory quality management elements of the emerging Municipal Drinking Water License regime in support of the Safe Drinking Water Act, 2002. Specifically it will identify the processes that an operating authority operating a municipal drinking water system will be required to undertake in order to receive accreditation.

Under the Act, municipalities (or municipal service boards, such as the Commission) will be required to obtain a license to use and operate each drinking water system. A license will be issued only when five key requirements are met:

- Permit to Take Water,
- Drinking Water Works Permit,
- Operational Plan specified in the Standard,
- Accredited Operating Authority,
- Financial Plan.

In order to receive accreditation, an operator must satisfy the requirements of the Standard. The Standard includes the creation of an “Operational Plan” that ensures the proper operation and maintenance of the water system. The Financial Plan referenced above is the Full Cost Recovery Plan noted previously under Bill 175.

The Quality Management Standard in conjunction with Bill 175 will impose significant demands on management to proactively plan, monitor, test and review its operating and management procedures, practices and policies. There is no definitive time frame for implementation of either the Standard or full cost

recovery, but it is anticipated that both will come into effect by mid to late 2005.

Regulatory pressures will continue to impose increasing demands on management and staff to cope with ever increasing requirements. The imposition of the Sustainable Water and Sewage Systems Act and the Drinking Water Quality Management Standard will drive both increased capital spending and increased operating and maintenance activities, along with the associated staffing needs.

Capital Works for 2004

In 2004 a total of \$1.8 million was spent on capital improvements in the system. Major system works in 2004 included installation of new or replacement watermains and services as follows:

- 200mm watermain on Second Line W from Peoples Rd to Farwell Terrace
- 150mm watermain on Pine Street from MacDonald Ave. to McNabb Street
- 300mm watermain on Bruce Street from Salisbury Ave. to Pim Street

Also, the 400mm watermain on Base Line was extended to Leigh’s Bay Road to service the new Flakeboard Canada plant. Developers installed watermains and water services to 72 residential lots in subdivisions including Clearview Heights Phase 1, Cody Heights Phase 1 and Queensgate Phase 2.

Management Responsibility

To the Members of City Council

The attached financial statements and other financial information have been prepared by the Commission's management which is responsible for their integrity and objectivity. To fulfill this responsibility, the Commission maintains appropriate systems of internal control and policies and procedures to ensure that its reporting practices and accounting and administrative procedures are of high quality, consistent with reasonable costs. These policies and procedures are designed to provide reasonable assurance that relevant and reliable financial information is produced. The statements have been prepared in conformity with accounting principles as recommended by the public sector accounting board. Where appropriate, they reflect estimates based on judgments of management. Financial information presented elsewhere in this Annual Report is consistent with that shown in the accompanying financial statements.

KPMG LLP, the independent auditors appointed by the Commission, have examined the financial statements of the Commission in accordance with auditing standards generally accepted in Canada to enable them to express to the Commission their opinion, without reservation, on the financial statements. Their report as auditors is set out on the following page.

The statements have been further examined by the Commissioners, who meet regularly with management to review the activities of the Commission. The auditors have full access to the Commissioners. The Commissioners oversee management's financial reporting responsibilities and are responsible for reviewing and approving the financial statements.



Terry Greco, CA
Treasurer



Auditors' Report

To the Commissioners of the Sault Ste. Marie Public Utilities Commission, Members of Council, Inhabitants and Ratepayers of The Corporation of the City of Sault Ste. Marie

We have audited the statement of financial position of the City of Sault Ste. Marie Public Utilities Commission as at December 31, 2004 and the statements of financial activities and fund balance and changes in financial position for the year then ended. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at December 31, 2004 and the results of its operations and the changes in its financial position for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

A handwritten signature in black ink that reads 'KPMG LLP'.

Sault Ste. Marie, Canada
March 8, 2005

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Statement of Financial Position

December 31, 2004, with comparative figures for 2003

	2004	2003
Financial assets:		
Receivable from related company, PUC Services Inc.	\$ -	\$ 301,070
Accounts receivable	1,464,695	1,256,185
Unbilled service revenue	438,911	569,235
Local improvements receivable	151,231	151,231
Prepaid expenses	2,551	24,355
Loan receivable from related company, PUC Energies Inc.	280,000	280,000
	2,337,388	2,582,076
Financial liabilities:		
Accounts payable and accrued liabilities	1,182,992	1,047,665
Payable to related company, PUC Services Inc.	317,443	-
	1,500,435	1,047,665
Total net financial assets	836,953	1,534,411
Inventory	223,085	202,667
Total net assets	1,060,038	1,737,078
Municipal position:		
Operating fund	1,060,038	1,737,078
Total Municipal position	\$ 1,060,038	\$ 1,737,078

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

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Statement of Financial Activities and Fund Balance

Year ended December 31, 2004, with comparative figures for 2003

	2004	2003
Revenues:		
Service revenue:		
Residential	\$ 3,822,735	\$ 3,592,934
General	2,891,846	2,566,374
Hydrants	397,455	343,998
	7,112,036	6,503,306
Other:		
Occupancy fees	165,603	117,988
Investment income	32,867	53,320
Non-service revenue	277,798	333,110
	476,268	504,418
Total revenues	7,588,304	7,007,724
Expenditures:		
Current:		
Purification and pumping	2,004,370	1,822,000
Transmission and distribution	1,537,182	2,244,913
Hydrants	441,196	441,975
Billing and collection	835,125	756,925
General and administration	1,616,009	1,388,904
	6,433,882	6,654,717
Capital:		
Transmission and distribution	1,725,163	1,724,628
Hydrants	106,299	88,133
	1,831,462	1,812,761
Total expenditures	8,265,344	8,467,478
Excess of expenditures over revenues	(677,040)	(1,459,754)
Fund balance, beginning of year	1,737,078	3,196,832
Fund balance, end of year	\$ 1,060,038	\$ 1,737,078

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

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Statement of Changes in Financial Position

Year ended December 31, 2004, with comparative figures for 2003

	2004	2003
Cash provided by (used for):		
Operations:		
Excess of expenditures over revenues	\$ (677,040)	\$ (1,459,754)
Uses:		
Increase in accounts receivable	(208,510)	-
Increase in prepaid expenses	-	(12,626)
Increase in unbilled service revenue	-	(25,876)
Increase in inventory	(20,418)	(16,290)
	(905,968)	(1,514,546)
Sources:		
Decrease in unbilled service revenue	130,324	-
Decrease in accounts receivable	-	81,201
Decrease in local improvements receivable	-	159,386
Increase in accounts payable and accrued liabilities	135,327	588,345
Decrease in prepaid expenses	21,804	-
	287,455	828,932
Increase (decrease) in cash from operations	(618,513)	(685,614)
Financing:		
Change in receivable from PUC Services Inc.	301,070	685,614
Change in payable from PUC Services Inc.	317,443	-
	618,513	685,614
Net decrease in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$ -	\$ -

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

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Analysis of Operating Fund Operations

Year ended December 31, 2004, with comparative figures for 2003

	2004	2004	2003
	Budget	Actual	Actual
Revenues:			
Service revenue:			
Residential	\$ 4,119,245	\$ 3,822,735	\$ 3,592,934
General	2,924,170	2,891,846	2,566,374
Hydrants	368,302	397,455	343,998
	7,411,717	7,112,036	6,503,306
Other:			
Local improvements	55,000	-	-
Occupancy fees	127,494	165,603	117,988
Investment income	61,400	32,867	53,320
Non-service	93,030	277,798	333,110
	336,924	476,268	504,418
Total revenues	7,748,641	7,588,304	7,007,724
Expenditures:			
Operations:			
Purification and pumping	2,054,740	2,004,370	1,822,000
Transmission and distribution	1,711,637	1,537,182	2,244,913
Hydrants	485,673	441,196	441,975
Billing and collection	806,350	835,125	756,925
General and administration	1,480,162	1,616,009	1,388,904
Total expenditures	6,538,562	6,433,882	6,654,717
Net revenue	1,210,079	1,154,422	353,007
Financing and transfers:			
Transfers to capital fund	(1,654,600)	(1,831,462)	(1,812,761)
Change in operating fund balance	(444,521)	(677,040)	(1,459,754)
Operating fund balance, beginning of year	1,737,078	1,737,078	3,196,832
Operating fund balance, end of year	\$ 1,292,557	\$ 1,060,038	\$ 1,737,078

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

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Notes to Financial Statements

Year ended December 31, 2004

The Sault Ste. Marie Public Utilities Commission (the "Commission") is a body appointed by the Corporation of the City of Sault Ste. Marie to supply water and related services to its residents.

1. Significant accounting policies:

The financial statements of the Commission are prepared by management in accordance with accounting principles generally accepted in Canada for government organizations as recommended by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. Significant aspects of the accounting policies adopted by the Commission are as follows:

(a) Inventory:

Inventory, which consists of parts and supplies acquired for internal construction or consumption, is valued at the lower of cost and replacement cost.

(b) Capital assets:

Capital assets are reported as an expenditure on the statement of financial activities and fund balances in the year of acquisition.

(c) Revenue recognition:

Revenue is recognized on the accrual basis, which includes an estimate of unbilled revenue for water consumed by customers since the date of each customer's last meter reading. Actual results could differ from estimates made of actual water usage.

(d) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues and expenditures, assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from these estimates.

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Notes to Financial Statements

Year ended December 31, 2004

2. Budget figures:

The budgets established for capital funds are based on a project-oriented basis, the costs of which may be carried out over one or more years. As such, they are not directly comparable with current year actual amounts and budgets have not therefore been reflected on the statement of financial activities and fund balance.

3. Related party transactions:

The following entities are identified as related parties to the Commission:

PUC Inc. – 100% owned by the Corporation of the City of Sault Ste. Marie (City).

PUC Distribution Inc. (Distribution) – 100% owned by PUC Inc.

PUC Services Inc. (Services) – 100% owned by PUC Inc.

PUC Energies Inc. (Energies) – 100% owned by PUC Inc.

PUC Telecom Inc. (Telecom) – 100% owned by PUC Inc.

The Commission has a management, operation and maintenance agreement with Services, which expires January 1, 2011, under which Services manages, controls, administers and operates the business of the Commission.

The Commission charges interest on balances receivable from Services at the Royal Bank prime less 2%. Interest of \$17,467 (2003 - \$37,920) was charged during the year.

The Commission was charged management fees and operational fees by Services in the amount of \$1,878,196 (2003 - \$1,747,916). Occupancy fees charged to the other related companies was \$165,603 (2003 - \$117,117). These transactions have been recorded at the exchange amount which is the agreed amount between the related parties.

4. Expenditures by object:

Total expenditures by object are as follows:

	2004	2003
Salaries and benefits	\$ 2,140,087	\$ 2,198,424
Materials, supplies and services	4,293,795	4,456,293
Capital	1,831,462	1,812,761
	<hr/>	<hr/>
	\$ 8,265,344	\$ 8,467,478

Governance

The assets of the Public Utilities Commission are owned by the Corporation of the City of Sault Ste. Marie. The Commission is responsible for ensuring that the water treatment and distribution systems are properly managed and maintained. In 2000, a 10 year management agreement was signed with PUC Services Inc. whereby PUC Services will manage, operate and maintain the treatment and distribution systems. Commission assets will continue to be owned by the City.

The Commission is composed of three commissioners, one of whom serves as Chair. These members were appointed by Council but starting January 2001 the Board of Directors of PUC Inc. has the power to appoint members to the Commission. The Commission holds public meetings as required to review the work of PUC Services, approve capital and operating budgets and annual financial statements and consider matters that are brought to its attention by the President of the Public Utilities Commission.



Current Members of the Commission

Commission Chair Mark Howson P. Eng., MBA Senior Maintenance Engineer, Algoma Steel Inc.

Maureen Sullivan MBA CHRP Human Resources, Ministry of Natural Resources

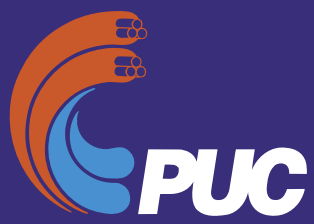
Pat Mick City Councillor

Officers

H.J. Brian Curran P. Eng., MBA President

Terry Greco CA Treasurer

Clyde Healey CHRP Secretary



www.smpuc.com/water