Agenda - Executive Policy Committee - June 22, 2005

Report - Alternate Service Delivery Committee - June 20, 2005

Moved by Councillor

That Rule 9.3 of the Procedure By-law be suspended in order that the following item, which was received too late to be placed on the regular agenda, may also be considered by Committee at this time.

Item No. 2 Annual Selection Report 2005 - Glacial Sand and Gravel Special Operating Agency
File GL-5.6.1

STANDING COMMITTEE RECOMMENDATION:

On June 20, 2005, the Alternate Service Delivery Committee concurred in the administrative recommendation and submits the following to Council:

1. That the 2005 Selection Report for the Glacial Sand and Gravel Special Operating Agency (GSG), which contains Historical Financial Statements and the budget for Fiscal 2005, be approved as outlined in Appendix A to the Report of the Director of Public Works dated June 15, 2005.

2. That effective January 1, 2005, the $400,000.00 Idea Bank operating line of credit approved by Council on February 28, 2001, be converted to a term loan at the City's applicable borrowing rate to finance Glacial Sand and Gravel's recently replaced truck weigh scale and other anticipated sustaining capital acquisitions as indicated in its 2005 budget. Glacial will continue to access operating credit through its inter-company balance with the General Revenue Fund at the City's applicable borrowing rate to meet ongoing cash flow requirements.

3. That the 2004 audited financial statements for the Glacial Sand and Gravel Special Operating Agency, as outlined on Appendix B of the Report of the Director of Public Works dated June 15, 2005, be received as information.

4. That the Proper Officers of the City be authorized to do all things necessary to implement the intent of the foregoing.

Agenda - Executive Policy Committee - June 22, 2005

Report - Alternate Service Delivery Committee - June 20, 2005

DECISION MAKING HISTORY:

STANDING COMMITTEE RECOMMENDATION:

On June 20, 2005, the Alternate Service Delivery Committee concurred in the administrative recommendation and submitted the matter to the Executive Policy Committee and Council.

ADMINISTRATIVE REPORT

Re: **ANNUAL SELECTION REPORT 2005: GLACIAL SAND AND GRAVEL SPECIAL OPERATING AGENCY**

For Submission To: ALTERNATE SERVICE DELIVERY COMMITTEE

Submitted By: Bill Larkin, P. Eng. Director of Public Works

Report Date: June 15, 2005

Recommendations:

1. That Council approve the 2005 Selection Report for the Glacial Sand and Gravel Special Operating Agency (GSG), which contains Historical Financial Statements and the budget for Fiscal 2005 as tabled in Appendix A.
2. That effective January 1, 2005 the $400,000 Idea Bank operating line of credit approved by Council on February 28, 2001, be converted to a term loan at the City's applicable borrowing rate to finance Glacial's recently replaced truck weigh scale and other anticipated sustaining capital acquisitions as indicated in its 2005 budget. Glacial will continue to access operating credit through its inter-company balance with the General Revenue Fund at the City's applicable borrowing rate to meet ongoing cash flow requirements.
3. That the 2004 audited financial statements for the Glacial Sand & Gravel Special Operating Agency be received as information in Appendix B.

REPORT SUMMARY:

Key Issues:

- Critical elements of Glacial's original business plan changed between its inception in 2001 and final "transition" year 2003;
- Glacial's financial performance worsened in 2004 owing to a variety of compounding factors including:
    - A significant decline in sales due to record poor weather, the loss of its exclusive sales arrangements with The City of Winnipeg, and the departure of the Operations Coordinator early in Glacial's peak sales season; and,
    - increased expenditures necessary to maintain and repair its outdated and failing material processing and handling equipment.

IMPLICATIONS OF THE RECOMMENDATION(S):

General Implications:

X	None
	For the organization overall and/or other departments
	For the community and/or organizations external to the City
	Involves a multi-year phase in process

Comments: None

Policy Implications:

X	No
	Yes

Comments: None

Environmental Implications:

X	No
	Yes

Comments: None

Human Resource Implications:

X	No
	Yes

Comments: None

Financial Implications:

X	Within approved current and/or capital budget
	Current and/or capital budget adjustment needed

Comment: See attached financial projections.

REASON FOR THE REPORT:

The Glacial Sand and Gravel Operating Charter stipulates that a Selection Report (summary of the annual business plan) and an annual report will be submitted to Council each year.

HISTORY:

Glacial Sand and Gravel (GSG) was designated a Special Operating Agency (SOA) by Council effective January 1, 2001. Operating as a SOA, and adhering to business-like principles, was intended to produce the following benefits:

> Improve financial returns to the City over other alternative service delivery (ASD) options;
> Maintain control of the City of Winnipeg's sand and gravel resource assets; and
> Keep other ASD options open in the future.

The reduction in construction projects performed by City staff prior to GSG's consideration for Alternative Service Delivery resulted in declining aggregate material sales from Pine Ridge. The creation of GSG as a SOA provided an opportunity for the Agency to market value added processed products and raw pit materials. The assumption was that operating as a high value-added producer of crushed gravel and aggregate materials would maximize the economic returns from the assets.

DISCUSSION:

2004 was Glacial Sand and Gravel's first year of operation without the City as a guaranteed customer for various maintenance materials including Treated Sand for use as an abrasive and de-icing agent on winter streets. In this new competitive environment, the Agency had to bid on City contracts for the supply of these materials. The Treated Sand alone had generated nearly $1.5 million in revenue for Glacial in the previous two fiscal years.

The major component of the Agency's operations is the Pine Ridge Gravel Pit. This pit remains one of the last remaining high quality, clean, above-water sand and gravel deposits in close proximity to the City of Winnipeg. Glacial Sand and Gravel produces a variety of sand, gravel and aggregate products at this location.

The second component of the Agency's operation is the Transcona Gravel Pit located off Provincial Hwy 207. This gravel pit is currently being mined on a per tonne royalty basis by a private contractor until its agreement with Glacial expires in 2005/06. Limestone products are purchased from external suppliers for re-sale primarily to internal City of Winnipeg customers.

The hauling of all aggregate material is either carried out by the customers themselves or by a trucking firm under contract with the City of Winnipeg.

The original business plan envisioned GSG as a cost effective value added producer of crushed aggregates and other primary building materials. The current operating model has evolved with two deviations from the original business plan. These deviations include:

i. A much lower level and different type of capital and maintenance investment in processing and handling equipment at GSG. A shift occurred from making significant investments in modern efficient value added crushing and handling equipment to maintaining reliance on existing outdated crushing and handling equipment supplemented by a new screening plant; and

ii. A departure from the assumption that GSG would make significant sales to large aggregate consumers while continuing to benefit from its exclusive sales to the City of Winnipeg.

In the four years since its inception as an SOA in 2001, GSG has seen significant changes in key management and staff positions. These changes include two Chief Operating Officers, three Operations Coordinators and three Pit Foremen. GSG also relies heavily on certain administrative support services provided through the Department of Public Works such as Information Technology, Human Resource Management, Accounting and Financial Reporting. Public Works has also faced turnover at all levels in recent years due to retirements and other reasons. The turnover of key management, staff and support resources as described above has led to a noticeable amount of instability and lack of continuity in the strategic, operating and financial management of GSG.

Competitive Improvements

In adhering to business-like principles, the Agency made the following competitive improvements in 2004:

- The ongoing development of computerized pit management systems that will facilitate the input and analysis of data related to sales, production costing, and financial accountability;

- GSG made some significant investments in repairing and upgrading its aging equipment inventory. Some recent examples include:
    - Significant repair, maintenance and safety upgrades on several material handling conveyors, screeners, and wheel loader;
    - The recent installation of a new 80 foot truck scale with associated scale house relocation and modifications to maintain safe and effective traffic flow; and,

- Office automation hardware and software upgrades to mitigate the risk of data loss from outdated systems, improve flexibility in work hours, and replace failing hardware.

Enhanced Pit Management

The move in years previous to focus on screening materials and use contracted custom crushing services as needed has led to improved awareness of how to mine and screen materials more effectively at Pine Ridge. GSG has made site and operating modifications that enhance resource extraction and processing efficiency, equipment and truck traffic flow, promote pit safety and better serve customers.

Marketing

GSG continued to refine its pricing practices and processes to be more competitive and structured by eliminating surcharges historically applied to certain materials or cartage, increasing prices based on current market conditions and competitor prices, and developing basic structured discounting practices. The ultimate completion of the product costing and inventory management system currently under development will greatly enhance the Agency's ability to develop appropriate product pricing.

GSG continued to grow its organizational awareness of general marketing and sales concepts and practices in order to enhance its competitiveness and fulfill its mandate of acting in a business-like manner. This included extending hours of service at the truck scale and hours of service for contractors operating in our pits as well as a focus on customer service in all interactions whether in person or other.

GSG also reviewed and re-focused its product mix in order to improve efficiency. This required the purging or re-processing of unusable and/or what was believed to be poor margin inventory.

Critical Success Factors for 2005

The following is a listing of the critical success factors facing Glacial for 2005 (in order of decreasing importance):

1. Replacing the substantial annual sales volumes realized under the former exclusive sales arrangements with the City of Winnipeg;
2. Minimizing cost of sales through prudent management of staff and equipment;
3. The ability to obtain cost effective and sensitive operating and administrative support services such as accounting, IT, HR, engineering, etc. through arrangements with both internal City of Winnipeg providers and external providers; and,

4. Overcoming the instability created by the loss of key staff, management and administrative support over the past four years.

2004 Financial Highlights

GSG has faced several fundamental financial and operating issues under its past business model that have detracted from its economic viability. These include:

- Reliance on sales to City of Winnipeg departments;
- High cost structure relative to most market competitors (e.g. higher labor costs, aging and dilapidated equipment, marginal production efficiency);
- Lack of vertical integration and business diversification relative to market competitors such as the ability to operate in complimentary areas of business (trucking, construction, concrete products, equipment manufacture/repair/dealing, etc.);
- Growing debt burden impacts (operating and term debt);
- Lack of cash flow to finance necessary efficient, high volume production and handling equipment as originally anticipated; and,
- Absence of well defined marketing processes and strategy (pricing policies, product mix, market positioning/promotion) leading to inefficient and reactive production and marketing and therefore reduced profitability; and

Along with the issues described above, the new competitive environment, record poor weather, and unanticipated equipment costs exacerbated GSG's under-performance considerably. The following reflect Glacial's audited financial results for fiscal 2004:

- Gross Revenues of approximately $2,352,000 underperformed budget by $748,000.
- Total expenses outperformed budget by $70,000.
- Earnings Before Taxes (EBT) and Government Grants, which is an indication of the Agency's ability to generate operating income, of ($718,000) underperformed budget by $678,000.
- Net Income of ($705,000) also underperformed budget by approximately $678,000.

	2004 Budget ($000s)	2004 Actual ($000s)	Variance ($000s)	Comments:
Revenues	3,087	2,339	(748)	**Revenues:** • Lost sales to City of Winnipeg of ($450,000) • Revenue recognition changes of ($250,000) • Other impacts such as lower demand due to record poor weather ($48,000)
Cost of Sales	2,141	2,351	210	
Gross Margin	946	(12)	(958)	
Selling, General & Administrative Expenses	573	296	(277)	**COS:** • Offset with S,G,&A expense reduction below. • Unable to reduce Cost Of Sales consistent with lower sales due to increased costs related to maintaining outdated equipment and flat labour costs resulting from effort to overcome weather related production problems.
Other Expenses	413	410	(3)	
Earnings Before Taxes	(40)	(718)	(678)	
Provision for taxes	-	-	-	**S,G, & A Expenses:** • Difference primarily due to reclassification of certain expenses to Cost Of Sales.
Government Grants	13	13	-	
Net Income(Loss)	(27)	(705)	(678)	

Operating revenues were negatively impacted by reduced sales resources, poor customer demand for certain products due to weather impacts and the inability to meet demand for other products due to equipment breakdowns and weather related production problems.

Cost of Sales (COS) was negatively impacted by the abnormally cold wet weather as well as by unanticipated but significantly increased levels of spending on Glacial's older and less efficient processing and handling equipment. These factors prevented COS from declining with declining sales as one might typically expect. Further, the majority of the increase in COS versus budget reflects a modified presentation from the budget (and previous years') presentation format where certain operating expense categories have been reclassified to COS from Selling, General & Administrative (S,G,&A). Before this reclassification of expenses to COS, S,G&A expenses were largely unchanged from budget.

For 2005, projected revenues and expenditures are based on those experienced from 2002 to 2004 and on management's best estimates given recent performance and market conditions. The estimates are believed to be conservative and take into account market uncertainty. Expenditures will continue for necessary equipment maintenance and repairs but reflect prudence in capital spending. Revenues will reflect the targeting

of screened aggregate sales as in 2004 with crushed products made and sold largely on demand. Projected 2005 revenues for Glacial will be $2,292,000 with Loss Before Tax of ($489,000) and Net Loss is projected at ($476,000).

Historical and pro forma financial statements are attached. These include projected Balance Sheet, Statement of Operations and Retained Earnings, and Statement of Cash Flows (see Appendix A).

Performance Measurement

2004 was the fourth year of operation for Glacial Sand and Gravel as an SOA. The Agency continues to establish performance measurements for its operations. The table on the following page outlines the status of performance measures for four measurable performance goals.

GOAL	PERFORMANCE MEASUREMENT	MEASURE OF SUCCESSS/TARGET	STATUS (as of Dec. 31, 2004)
Financial	• Budgeted net income as per Selection Report projections	• To meet and/or exceed	• Underperformed
Operational	• Expand volume of materials produced at Pine Ridge location	• To meet and/or exceed	• Underperformed
	• Increase overall Agency volumes	• To meet and/or exceed	• Underperformed
	• Implement management information systems	• Systems installed	• Inventory and costing systems development progressing
	• Meet and/or exceed productivity rates	• Initial benchmarking required	• To be developed
Customer Satisfaction	• Obtain customer satisfaction feedback	• Feedback and action taken	• To be implemented
Training and Development	• Implement a comprehensive training strategy	• Strategy implemented	• Strategy implemented
	• Provide cross-training opportunities	• Strategy implemented	• Cross training provided on an ongoing basis
	• Obtain staff feedback	• Feedback and action taken	• Ongoing

Requested Conversion of Operating Debt

GSG purchased a much needed 80 foot long truck weigh scale for approximately $100,000 in late 2004 to replace its aging 40 foot long scale. Since planning and implementing the scale acquisition, the equipment reserve funds previously expected to provide term debt for this acquisition are no longer available to Glacial.

GSG has historically been provided a dedicated operating debt of $400,000 which it is currently not using from the City's "Idea Bank". Given that GSG does not anticipate needing the Idea Bank operating line of credit in the future, due to the availability of funds accessed through the inter-company balance with the City's General Revenue Fund, management is recommending that Council approve the conversion of this dedicated operating credit to term debt against which GSG can finance the new truck scale and other fixed assets as needed in the future.

The conversion of this debt will allow the Agency to properly structure its balance sheet by funding long term assets with long term debt thereby operating in a more business-like manner. If approved, the terms of each debt will be negotiated between GSG and Corporate Finance as appropriate for each fixed asset required.

Conclusion

Glacial's financial future under the current operating model and new market realities remains uncertain. For this reason, Glacial should continue to operate on a status quo basis for 2005. Unlike the Agency's previous selection reports that contained an annual budget and four-year projections, this report, as in 2004, presents a one-year budget and historical financial information for comparative purposes.

Advisory Board

The role of the Advisory Board is to provide advice on the Agency's strategic operations and on changes to its mandate, structure, business practices, and finances.

The Advisory Board is comprised of seven members; four City of Winnipeg employees, one CUPE Local 500 executive representative and two business representatives. It is anticipated that the Board will replace in 2005 one business representative who resigned from the Advisory Board in the spring of 2004.

Advisory Board Members:

Bill Larkin P. Eng.	Director of Public Works
W. Joe Funk P. Eng., MBA	Chief Operating Officer
Bruce McPhail P. Eng	CAO Representative
Jeff Laurent	Employee Representative
Jim Husiak, C.A.	CUPE Local 500 Representative
Bob Morris (Consultant)	Business Representative
Ed Bruning (I.H. Asper School of Business)	Business Representative

Financial Impact Statement **Date:** **JUNE 10, 2005**

ANNUAL SELECTION REPORT 2005: GLACIAL SAND AND GRAVEL SPECIAL OPERATING AGENCY

COMMENTS:

Financial Projections are included as appendices to this report.

"Original signed by Darcy Stewart, CA:
Manager of Finance & Administration

Approved by Divisional Accountant Trainee: ☒

7056

IN PREPARING THIS REPORT THERE WAS CONSULTATION WITH, AND CONCURRENCE BY:

Corporate Finance

This Report Submitted by:

Department:	Public Works Department	
Division:	Glacial Sand & Gravel SOA	
Prepared by:	W. Joe Funk P. Eng., MBA	Phone No: 986-5335
File name:	Glacial 2005 Selection Report (Final May 27 05)	

Appendix A: 3 Year Financial History and Projections

Glacial Sand and Gravel – Special Operating Agency

3 Year Financial History and Projections to

December 31, 2005

7058

GLACIAL SAND & GRAVEL SOA

Balance Sheet
At December 31,

	2002	2003	2004	2005 (Projected)
Assets				
Current				
Cash	$ 100	$ 29,274	$ 39,154	
Due from City of Winnipeg- General Revenue fund	-	-	-	-
Accounts receivable	245,849	291,746	454,984	254,051
Inventory	394,989	551,493	548,630	274,315
Income taxes recoverable	61,098	85,973	86,001	86,001
Prepaid expenses (Note 3)	-	-	-	-
Total Current Assets	702,036	958,487	1,128,769	614,367
Capital assets	4,279,083	4,527,392	4,515,844	4,388,671
	$ 4,981,120	$ 5,485,879	$ 5,644,613	5,003,038
Liabilities				
Current				
Due to City of Winnipeg- General Revenue Fund	$ 203,669	$ 671,038	$ 1,157,038	1,589,275
Accounts payable and accrued liabilities	546,921	543,287	747,782	309,043
Provision for Income taxes payable	-	-	-	-
Rehabilitation payable	81,368	-	-	34,300
Deferred Revenue			253,998	
Vacation	39,641	41,843	67,313	69,994
Current portion of long term debt	84,936	151,405	197,164	212,846
Total Current Liabilities	956,535	1,407,572	2,423,295	2,215,457
Long Term				
Retirement allowance	100,000	84,000	84,000	90,985
Debt - City of Winnipeg	3,996,470	4,129,115	3,977,450	4,012,536
	4,096,470	4,213,115	4,061,450	4,103,521
RETAINED EARNINGS / (DEFICIT)	(71,885)	(134,808)	(840,134)	(1,315,942)
	$ 4,981,120	$ 5,485,879	$ 5,644,611	5,003,036

Note: Format differs from that of audited statements for presentation purposes.

GLACIAL SAND & GRAVEL SOA

Statement of Operations and Retained Earnings / (Deficit)
For the year ended December 31,

	2002	2003	2004	2005 (Projected)
Revenue	$ 2,583,046	$ 2,958,505	$ 2,339,074	$ 2,292,083
Cost of sales	1,872,044	2,134,100	2,350,999	1,942,747
Gross profit	711,002	824,405	(11,925)	349,336
Expenses				
Bank charges and interest expense (revenue)	1,109	-	14,149	65,932
Depreciation - property and equipment	49,628	91,132	124,505	108,572
Selling, general and administrative	594,593	581,217	295,839	382,796
Interest on long-term debt	260,121	280,182	271,775	280,947
	905,451	952,531	706,266	838,247
Earnings (loss) before income tax equivalents and government grant	**(194,449)**	**(128,127)**	**(718,192)**	**(488,911)**
Provision for income tax equivalents	86,840	53,597	-	-
Government grant	4,941	11,607	12,866	13,103
Net earnings (loss) for the year	**(102,668)**	**(62,923)**	**(705,326)**	**(475,808)**
RETAINED EARNINGS / (DEFICIT) BEGINNING OF YEAR	30,783	(71,885)	(134,808)	(840,134)
RETAINED EARNINGS / (DEFICIT) END OF YEAR	$ (71,885)	$ (134,808)	$ (840,134)	$ (1,315,942)

Note: Format differs from that of audited statements in order to highlight Cost of Sales and Gross Profit.
Certain expense accounts have been reclassified for presentation purposes.

GLACIAL SAND & GRAVEL SOA

STATEMENT OF CASH FLOWS
For the year ended December 31,

	2002	2003	2004	2005 (Projected)
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income for the year	$ (102,668)	$ (62,923)	$ (705,326)	$ (475,808)
Depreciation, depletion and amortization which do not require a cash outlay	109,628	173,079	183,808	177,172
Changes in non-working capital items:	.			
Decrease (increase) in accounts receivable	25,424	(45,897)	(163,238)	200,933
Decrease (Increase) in inventory	(250,877)	(156,504)	2,863	274,315
Increase (decrease) in income taxes recoverable	(61,098)	(24,875)	(28)	-
Decrease in prepaid expenses	83,461	-	-	-
Increase in accounts payable and accrued liabilities	235,529	(3,634)	204,495	(438,739)
Increase (decrease) in income taxes payable	(26,224)	-	-	-
Increase (decrease) in rehabilitation payable	(1,128)	(81,368)	-	34,300
Increase (decrease) in deferred revenue			253,998	(253,998)
Increase (decrease) in accrued vacation	9,281	2,202	25,470	2,681
	21,328	(199,920)	(197,958)	(479,144)
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of fixed assets (net)	(423,551)	(421,386)	(172,260)	(50,000)
CASH FLOWS FROM FINANCING ACTIVITIES				
Increase in retirement allowance	18,000	(16,000)	-	6,985
Increase (decrease) in debt- City of Winnipeg	33,031	199,114	(105,905)	50,768
	51,031	183,114	(105,905)	57,753
NET INCREASE (DECREASE) IN CASH	(351,192)	(438,192)	(476,123)	(471,391)
Cash (bank indebtedness) at beginning of year	147,623	(203,569)	(641,761)	(1,117,884)
Bank indebteness at the end of year	$ (203,569)	$ (641,761)	$ (1,117,884)	$ (1,589,275)

Note: Presentation differs from format of audited statements. Cash is netted against bank indebtedness in this presentation.

Notes to the Financial Projections

For Year ending December 31, 2005

1. Description of Business

On March 20, 1997, Council adopted a document entitled "Reshaping our Civic Government". The document identified the development of Special Operating Agencies (SOAs) as one of the five strategic initiatives needed to create a more affordable and fundamentally better Civic Government. On September 24, 1997, Council adopted the strategic direction with regard to SOAs identified in the report entitled "Special Operating Agencies Initiative." Consistent with the foregoing process, Equipment and Material Services of the Public Works Department prepared a report that outlined all options for alternate service delivery. This report identified the Special Operating Agency option as the most financially viable option. On February 23, 2000, Council directed Public Works to prepare a business plan based on the SOA recommendation. GSG commenced operations as an SOA on January 1, 2001.

The SOA deals in the following products sold to the City of Winnipeg and other customers:

1.) Sand, gravel and aggregate products mined and processed at the Pine Ridge and Transcona pits; and
2.) Crushed limestone products purchased and re-sold to City of Winnipeg departments and various external markets.

2. Accounting Principles

The projected financial statements have been prepared on the basis of Canadian generally accepted accounting principles. The projections include the following significant policies.

The preparation of periodic financial statements necessarily involves the use of estimates and approximations because the precise determination of financial data frequently depends on future events.

These financial statements have been prepared by management within reasonable limits of materiality and within the framework of accounting policies summarized below.

The financial statements have been prepared on the basis of Canadian generally accepted accounting principles and include the following significant accounting policies:

Inventory:

Inventory is recorded at the lower of cost and net realizable value.

Capital Assets:

Capital assets transferred from the City of Winnipeg on January 1, 2001 were recorded at their estimated value. Subsequent acquisitions are recorded at cost. Capital assets are amortized over the estimated useful life using the following rates and methods:

Machinery	10 years	Straight Line
Buildings	4 – 5%	Declining Balance
Office Equipment	20%	Declining Balance
Computer Equipment	30%	Declining Balance

The depletion of the gravel pit is recorded at a rate of 20 cents per tonne of aggregate inventory extracted on an annual basis.

Revenue Recognition:

Revenue is recognized upon delivery of products.

Financial Instruments:

Financial instruments include cash, accounts receivable, income taxes recoverable, due to City of Winnipeg - General Revenue Fund, accounts payable and accrued liabilities, and long-term debt. Unless otherwise stated, it is management's opinion that the Agency is not exposed to significant interest, currency or credit risks arising from these financial instruments. The book value of the Agency's financial assets and liabilities approximates their fair value.

3. Fixed Assets, Plant & Equipment

The agency acquired certain of the equipment and structures owned by the former Primary Materials Branch. In addition, assets in the amount of $15,720 has been included at book value. The Agency annually evaluates the merits of acquiring additional strategic plant and equipment such as a modern crusher, wheel loaders, overland conveyors, etc. vs. renting. Previous capital expenditures are being financed via long-term debt through Fleet Management Agency, repayable over a 5 year period at an interest rate of 6.5% (the City of Winnipeg long term borrowing rate).

The City and the SOA determined, and mutually agreed, that the value of the Pine Ridge Pit at December 31, 2001 was $3,800,000, and this value was placed on the SOA balance sheet along with a similar amount in long-term debt. Interest is paid at a rate of 6.5%. Principal will be repaid at a mutually agreed upon date in the future, consistent with Council decision in this regard.

4. Financial Projections

This financial projection is an estimate of the financial position, results of operations, and change in cash flow for the operation of GSG Special Operating Agency, using management's assumptions that reflect the Agency's planned course of action for the year ending December 31, 2005.

These projections are based on the SOA operating as a self-contained business unit, including all costs required to support its operations. Cost categories considered and included are: human resources, operations and maintenance, facilities, capital expenditures and associated

operating or term debt, overhead and one-time conversion costs. These costs represent a full costing model.

Management's judgment has been used in the assumptions and the most probable set of economic conditions, together with the hypotheses stated in note 5 below. The hypotheses are consistent with the purpose of the information, but are not necessarily the most probable in management's judgment. Since assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to the date of this projection, the actual results achieved during the projected period will vary from the projections and the deviations may be material.

5. Hypotheses

The financial projection has been prepared based on the following hypotheses:

a) That the SOA will be allowed to purchase any support services from the City or external providers required to sustain ongoing operations.

b) As the SOA continues as part of the municipal government structure, the entity is not subjected to corporate income taxation. However, in order to approximate a business model, the financial projections of the entity reflect a provision for income tax equivalents at a rate of 46%, payable to the City of Winnipeg. In addition, future income tax assets which represent the carry forward of unused tax losses have been included for illustrative purposes where there is a reasonable belief by management that these tax assets can be utilized in the future. These are utilized in future years to offset income tax equivalents payable. No future income tax liability has been recorded as the assumption has been made that depreciation/depletion for accounting purposes approximates capital cost allowance for taxation purposes.

c) The City of Winnipeg will continue to extend operating credit at an assumed rate of 5% and long term lending sufficient for the SOA to operate with interest charged at 6.5%.

d) The Council approval of GSG's Selection Report.

e) Funding for necessary strategic plant and equipment acquisitions must come from "Idea Bank" funds and/or GSG cash flows.

6. Assumptions - Revenue

Approximate sale tonnages and dollars are based on recent experience and anticipated market conditions going forward. Hauling revenues are also based on recent experience.

Sales	**Tonnes**		**Dollars**	
	2004 (actual)	**2005 (projected)**	**2004 (actual)**	**2005 (projected)**
Sand, gravel and related aggregate products	326,600	460,000	$ 1,241,000	$ 1,651,000

Limestone products	36,000	30,000	$ 220,000	$ 183,000
Treated Sand	55,400	0	$ 571,000	$0
Total Material Sales	**418,000**	**490,000**	**$ 2,032,000**	**$ 1,834,000**
Hauling services on above	125,000	120,000	$ 307,000	$ 458,000
Total Operating Revenues	-	-	**$ 2,339,000**	**$ 2,292,000**

Sand, Gravel and related aggregate product sales of 460,000 tonnes for 2005 is based on 2004 volumes with a significant increase in Transcona volume (60,000 – 80,000 tonne increase expressed by the contractor) and a significant increase in sales from inventory at Pine Ridge. The increases are expected as a result of recently secured volumes, anticipated weather improvements in 2005 and the additional sales effort of the Operations Coordinator hired late in 2004. The dollar value per tonne for 2005 is lower by approximately 6% owing to the decrease in high priced Treated Sand sales and to the increase in lower priced royalty sales volumes. Limestone projections for 2005 are consistent with Glacial's historical averages. Hauling revenue per tonne is expected to increase due to changes in Glacial's revenue accounting and pricing practices for 2005.

7. Assumptions - Expenses

a) **Cost of Sales**

- **Salaries and benefit costs**

  The SOA expects to operate with the following staff levels in 2005:

  - WAPSO Exempt 1
  - WAPSO 1
  - CUPE 9
  - CUPE (summer students) 3

  Employee benefits are estimated to be 17% of total gross salaries.

  2005 labour costs are expected to decline from 2004 when Glacial was negatively impacted by poor weather and associated higher labour costs.

- **Equipment costs**

  Overall equipment costs for 2005, particularly expenditures related to repairing and maintaining Glacial's plant and equipment, are expected to decline significantly from 2004 levels when substantial restorative and safety investments were made.

- **Material costs**

  2005 material costs reflect a decline of approximately $150,000 from 2004 levels. The decline is associated with the purchase of salt used for treating sand in 2004.

b) **Audit Fees**
The SOA expects to pay $6,500 towards audit fees.

c) **Automobile Allowances**
Automobile allowance expenses of approximately $10,000 are expected to be incurred by GSG management.

d) **Advertising/Sales Promotion**
The SOA expects to spend $2,000 for advertising and promotion.

e) **Depreciation**
Depreciation is based on rates identified in Note 2.

f) **Depletion**
Pit depletion charged at $0.20/tonne for material from Pine Ridge and Transcona pits.

l) **Administrative Charges**
The SOA expects to purchase administrative services from both the Public Works Department and Corporate Services. Included in these costs are fees for financial, human resources, information technology, legal, purchasing and others expected to total $27,000 and $26,000 respectively in 2005.

m) **Interest**
Interest will be paid at 6.5% annually for long-term debt and 5.0% for operating credit.

n) **Other Governmental Charges**
Payments for the Provincial Rehabilitation Levy of 10¢/tonne and the Rural Municipality of Springfield's Aggregate Mining Levy and Road Maintenance Levy of 6.8¢/tonne combined will be expensed on an annual basis. The Provincial Rehabilitation Levy extinguishes the SOA from further site restoration obligations.

8. Assumptions – Assets and Liabilities

a) **Cash on hand**
Petty cash of $100 will be available for incidental expenditures.

b) **Accounts Receivable**
Accounts receivable have been calculated on the basis of approximately 45 days of sales being outstanding at year end. As a result 12% of revenues have been shown as the receivable balance. The SOA has budgeted $10,000 for 2005 to cover bad debts.

c) **Aggregate Inventory**
The agency has purchased the gravel pit asset at a value of $3,800,000. It is being financed as long-term debt from the City of Winnipeg at an annual rate of 6.5%.

d) **Property and equipment**
The agency will purchase in accordance with Note 3.

e) **Accounts payable and accrued liabilities**
Accounts payable will be paid on the basis of 45 day terms. Therefore it has been assumed that accounts payable will be 12% of total expenses.

f) **Retirement allowance and vacation liability**
At the time of agency inception, a retirement liability was determined that would extinguish the amounts entitled to employees of the agency upon retirement. Vacation liability is calculated based on overall payroll growth from the previous year.

g) **Due to City of Winnipeg**
The agency will require short-term financing in the form of an operating line of credit from the City of Winnipeg from the General Revenue Fund. Interest is assumed at a rate of 5.0%.

h) **Long-term debt**
Debt for property and equipment purchases is obtained from either Fleet Management Agency or the City of Winnipeg. Debt taken for the purchase of the gravel pit in the amount of $3,800,000 will incur interest charges at 6.5%.

9. Long-term Debt

$3,800,000 in debt for the Pine Ridge Pit has no fixed term of repayment (see Note 3) Long term debt at December 31 of the following years consists of the following:

	2005
Debt (interest rate 6.5%)	$ 4,225,400
Less: current portion	$ 212,800
Long-term portion	$ 4,012,600

Appendix B: Audited Financial Statements

Glacial Sand and Gravel – Special Operating Agency

Audited Financial Statements at

December 31, 2004

Financial Statements

The City of Winnipeg Glacial Sand and Gravel – Special Operating Agency

December 31, 2004

To the Mayor and Members of City Council
The City of Winnipeg

We have audited the statement of financial position of **The City of Winnipeg Glacial Sand and Gravel – Special Operating Agency** as at December 31, 2004 and the statements of operations and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Agency'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 City of Winnipeg Glacial Sand and Gravel – Special Operating Agency** as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Winnipeg, Canada,
April 19, 2005

Chartered
Accountants

THE CITY OF WINNIPEG
GLACIAL SAND AND GRAVEL - SPECIAL OPERATING AGENCY

STATEMENT OF FINANCIAL POSITION

As at December 31
(in thousands of dollars)

	2004	2003
ASSETS		
Current		
Cash (Note 6)	$ 39	$ 29
Accounts receivable (Note 3)	455	292
Income taxes recoverable (Note 4)	86	86
Inventory	549	551
	1,129	958
Capital assets (Note 5)	4,516	4,527
	$ 5,645	$ 5,485
LIABILITIES		
Current		
Due to City of Winnipeg - General Revenue Fund (Note 6)	$ 1,157	$ 671
Accounts payable and accrued liabilities	748	543
Deferred revenue (Note 7)	255	-
Vacation payable (Note 8a)	67	42
Current portion of long-term debt (Note 9)	197	151
	2,424	1,407
Retirement allowance (Note 8b)	84	84
Long-term debt (Note 9)	3,977	4,129
	6,485	5,620
CAPITAL DEFICIENCY		
Deficit	(840)	(135)
	$ 5,645	$ 5,485

See accompanying notes to the financial statements

THE CITY OF WINNIPEG
GLACIAL SAND AND GRAVEL - SPECIAL OPERATING AGENCY

STATEMENT OF OPERATIONS AND DEFICIT

For the years ended December 31
(in thousands of dollars)

	2004	2003
REVENUES		
Sales of goods and services (Note 10)	$ 2,352	$ 2,959
EXPENSES		
Administrative services (Note 10)	42	72
Amortization and depletion	184	173
Interest on long-term debt (Note 9)	286	280
Material, parts and supplies	580	516
Salaries and benefits	670	634
Services	1,295	1,400
	3,057	3,075
Net loss before income taxes	(705)	(116)
Income tax recovery (Note 4)	-	53
Net loss for the year	(705)	(63)
(DEFICIT)/RETAINED EARNINGS, BEGINNING OF YEAR	(135)	(72)
DEFICIT END OF YEAR	$ (840)	$ (135)

See accompanying notes to the financial statements

THE CITY OF WINNIPEG
GLACIAL SAND AND GRAVEL - SPECIAL OPERATING AGENCY

STATEMENT OF CASH FLOWS

For the years ended December 31
(in thousands of dollars)

NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:

	2004	2003
OPERATING		
Net loss for the year	$ (705)	$ (63)
Non-cash items related to operations		
Amortization and depletion	184	173
Retirement allowance	-	(16)
Working capital from operations	(521)	94
Net change in working capital	324	(310)
	(197)	(216)
FINANCING		
Due to City of Winnipeg - General Revenue Fund	486	467
Repayment of long-term debt	(151)	(85)
Proceeds of issuance of long-term debt	45	284
	380	666
INVESTING		
Proceeds on disposal of capital assets	68	-
Purchase of capital assets	(241)	(421)
	(173)	(421)
INCREASE IN CASH POSITION	10	29
CASH POSITION, BEGINNING OF YEAR	29	-
CASH POSITION, END OF YEAR	$ 39	$ 29

See accompanying notes to the financial statements

THE CITY OF WINNIPEG
GLACIAL SAND AND GRAVEL - SPECIAL OPERATING AGENCY

NOTES TO THE FINANCIAL STATEMENTS

For the year ended December 31, 2004
(in thousands of dollars, except as noted)

1. Description of Business

Glacial Sand and Gravel - Special Operating Agency ("Agency") commenced operations on January 1, 2001. Since the inception, sales of gravel pit aggregate, limestone, and treated sand are realized from both The City of Winnipeg and private industry customers.

2. Summary of Significant Accounting Policies

The preparation of periodic financial statements necessarily involves the use of estimates and approximations because the precise determination of financial data frequently depends on future events. These financial statements have been prepared by management within reasonable limits of materiality and within the framework of accounting policies summarized below.

The financial statements have been prepared on the basis of Canadian generally accepted accounting principles and include the following significant accounting policies:

Inventory

Inventory is recorded at the lower of cost and net realizable value.

Capital assets

Capital assets transferred from the City of Winnipeg on January 1, 2001 were recorded at their estimated value. Subsequent acquisitions are recorded at cost. Capital assets are amortized over the estimated useful life using the following rates and methods:

Machinery	10 years	Straight-line
Buildings	4-5%	Declining balance
Office equipment	20%	Declining balance
Computer equipment	30%	Declining balance

The depletion of the gravel pit is recorded at a rate of 20 cents per tonne of aggregate inventory extracted on an annual basis.

Revenue Recognition

Revenue is recognized upon delivery of products.

Financial Instruments

Financial instruments include cash, accounts receivable, income taxes recoverable, due to City of Winnipeg - General Revenue Fund, accounts payable and accrued liabilities, and long-term debt.
Unless otherwise stated, it is management's opinion that the Agency is not exposed to significant interest, currency or credit risks arising from these financial instruments. The book value of the Agency's financial assets and liabilities approximates their fair value.

3. *Accounts Receivable*

	2004	2003
Trade accounts receivable	$ 465	$ 326
Allowance for doubtful accounts	(10)	(34)
	$ 455	$ 292

4. *Income Tax Equivalency*

As part of the municipal government, the Agency is not subject to corporate income taxes. However, in order to approximate a business model, the operation of the Agency was assessed with an income tax equivalency charge/recovery of 46% which was payable to (recoverable from) The City of Winnipeg. Amounts paid were to be directed to infrastructure renewal in the City of Winnipeg. This was discontinued in 2004 because of the significant losses.

5. *Capital Assets*

	Cost	Accumulated Amortization/ Depletion	Net Book Value 2004	Net Book Value 2003
Gravel pit	$ 3,800	$ 298	$ 3,502	$ 3,560
Machinery	1,104	238	866	835
Building under capital lease	51	4	47	48
Computer equipment	88	33	55	36
Land clearing	28	-	28	28
Building	19	3	16	17
Office equipment	4	2	2	3
	$ 5,094	$ 578	$ 4,516	$ 4,527

6. *Due to City of Winnipeg - General Revenue Fund*

The City of Winnipeg operates a centralized treasury function with a single operating bank account in the General Revenue Fund. Consequently, the Agency does not have a bank account. Cash transactions are credited or charged to the "Due (to)/from" account, and amounts reported as cash represent bank deposits not yet charged to this account. Interest is credited or charged based on the City's average short-term earnings (cost of funds) on the single bank account.

The Agency has negotiated an operating line of credit of up to $400 thousand from The City of Winnipeg - Idea Bank Reserve, at a rate of 6.5%.

7. *Deferred Revenue*

Amounts billed for products not yet delivered are recorded as deferred revenue and are recognized as revenue when those products are delivered.

8. Employee Benefits

a) Vacation

The Agency's employees accrue vacation credits, which together with unused holidays from previous years generally become a charge to operations in the year they are earned.

b) Retirement allowance

Under various union agreements, unused sick leave credits accumulate and employees with specified minimum service requirements become entitled to a cash payment upon retirement, death or termination of service under certain conditions (excluding resignation). An actuarial valuation has estimated the retirement allowance liability at December 31, 2004 at $84 thousand (2003 - $84 thousand).

c) Pension

The Agency's employees are eligible for pensions under the Winnipeg Civic Employees' Benefits Program. The Plan is a defined benefit plan. The City of Winnipeg allocates its pension costs to various departments. During the year, $31 thousand (2003 - $31 thousand) of pension costs were allocated to the Agency. An actuarial valuation for the Winnipeg Civic Employees' Benefits Program was made as of December 31, 2003 and has an actuarial surplus.

9. Long-Term Debt

	2004	2003
City of Winnipeg - Equipment and Materials Services:		
Equipment financing program loan, interest at 6.5%, payment of $5 hundred monthly, due December 2005	6	11
Equipment loan, interest at 6.5%, payment of $5 thousand monthly, due December 2005	56	109
Gravel pit loan, interest at 6.5%, no repayment schedule	3,800	3,800
City of Winnipeg - Fleet Management - Special Operating Agency		
Equipment replacement loan, interest at 6.5%, payment of $2 thousand monthly, due September 2005	18	42
Equipment loan, interest at 6.5%, payment of $6.5 thousand monthly, due February 2008	223	284
Capital lease obligations	71	34
	4,174	4,280
Current portion of long-term debt	(197)	(151)
	$ 3,977	$ 4,129

9. Long-Term Debt (continued)

a) Principal repayments due within the next five years are as follows:

2005	$ 197
2006	78
2007	83
2008	16
2009	-
Thereafter	3,800
	$ 4,174

b) Interest on the equipment loans during the year was $39 thousand (2003 - $33 thousand) and has been paid to The City of Winnipeg - Equipment and Material Services and Fleet Management - Special Operating Agency; and

The interest payable on the gravel pit loan during the year of $247 thousand (2003 - $247 thousand) is to be directed to infrastructure renewal in the City of Winnipeg.

c) Cash paid for interest during the year was $39 thousand (2003 - $33 thousand).

10. Related Party Transactions

Included in the Agency's revenues/expenses are the following transactions, which occurred in the normal course of operations and are recorded at the exchange amount:

a) Sales of goods and services of $1.146 million (2003 - $1.540 million) to The City of Winnipeg and

b) General government charges in the amount of $26 thousand (2003 - $26 thousand) to The City of Winnipeg - General Revenue Fund which represents the estimated share of The City of Winnipeg's general expenses applicable to the Agency, and

c) Charges in the amount of $143 thousand (2003 - $85 thousand) to Fleet Management - Special Operating Agency for services related to equipment supply, maintenance, and fuel.

11. Economic Dependence

The Agency is dependent upon City of Winnipeg financing for its future viability.

12. Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's financial statement presentation.