

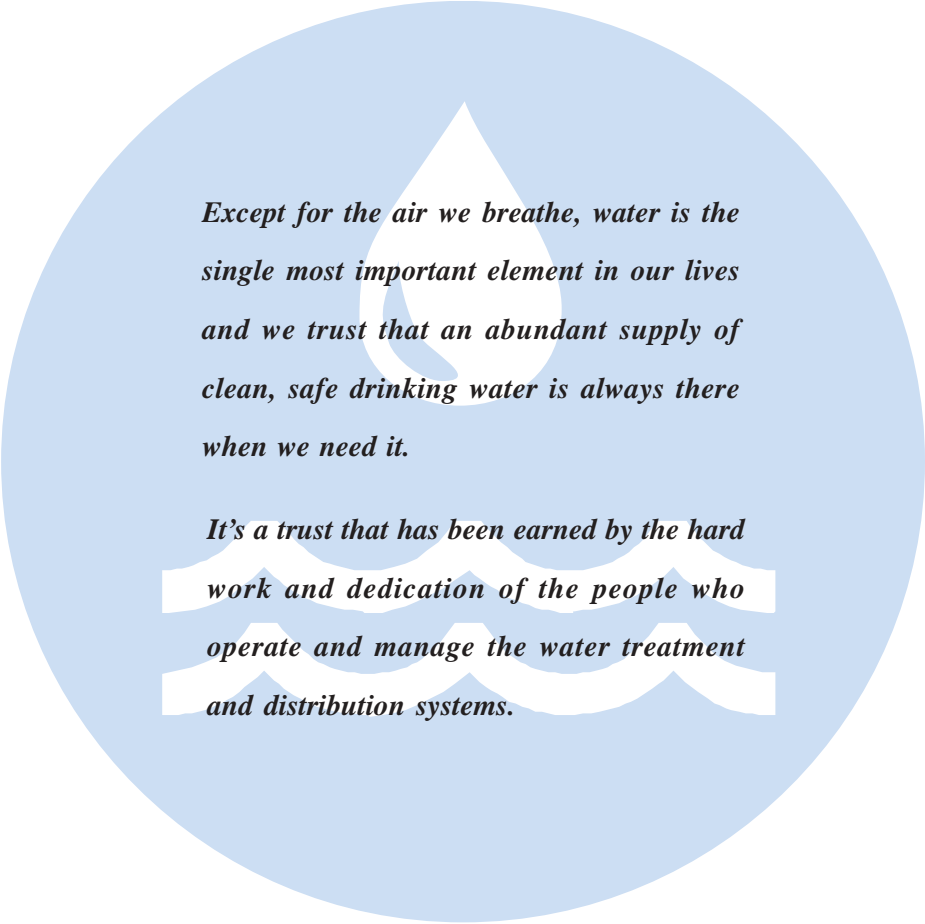
Your *Supplier*
of Clean, Safe
WATER



City of Sault Ste. Marie
Public Utilities Commission
ANNUAL REPORT 2002

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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.

It's a trust that has been earned by the hard work and dedication of the people who operate and manage the water treatment and distribution systems.

Highlights for 2002

Financial	2002	2001
Service Revenue	\$6,290,000	\$6,031,200
Net Loss	(\$411,000)	(\$743,800)
Total Municipal Position	\$3,196,800	\$3,607,800
Operations	2002	2001
Number of Customers	25,366	25,299
Annual Sales (m ³)	10,676,586	11,212,710
Peak Daily System Demand (m ³)	63,000	64,403

Date: March 26, 2003

To: Chairman Mark Howson and Members of the Public Utilities Commission

Re: 2002 Annual Report

Water consumed by the residents of Sault Ste. Marie met or exceeded Ontario Drinking Water Quality Objectives throughout 2002. The water treatment plant, which supplies approximately half of the community's water requirements, operated without incident. The six wells that supply the remainder the City's water requirements continued to provide excellent quality water.

As groundwater is an important source of water to Sault Ste. Marie a groundwater management and protection study was initiated in 2002 to identify hydrogeological characteristics, assess potential risks to groundwater contamination and to develop a plan to manage and protect the resource. This major study, 85% of which was funded by the Government of Ontario, will form the basis for land and water use policies to ensure the protection of a valuable aquifer. The study is scheduled for completion in early 2003.

While residents and businesses of Sault Ste. Marie pay amongst the lowest water rates in Ontario, rate increases are required to replace aging infrastructure and to cover the increased cost of operating a water utility because of the introduction of more regulations to protect consumers. Water rates were increased by an average of 5% effective January 1, 2002 and the Commission approved another average increase of 9% effective January 1, 2003.

Water consumption in 2002 was 10.7 million cubic meters compared to 11.2 million cubic meters in 2001. Revenues were \$7.0 million compared to \$6.49 million in 2001. Operating, maintenance and administration costs were \$6.1 million compared to \$5.5 million the year previous. The increase was primarily the result of the cost of the major groundwater study and a revision in the manner in which administrative expenses were allocated to the Commission in 2002. Because of lower capital expenditures in 2002, the Commission had a net loss of \$0.4 million compared to a loss of \$0.7 million in 2001.

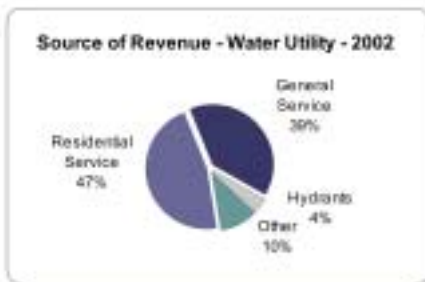


H. J. Brian Curran P. Eng., MBA
President
Public Utilities Commission

Year in Review



Total revenues in 2002 were \$7.0 million, up 7.8 % from 2001.



Net revenues before capital expenditures were \$0.9 million. Operations accounted for the bulk of expenditures at 82% of the total. Spending on capital improvements amounted to \$1.33 million.



The Public Utilities Commission is responsible for the maintenance and operation of 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 residents 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 management, maintenance and operation of the waterworks system is carried out by PUC Services Inc. under a 10 year contract.

Water Rates

No consumer welcomes a price increase. In the case of water, however, consumers must appreciate that heightened vigilance to protect the quality of water supply, as required by new government regulations, has a cost. The age of the distribution system is such that the frequency of repairs and replacement has increased. To ensure full cost recovery, required by the provincial government and in keeping with past Commission practice, a 5% rate increase was approved for all water users effective January 1, 2002. The Commission also approved a 9% increase effective January 1, 2003. The latter increase was based on recommendations of a study that was completed for the Commission by KPMG. The study concluded that a 9% increase was required to continue to fund annual expenditures and to build a sufficient capital reserve to accommodate expected increases in system replacement. Changes to the manner in which multiple dwelling customers were charged were also identified and subsequently adopted.

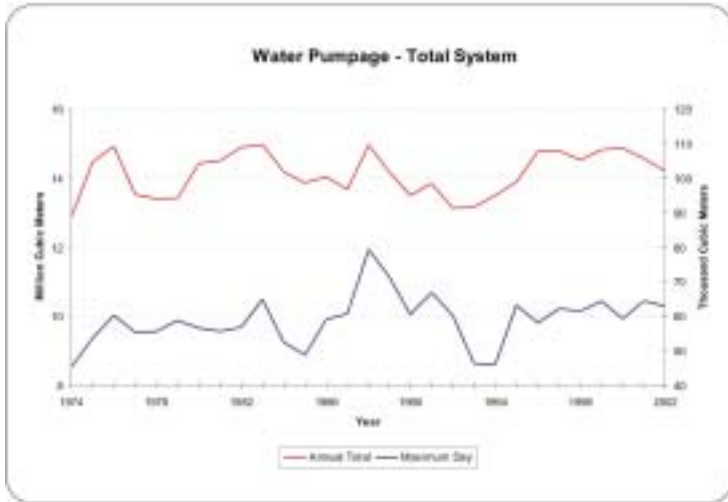
Water Quality

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. All test results are available for review by accessing either the PUC website (www.ssmruc.com) or the City of Sault Ste Marie's web site (www.city.sault-ste-marie.on.ca/puc/puc_main.htm) or by requesting a copy of the results from the Commission.

There were two occurrences of an exceedence for discharge turbidity during 2002 at the Goulais pump station; one on January 2nd and another on December 2nd. Both cases occurred upon start up of the pump wherein a turbidity spike above the 1.0 ntu limit resulted for several minutes. Action was taken in both instances to divert the water to drain along with the backflow flushing of the main. Chlorine residuals were maintained at all times. Turbidity notification was provided to the Spills Action Centre and the Local Health Unit as required, to their satisfaction.

Also during 2002 there were two distribution samples found to have tested positive for Total Coliform. Both samples were taken from the same sample site at a school that had just been converted from a private well supply. Sampling during this conversion turned up samples with Total Coliform. Throughout this timeframe the school was placed on bottled drinking water supplied by the School Board.

Water Distribution crews placed a flushing hydrant in the area to elevate the chlorine residual in the system, which after three consecutive days of coliform free sampling, allowed the school to be placed on the municipal system. In each case proper notification was given to the Spills Action Centre and the Local Health Unit as required.



System Water Production

Total water production in 2002 was 14.22 million cubic meters compared to 14.67 million cubic meters in 2001. The peak maximum day was 63.0 thousand cubic meters, which occurred in July. The capacity of the supply and treatment system is approximately double present demand. Consumption has been essentially unchanged over the past two decades.

Watermain Break History

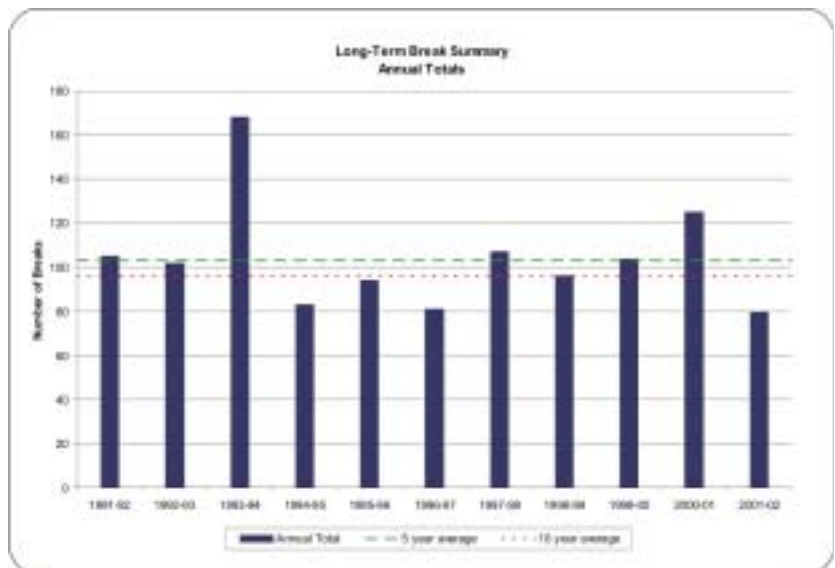
Watermain breaks are a normal occurrence in a water distribution system, with most breaks occurring in winter. Generally, the colder the weather, the greater the number of breaks. The majority of the breaks occur on cast iron mains as a result of differential frost action within the ground as frost penetrates deeper into the ground or as it thaws.



Most cast iron mains were installed from the mid-1940's to the mid-1960's which was the period of greatest growth within the City. The wall thickness of the mains manufactured during this time period are significantly thinner than those manufactured in the early 1900's. It is the smaller diameters of these "thin-walled" mains that are most susceptible to breakage.

In the late 60's cast iron was replaced with ductile iron which is not susceptible to frost action but which has shown advanced levels of corrosion in various areas of the City. This leads to leakage from pitting and blowouts of the pipe wall.

The 2001-2002 winter break count was the lowest in the past 10 years. This is due to the unusually mild winter last year.



Consolidated C of A

Early in April 2002, the Ministry of Environment issued the final version of the Commission's first consolidated Certificate of Approval (C of A). This new certificate replaces all previous issued approvals related to water supply and treatment works associated with the municipal water supply system and amalgamates them into this one document. The certificate contains numerous terms and conditions relating to performance, monitoring and recording, operations and maintenance, compliance reporting and declaration.

One of the more significant conditions was the requirement to conduct a study to determine whether the Lorna and Shannon wells are under the direct influence of surface waters (GUDI study). This study was initiated in November by R.J. Burnside & Associates in conjunction with the Sault Ste. Marie Area Groundwater Study and was submitted to the Ministry by the due date of January 30, 2003. The study confirmed these wells are not under the direct influence of surface waters. The Ministry is currently reviewing the report and we await their ruling on this matter.

Another significant condition was the requirement to make physical modifications to the Water Treatment Plant to provide filter to waste capability in order to avoid turbidity spikes in the finished water. This was to be completed by July 1, 2003. We have received approval to utilize an alternative method as a temporary measure. But the physical alterations will eventually have to be constructed. The Ministry has indicated this could be postponed until the plant is expanded at some future date.

North Eastern Ontario Water Works Conference

The 39th annual Northeastern Ontario Water Works Conference, which was held in Sault Ste. Marie on May 28 & 29 2002, was sponsored by PUC Services Inc. This year's conference was an innovative variation on past sessions providing operators of water treatment and distribution facilities, eight hours of certification training in addition to the typical informative sessions, vendor displays and networking opportunities of the regular format.

The Conference was very successful. More than 80 delegates from throughout Northeastern Ontario attended.

Sault Ste. Marie Area Groundwater Study

The Sault Ste. Marie Public Utilities Commission is responsible for the supply and delivery of safe drinking water to the residents of Sault Ste. Marie and the Rankin Reserve. Approximately fifty percent of that supply comes from six deep wells owned and operated by the Commission. Furthermore, all private wells within the City boundaries, Prince Township and Rankin Reserve draw water from the same aquifers that feeds the Commission wells. Any well that penetrates this aquifer is a potential pathway for contamination of the aquifer. It is therefore vitally important that the Commission take adequate steps to manage and protect this groundwater resource.

In April 2001, the Commission embarked upon an initiative to implement a comprehensive groundwater study aimed at protecting source waters and the aquifers supplying the City's municipal wells. The proposed protection strategy would benefit all residents of Sault Ste. Marie, Rankin Reserve, and Prince Township since the subject aquifers provide water supply for the communal needs of all parties involved.

In August, 2001, the Ministry of Environment announced its funding initiative in the amount of \$10 million to promote municipal groundwater studies aimed at protecting groundwater resources across the province. The Commission, as the lead agency for area participants, which include the City of Sault Ste. Marie, Prince Township, the Algoma Health Unit, the Ministry of Environment the Sault Ste. Marie Region Conservation Authority, the Sault North Planning Board and the Batchewana Band of First Nations, submitted an application for funding to conduct a study within Sault Ste. Marie and the surrounding areas. The Ministry announced approval on November 14th for 85 % of the estimated cost of \$390,000.

In March 2002, R. J. Burnside & Associates Limited of Orangeville Ontario was retained to implement the study. The project objectives are to:

- gather all data related to water resources availability and usage and develop a comprehensive database,
- complete a groundwater resource assessment,
- undertake a water-use/water budget assessment,

- prepare detailed hydrogeological maps,
- complete potential contaminant sources inventory,
- determine groundwater vulnerability,
- review land use planning in the light of the groundwater resources availability and the potential for groundwater contamination, and
- develop groundwater management and protection strategies.

The initial step of this study was to compile all available data relating to groundwater resources, including water wells, water use, wastewater disposal, etc. In May, 2002, R. J. Burnside initiated a door-to-door water well / septic system survey and contaminant sources inventory. This field inventory part of the project was carried out through the summer and completed by early fall.

An Open House was held in September to provide background information for the project and present groundwater mapping and other relevant information related to the groundwater study. Comments received were incorporated into the study as appropriate. A second Open House will be held in early 2003 in order to present a draft report and the findings to-date, including proposals for the resource management plan.

Water System SCADA

In 2002, we completed the upgrade of the filtration plant master station software and hardware, originally installed in 1986. Also, all the plant remote terminal units (RTU's) were replaced. Work will continue through 2003 to replace the RTU's at the various pumping stations and to install updated radio links.

Capital works for 2002

In 2002, a total of \$1.33 million was spent on capital improvements in the system. Wherever possible, replacement of watermains is coordinated with City improvements to roadways so that such expenditures could be minimized. Major system works in 2002 included:

- replacement of watermains and services along the following reconstructed streets: Lake Street from Trunk Road south to Wellington Street East; Henrietta Avenue from Wellington Street West to Farwell Terrace; Tancred Street from Bay Street to Wellington Street East; Black Road from McNabb Street to Trunk Road;
- continued installation of an upgraded SCADA system to replace the original system installed with the Water Treatment Plant in 1986 and extended the system to include the pumping stations via radio links;
- extension of municipal water along Fourth Line West and Brule Road including the addition of a booster pumping station to service the Crimson Ridge Subdivision and Golf Course;
- extension of municipal water supply along Korah Rd west of Cooper Street to service the Isabel Fletcher Public School;
- servicing of 31 lots in the second phase of the Millcreek Heights Subdivision along Millcreek Drive;
- installation of a major service line for the new Wal Mart store, which involved extending a 250mm (10 inch) water main across Second Line East; one of the busiest streets in the city. The work took several days to coordinate and complete;
- connection of a 200mm (8 inch) service line for the new Davey Home Long – term Care Facility.

In 2001 the PUC declared the water tower and associated property surplus to the needs of the City's waterworks. City Council, in requested, with public consultation, a report indicating the possible options for the re-use of the tower. In late 2002 a report was submitted to Council, based upon an operational review and public input, recommending the dismantling of the water tower and sale of the property. Council requested a further attempt be made to find a potential buyer, before the option of dismantling was undertaken.

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 generally accepted in Canada and where applicable, generally accepted accounting principles as recommended by the public sector accounting board. Where appropriate, they reflect estimates based on judgements of management. Financial information presented elsewhere in this Annual Report is consistent with that shown in the accompanying consolidated 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.

A handwritten signature in black ink, appearing to read "Terry Greco". The signature is written in a cursive style with a large initial "T" and "G".

Terry Greco, CA
Treasurer



AUDITORS' REPORT

To the 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, 2002 and the statements of financial activities and fund balances 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 auditing standards generally accepted in Canada. 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, 2002 and the results of its operations and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in Canada.

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

Chartered Accountants

Sault Ste. Marie, Canada

March 12, 2003

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Statement of Financial Position

December 31, 2002, with comparative figures for 2001

	2002	2001
	\$	\$
Financial assets:		
Cash	–	40,000
Receivable from related company, PUC Services Inc.	986,864	979,390
Accounts receivable	1,337,206	1,478,211
Unbilled service revenue	543,359	435,688
Local improvements receivable	310,617	603,640
Prepaid expenses	11,729	20,438
Loan receivable from related company, PUC Energies Inc.	280,000	–
	3,469,775	3,557,367
Financial liabilities:		
Accounts payable and accrued liabilities	459,320	135,053
	3,010,455	3,422,314
Total net financial assets	3,010,455	3,422,314
Inventory	186,377	185,535
	3,196,832	3,607,849
Total net assets	3,196,832	3,607,849
Municipal position:		
Fund balances:		
Operating fund	3,196,832	3,567,849
Reserve fund	–	40,000
	3,196,832	3,607,849
Total Municipal position	3,196,832	3,607,849

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 Balances

Year ended December 31, 2002, with comparative figures for 2001

	2002	2001
	\$	\$
Revenues		
Service revenue:		
Residential	3,261,083	3,084,108
General	2,732,707	2,660,106
Hydrants	296,255	287,005
	6,290,045	6,031,219
Other:		
Provincial government grant	331,500	–
Occupancy fees	104,897	145,295
Investment income	60,730	138,110
Non-service revenue	214,229	180,127
	711,356	463,532
Total revenues	7,001,401	6,494,751
Expenditures		
Current:		
Purification	541,743	170,512
Pumping	1,541,376	1,512,166
Transmission and distribution	1,419,811	1,588,707
Hydrants	488,840	383,428
Billing and collection	753,603	817,478
General and administration	1,332,622	1,059,055
	6,077,995	5,531,346
Capital:		
Transmission and distribution	1,263,949	1,566,646
Hydrants	70,474	86,467
Buildings	–	54,042
	1,334,423	1,707,155
Total expenditures	7,412,418	7,238,501
Excess of expenditures over revenues	(411,017)	(743,750)
Fund balances, beginning of year	3,607,849	4,351,599
Fund balances, end of year	3,196,832	3,607,849

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, 2002, with comparative figures for 2001

	2002	2001
	\$	\$
Cash provided by (used for):		
Operations:		
Excess of expenditures over revenues	(411,017)	(743,750)
Uses:		
Increase in accounts receivable	–	(338,047)
Increase in unbilled service revenue	(107,671)	–
Increase in inventory	(842)	(185,535)
Decrease in accounts payable and accrued liabilities	–	(10,620)
	(519,530)	(1,277,952)
Sources:		
Decrease in accounts receivable	141,005	–
Decrease in unbilled service revenue	–	35,879
Decrease in local improvements receivable	293,023	102,450
Increase in accounts payable and accrued liabilities	324,267	–
Decrease in prepaid expenses	8,709	22,909
	767,004	161,238
Increase (decrease) in cash from operations	247,474	(1,116,714)
Investing:		
Loan receivable from related company, PUC Energies Inc.	(280,000)	–
Financing:		
Change in receivable from PUC Services Inc.	(7,474)	1,116,714
Net increase (decrease) in cash position	(40,000)	–
Cash position, beginning of year	40,000	40,000
Cash position, end of year	–	40,000

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, 2002, with comparative figures for 2001

	2002 Budget \$	2002 Actual \$	2001 Actual \$
Revenues			
Service revenue:			
Residential	3,295,000	3,261,083	3,084,108
General	2,903,000	2,732,707	2,660,106
Hydrants	302,000	296,255	287,005
	6,500,000	6,290,045	6,031,219
Other:			
Provincial government grant	–	331,500	–
Occupancy fees	104,800	104,897	145,295
Investment income	173,700	60,730	138,110
Non-service revenue	121,000	214,229	180,127
	399,500	711,356	463,532
Total revenues	6,899,500	7,001,401	6,494,751
Expenditures:			
Operations:			
Purification	202,900	541,743	170,512
Pumping	1,591,000	1,541,376	1,512,166
Transmission and distribution	1,359,200	1,419,811	1,588,707
Hydrants	424,800	488,840	383,428
Billing and collection	826,100	753,603	817,478
General and administration	1,502,700	1,332,622	1,059,055
Total expenditures	5,906,700	6,077,995	5,531,346
Net revenue	992,800	923,406	963,405
Financing and transfers:			
Transfers to capital fund	(1,347,400)	(1,334,423)	(1,707,155)
Transfers from reserves and reserve funds	–	40,000	359,731
	(1,347,400)	(1,294,423)	(1,347,424)
Change in operating fund balance	(354,600)	(371,017)	(384,019)
Operating fund balance, beginning of year	3,567,849	3,567,849	3,951,868
Operating fund balance, end of year	3,213,249	3,196,832	3,567,849

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Notes to Financial Statements

Year ended December 31, 2002

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) Fund accounting:

Funds within the financial statements consist of the operating and reserve fund.

(b) Inventory:

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

(c) Capital assets:

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

(d) Reserves:

Certain amounts, as approved by the Commission, are set aside in reserves for future operating and capital purposes. Transfers to and/or from the reserves are an adjustment to the respective fund when approved.

(e) Investments:

Investments are recorded at cost which approximates market value.

(f) 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.

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Notes to Financial Statements

Year ended December 31, 2002

1. Significant accounting policies (continued):

(g) Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in Canada 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.

2. Budget figures:

Budgets established for capital funds, reserves and reserve 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 balances.

3. Related party transactions:

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

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 was charged management fees and operational fees by Services in the amount of \$1,701,171 (2001 – \$1,542,560). Occupancy fees charged to the other related companies was \$104,897 (2001 – 145,295). These transactions have been recorded at the exchange amount which is the agreed amount between the related parties.

CITY OF SAULT STE. MARIE PUBLIC UTILITIES COMMISSION

Notes to Financial Statements

Year ended December 31, 2002

4. Expenditures by object:

Total expenditures by object are as follows:

	2002	2001
	\$	\$
Salaries and benefits	1,701,776	2,211,748
Materials, supplies and services	4,376,219	3,319,598
Capital	1,334,423	1,707,155
	7,412,418	7,238,501

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



Left to Right: Pat Mick, Mark Howson, Maureen Sullivan

Officers

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

Terry Greco CA
Treasurer

Clyde Healey CHRP
Secretary