Canadian Dairy Commission
Commission canadienne du lait

CANADIAN DAIRY COMMISSION

ANNUAL REPORT

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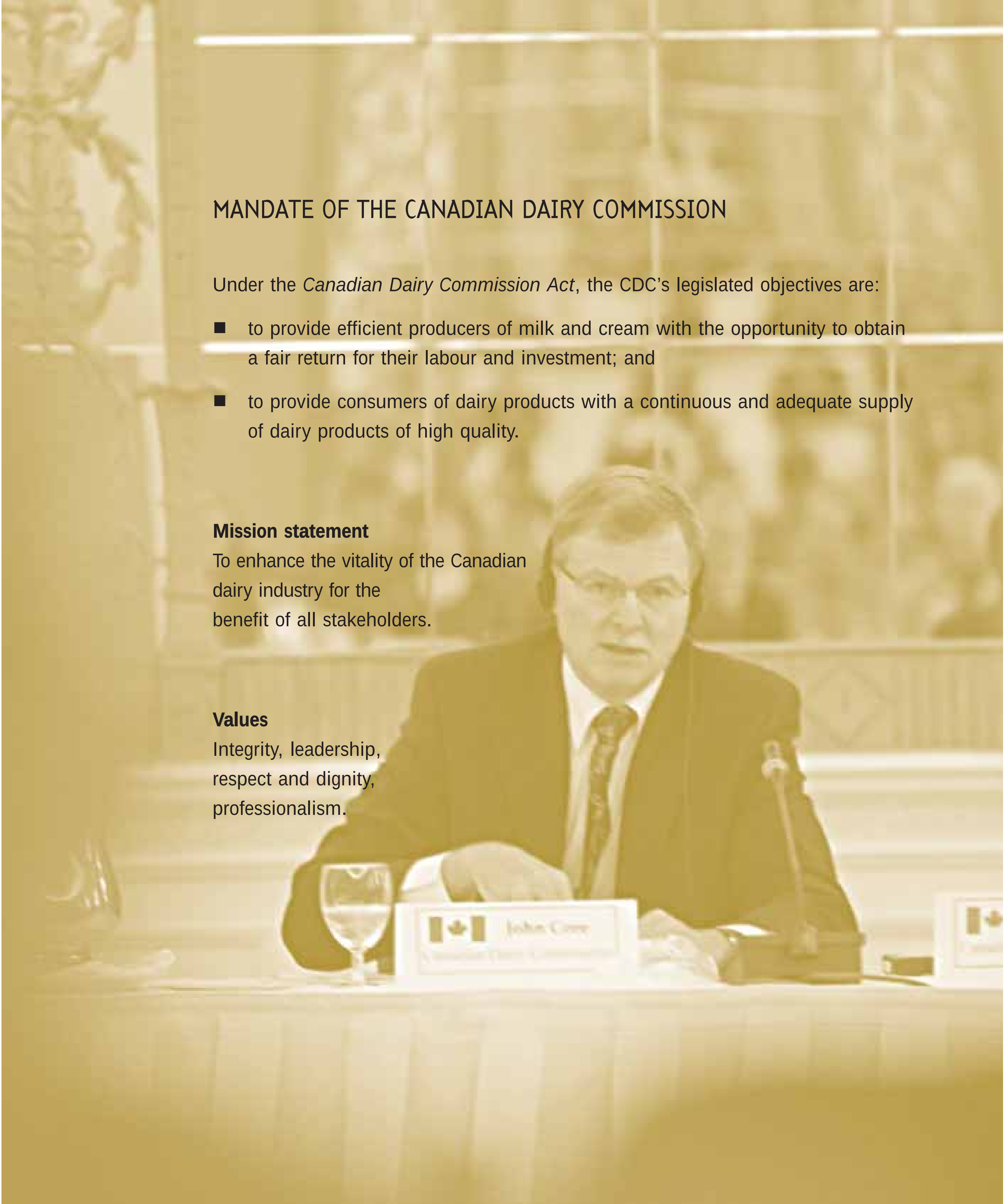

MANDATE OF THE CANADIAN DAIRY COMMISSION

Under the *Canadian Dairy Commission Act*, the CDC's legislated objectives are:

- to provide efficient producers of milk and cream with the opportunity to obtain a fair return for their labour and investment; and
- to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality.

Mission statement
To enhance the vitality of the Canadian dairy industry for the benefit of all stakeholders.

Values
Integrity, leadership, respect and dignity, professionalism.

Commission staff is available to serve you, in either official language, from 8 a.m. to 4:30 p.m. Eastern time, Monday to Friday (statutory holidays excluded).

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LETTER TO THE MINISTER

Mister Minister,

I am pleased to submit the Canadian Dairy Commission's Annual Report for the 2009-2010 dairy year. As we conclude the year, the Canadian Dairy Commission (CDC) is in a sound financial position and has achieved most of the objectives it had set for itself. Some of these objectives were not reached either because the industry was not ready to move forward on some issues or because circumstances required a change in direction. Overall, the CDC continued to help the Canadian dairy industry and its stakeholders respond positively to the many challenges that arose.

On the world stage, prices for dairy products have somewhat recovered as the world economy emerged from the 2008 economic recession. Prices in the milk classes that follow world or US prices have followed that trend but it was not strong enough to have a positive impact on overall returns of Canadian dairy producers.

In the Canadian dairy industry, the harmonization trend that started last year continued in 2009-2010. Discussions between Quebec and Ontario on the harmonization of milk allocation to dairy plants are suspended but the Maritime Provinces are making good progress. Four Eastern provinces have harmonized most of their producer quota policies and a fifth will integrate the joint management of these policies during the new dairy year. The CDC has been actively involved in each of these initiatives.

Demand for dairy products increased in 2009-2010. Industrial milk production reached 50.94 million hl in the past year, compared to 49.90 million hl in 2008-2009. Last December, the CDC announced that the support prices of skim milk powder and butter would remain unchanged as of February 1, 2010 as market conditions and the evolution of the cost of producing milk did not warrant an adjustment.

One of the highlights of the year for the CDC was the signing, on March 15, of the new Agreement on the Eastern Canadian Milk Pooling. This federal-provincial agreement replaces the former Agreement on All Milk Pooling. It provides the Supervisory Body that oversees the Agreement greater flexibility to respond to changes in the industry.

I would like to take this opportunity to express my appreciation for the co-operation we receive from industry stakeholders, provincial governments, your office and our colleagues at Agriculture and Agri-Food Canada and the other Agriculture and Agri-Food Portfolio agencies. We are also indebted to the CDC employees who run our operations with efficiency and fairness.

In closing, I would like to thank you, Mr. Minister, for supporting the work of the CDC.

Randy Williamson
Chairman

THE CANADIAN DAIRY INDUSTRY

From left to right, auditors Juan Gong, Phil Rebus, Vanessa Lecavalier and Peggy Ritchie

The Canadian dairy industry operates on a “dairy year” basis, which runs from August 1 to July 31. Most dairy policy decisions are made by a federal-provincial committee called the Canadian Milk Supply Management Committee (CMSMC). The Canadian dairy industry operates under a supply management system where raw milk production is kept in line with demand using production quotas. The quota for industrial milk used to manufacture dairy products such as butter, cheese and yogurt, is called Market Sharing Quota, or MSQ. Other key elements of supply management include regulated prices and import controls.

KEY HIGHLIGHTS OF 2009-2010

- In March 2010, the Commission signed the federal provincial agreement entitled Agreement on the Eastern Canadian Milk Pooling. This agreement replaces the Agreement on All Milk Pooling, which had been used to administer the pooling of revenues and markets between producers of the Maritimes, Quebec, and Ontario since 1996. The new agreement better reflects the current situation and will provide more flexibility to adapt to a changing environment.
- In order to reduce butter stocks, the Canadian Milk Supply Management Committee (CMSMC) decided to freeze market sharing quota (MSQ) for a six-month period. As a result, automatic quota increases were not implemented in February, April and June 2010.
- The CMSMC approved changes to the Harmonized Milk Classification System which moved nutraceuticals from class 4(a)1 to class 4(m) effective December 1, 2009, and extended the eligibility of ice cream novelties in class 5(c) to December 31, 2010.
- In March 2010, the CDC partnered with FIL-IDF Canada, Dairy Farmers of Canada, and the Dairy Processors Association of Canada to organize a conference on dairy sustainable development and environment.
- The Market Committee was entrusted by the CMSMC to review class 4(a)1 prices every three to four months and to establish prices based on market conditions starting in February 2010.
- The CDC approved six projects under the new Matching Investment Fund. Funding committed for this new program amounted to 0.5 million dollars for the 2009-2010 dairy year.
- In June, Agriculture Minister Gerry Ritz announced the reappointments of Mr. Randy Williamson as Chairman and of Mr. Gilles Martin as Commissioner of the CDC for three-year mandates.
- At its July 2010 meeting, the CMSMC voted to extend the Domestic Dairy Product Innovation Program until July 31, 2011.
- At the same meeting, the CMSMC asked the CDC to lead discussions on a national all milk pool with provincial boards, provincial governments and Dairy Farmers of Canada. The initial objective will be to establish a work plan and a schedule for negotiations.

- The CDC shipped 110 tonnes of skim milk powder to Haiti through different food aid agencies to help relief efforts following the devastating earthquake. Producers agreed not to be paid for the milk ingredients used and processors agreed to process this powder for free.
- At the end of the dairy year, Canadian requirements were at 51.06 million hl, up 2.04% from the previous year.

NUMBER OF FARMS AND COWS, AND TOTAL PRODUCTION

2005-2006 to 2009-2010

	Number of farms	Number of cows (thousands)	Total production* (million hl)
2005-2006	15,522	1,019.1	80.64
2006-2007	14,660	1,004.8	80.77
2007-2008	14,036	998.5	83.40
2008-2009	13,587	978.4	82.90
2009-2010	13,214	981.0	83.56

* At 3.6 kg of butterfat per hl

MILK PRODUCTION

Farm cash receipts

As a key contributor to the Canadian economy in the 2009 calendar year, the dairy industry ranked third behind grains and red meats, generating $5.5 billion in total net farm receipts.

Number of farms and production per farm

In the 2009-2010 dairy year, Canada had 13,214 dairy farms. Although there has been a decline in the number of dairy farms in Canada, individual farming units have grown in size and have increased their efficiency. The average production per farm in the 2009-2010 dairy year was 6,324 hectolitres, a 3.6% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,592 kg of milk.

In the 2009-2010 dairy year, Quebec and Ontario had the greatest percentage of dairy farms at 81.2%, followed by 13.2% in the Western provinces, and 5.6% in the Atlantic provinces.

NUMBER OF DAIRY FARMS IN 2009-2010

Newfoundland and Labrador	35
Prince Edward Island	213
Nova Scotia	253
New Brunswick	231
Quebec	6,492
Ontario	4,243
Manitoba	388
Saskatchewan	202
Alberta	615
British Columbia	542
TOTAL	13,214

MILK PROCESSING

In the 2009 calendar year, the dairy processing industry generated $13.6 billion* worth of products shipped from approximately 452 processing plants (272 of which are federally registered) accounting for 15% of all processing sales in the food and beverage industry. In the same year, the dairy processing sector employed 22,730 people.

* Based on the North American Industry Classification System prepared by AAFC.

MILK MARKETS

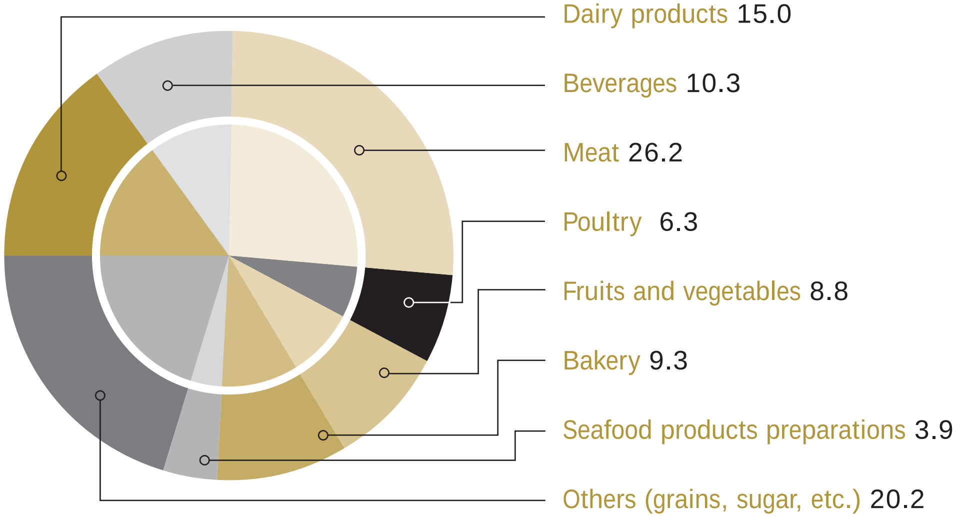
Canadian dairy producers supply two main markets:

- fluid milk, including creams and flavoured milks
- industrial milk used to make products such as butter, cheese, yogurt, ice cream and milk powders.

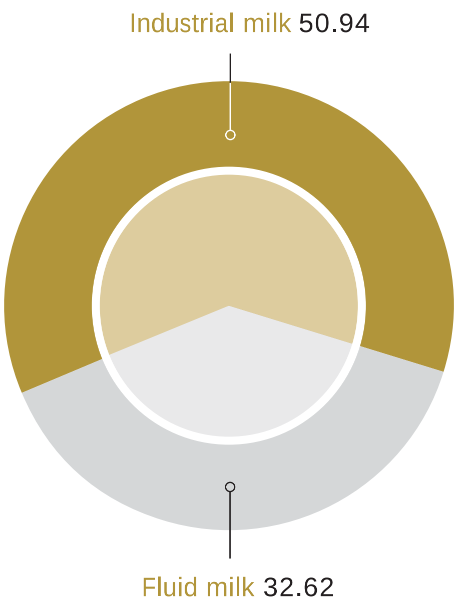
In the 2009-2010 dairy year, the fluid milk market accounted for approximately 39% of total producer shipments, or 32.62 million hl*. The industrial milk market accounted for the remaining 61% or 50.94 million hl* of total producer shipments.

* At 3.6 kg of butterfat per hl.

SHARE OF MANUFACTURED SHIPMENTS IN CANADA (%) - VALUE BASIS (2009)



INDUSTRIAL AND FLUID MILK PRODUCTION IN 2009-2010 (million hl)



Ingredients market

Canada's strong economic recovery in early 2010 coupled with the timely launch of the CDC's Matching Investment Fund (MIF) helped create new growth opportunities in the utilization of Canadian dairy ingredients.

The use of dairy ingredients in pre-packaged foods such as frozen entrées and desserts, cookies, breakfast mixes and chocolate products increased during the 2009-2010 dairy year. Dairy processors saw significant growth in the demand for butter, cream, skim milk powder and whole milk powder. The CDC's new Matching Investment Fund received over 30 proposals for consideration, of which six have been approved so far. Funding committed by the CDC under the MIF for the 2009-2010 dairy year amounted to $0.5 million.

In the Special Milk Class Permit Program (SMCPP) the equivalent of 6.71 million hl of milk (at 3.6 kg of butterfat per hl) in dairy ingredients was used, an increase of 4.8% compared to the previous year.

Renewed growth in the use of dairy ingredients in the 2009-2010 dairy year reflects the value of our dairy industry programs and marketing initiatives which encourage Canadian dairy and food processors to innovate and compete in the marketplace.

PRODUCTION OF MILK* (million hl)

Province	2008-2009			2009-2010		
	Fluid	Industrial	Total	Fluid	Industrial	Total
Newfoundland and Labrador	0.37	0.15	0.52	0.38	0.13	0.51
Prince Edward Island	0.15	0.93	1.08	0.16	0.95	1.11
Nova Scotia	1.11	0.72	1.83	1.10	0.74	1.84
New Brunswick	0.73	0.71	1.44	0.71	0.73	1.44
Quebec	7.46	23.82	31.28	7.20	24.82	32.02
Ontario	13.03	13.98	27.01	13.03	14.21	27.24
Manitoba	1.37	2.03	3.40	1.36	1.96	3.32
Saskatchewan	0.71	1.75	2.46	0.72	1.61	2.33
Alberta	3.97	2.91	6.88	3.95	2.91	6.86
British Columbia	4.10	2.90	7.00	4.01	2.88	6.89
Total	33.00	49.90	82.90	32.62	50.94	83.56**

* Before pooling. Data provided in kilograms of butterfat were converted to hectolitres for this table at the ratio of 3.6 kg of b.f. per hectolitre.

** This total cannot be compared to the total on page 9 as it includes milk supplied to food banks, milk sold at fairs and losses.

MILK UTILIZATION BY CLASS

Provincial marketing boards and agencies purchase milk from producers and sell it to processors for the manufacture of dairy products. The milk sold to processors in Canada is classified according to its end use based on the Harmonized Milk Classification System (see Appendix 1). The price paid for milk by processors varies according to the milk class. The following table shows how Canadian milk production was used in 2009-2010.

Class	Million hl	% of total milk
1	24.67	29.6
2	6.25	7.5
3(a) and 3(b)	28.75	34.5
4(a) and 4(a)1	15.31	18.4
4(b), 4(c), 4(d), 4(m)	0.95	1.1
5(a), 5(b), 5(c)	6.71	8.0
5(d)	0.72	0.9
TOTAL	83.36	100.0


From left to right, Francis Charette, Stéphane Loyer and Linda Giancristofaro, Special Milk Class Program agents

THE CANADIAN DAIRY COMMISSION

Adrienne Lachapelle, Special Milk Class Permit Program Agent, and Lindsay Fleming, Administrative Assistant

The Canadian Dairy Commission (CDC) is a Crown corporation created in 1966 by the *Canadian Dairy Commission Act*. The Commission reports to Parliament through the Minister of Agriculture and Agri-Food to whom it serves as an advisor on matters related to the dairy industry. The CDC is part of the Agriculture and Agri-Food Portfolio along with Agriculture and Agri-Food Canada, the Canada Agricultural Review Tribunal, the Canadian Food Inspection Agency, the Canadian Grain Commission, Farm Credit Canada and the Farm Products Council of Canada.

The federal government funds about half of the CDC's administrative costs. Other costs, including the CDC's marketing activities, are funded by dairy producers and the marketplace. The CDC supports the interests of all dairy stakeholders — producers, processors, further processors, exporters, consumers and governments.

The Commission employs 60 people who work in its offices which are located in Ottawa, Ontario. Since the success of the CDC depends on its employees' pursuit of excellence, the CDC encourages and supports superior individual and organizational performance.

GOVERNING BOARD

The governing board for the CDC is composed of the Chairperson, the Commissioner, and the Chief Executive Officer (CEO), collectively known as the Commission. The Commission meets every four to six weeks. As part of its overall stewardship, the governing board

- establishes and approves the CDC's strategic directions, Corporate Plan and budgets with input from senior management;
- reviews the financial statements of the CDC on a quarterly basis;
- approves the annual report and the year-end financial statements, the latter of which are audited by the Auditor General of Canada;
- ensures proper accountability through internal audits and evaluations of CDC's systems, practices and programs;
- reports on CDC activities and services to the industry as they relate to its legislated mandate and presents the related financial statements to the Canadian Milk Supply Management Committee at least four times a year; and,
- receives and follows up on the Auditor General's annual audit report on the Commission's financial statements as well as on the Special Examination report which is issued by the Auditor General at least once every 10 years.

The Chairperson is responsible for leading the Commission and ensuring that it acts in the best long term interest of the corporation. The Chairperson's primary role includes chairing the Commission and ensuring that it fulfills its mandate. The Chairperson is also the primary liaison to the Minister.

The Commissioner assists the Chairperson in ensuring that the Commission functions properly, meets its obligations and responsibilities, and fulfills its mandate. The Commissioner also acts as Chairperson in the absence of the Chairperson and, while doing so, has all the powers and duties of the Chairperson.

The CEO makes recommendations in the areas of planning and oversees the implementation of the Strategic Plan and of the Corporate Plan once it is approved by Treasury Board. He ensures the delivery of programs to the dairy industry and the CDC's compliance with applicable government policies. The CEO is also the primary liaison between the CDC and the dairy industry stakeholders and governments.

The members of the Commission have many years of dairy industry experience and their backgrounds bring a balanced approach to satisfying the objectives of the stakeholders.

COMMISSIONERS

Chairman (reappointed August 1, 2010 for a three-year term)

Randy Williamson

Mr. Williamson has a Marketing Diploma from the University of Western Ontario and a Sales and Marketing Diploma from the University of British Columbia. He has over 30 years of experience in the dairy processing industry. He began his career with Fraser Valley Milk Producers in 1974, moving to Dairyland Foods in 1986, and subsequently to Dairyworld Foods in 1992 and to Saputo in 2001, where he remained until his retirement in 2006.

Mr. Williamson also has extensive board experience as Director of the National Dairy Council (1990-2006), Director of the Nova Scotia Dairy Council (1998-2005), and President of the British Columbia Dairy Council (1994-1996).

Commissioner (reappointed August 1, 2010 for a three-year term)

Gilles Martin

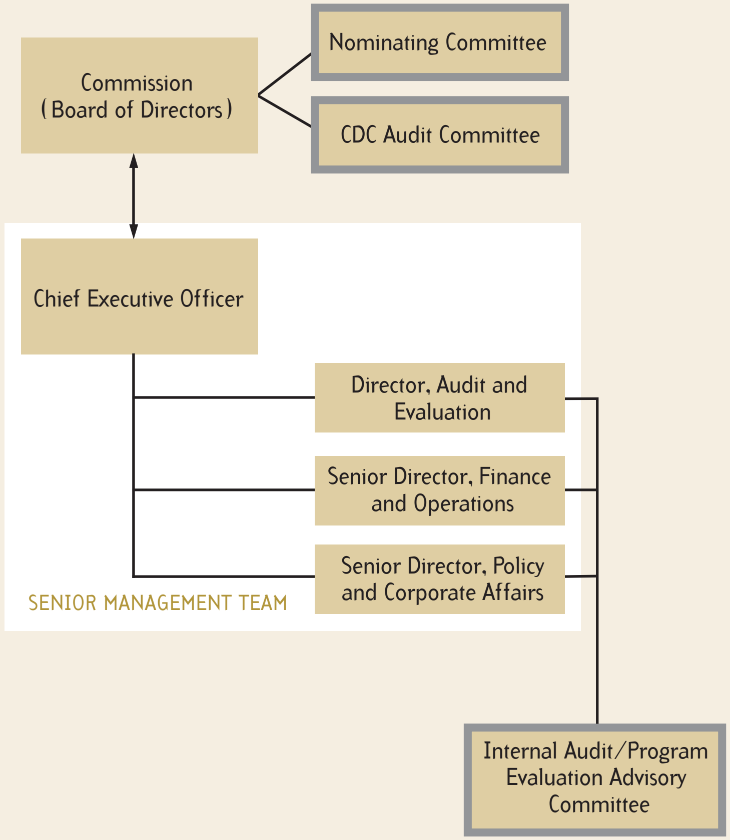
Mr. Martin has a post-secondary degree in Zootechnology from the Institut de technologie agroalimentaire in La Pocatière. He has been involved in the milk producing industry since 1977, and operates a dairy farm in Rivière-Ouelle, Quebec.

Over the past 20 years, Mr. Martin has been a respected member of the Union des producteurs agricoles, and has held various positions within the organization, notably President of his regional farmers' union, the Fédération de l'Union des producteurs agricoles de la Côte-du-Sud, and as a member of the Board of Directors of the Syndicat des producteurs de lait de la Côte-du-Sud. Presently, he is also the President and a founding member of the Centre de développement bioalimentaire du Québec, an agri-food research and development centre, and a board member of the agri-food co-operative Groupe Dynaco.

Chief Executive Officer (reappointed October 7, 2008 for a three-year term)
John Core

Mr. Core holds a Masters degree from the University of Guelph. He was a lecturer at Ridgetown College in Ontario at the beginning of his career. He then owned and operated a dairy and cash crop farm in Lambton County, Ontario, with his brothers. During his dairy farming years, Mr. Core was a board member for Dairy Farmers of Ontario from 1981 to 2001. He chaired this organization from 1990 to 2001. He was also a member of the board of Dairy Farmers of Canada from 1986 to 2001, and was the organization's President between 1999 and 2001. He is currently a member of the boards of the Guelph General Hospital and The Royal Agricultural Winter Fair.

John Core, Chief Executive Officer; Randy Williamson, Chairman; Gilles Martin, Commissioner



COMMITTEES

Audit Committee

Activities

The Committee met quarterly to review the financial statements and receive internal audit and program evaluation reports. Annual work plans and progress reports are presented to the Committee.

Members

- Commissioner (chair)
- Chairperson
- Chief Executive Officer

Internal Audit/Program Evaluation Advisory Committee

Activities

The Committee met periodically to review internal audit and program evaluation reports. Annual work plans were determined and progress reports were presented to the Audit Committee.

Members

- Chief Executive Officer (chair)
- Director, Audit and Evaluation
- Manager, Evaluation
- Manager, Financial Reporting, Accounting and Treasury
- Senior Director, Finance and Operations
- Senior Director, Policy and Corporate Affairs

Senior Management Team

Activities

The Senior Management Team is responsible for the day-to-day operations of the Canadian Dairy Commission.

Members

- Chief Executive Officer (chair)
- Director, Audit and Evaluation
- Senior Director, Finance and Operations
- Senior Director, Policy and Corporate Affairs

Nominating Committee

Activities

The Committee met in February 2010 and issued a recommendation to the office of the Minister of Agriculture and Agri-Food concerning the mandates of the Chairman and the Commissioner, which were to end in July 2010.

Members

- A member of the Commission (chair)
- Senior Director, Policy and Corporate Affairs
- Executive Director, Dairy Farmers of Canada
- President and CEO, Dairy Processors Association of Canada
- Representative from the Consumers Association of Canada at the Canadian Milk Supply Management Committee

1. Policy and Corporate Affairs Section, from left to right: **Gilles Froment**, Senior Director, Policy and Corporate Affairs; **Cesarea Novielli**, Human Resources Advisor; **Benoît Basillais**, Chief, Policy and Economics; **Chantal Paul**, Chief, Communications and Strategic Planning; **Danie Cousineau**, Secretary to the Commission

2. Finance and Operations Section, from left to right: **Roger Heard**, Senior Officer, Commercial Operations, **Josée Pigeon-Laplante**, Acting Manager, Special Milk Class Permit Program; **Mark Lalonde**, Chief, Marketing Programs; **Laval Létourneau**, Chief, Commercial Operations; **Gaëtan Paquette**, Senior Director, Finance and Operations; **Chantal Laframboise**, Manager, Pooling and Administration; **Richard Rancourt**, Chief, I.T.; **Andre Berckmans**, Manager, Financial Reporting, Accounting, and Treasury

3. Audit and Evaluation Section, from left to right: **Robert Hansis**, Director, Audit and Evaluation; **Hossein Behzadi**, Manager, Program Audits; **Nelson Coyle**, Manager, Evaluation; **Indira Gangasingh**, Manager, Assurance Services (absent from the picture).

CORPORATE GOVERNANCE

In 2009-2010, the Commission took the following measures to ensure good accountability.

- It held the CDC's third Annual Public Meeting in January in Ottawa.
- The Commission completed a process to evaluate the performance of the Board. The conclusion of this evaluation was that the Board functions efficiently. The results were communicated to the Minister of Agriculture and Agri-Food and the Treasury Board Secretariat.
- The Commission updated its Corporate Risk Profile. This is an internal document that is reviewed at least once per year (latest review was January 2010) by CDC management. It outlines the risks identified by managers and directors as posing a threat to the core mandate of the CDC and/or to the achievement of its goals. The plan defines each risk, describes the existing measures for managing the risk, as well as incremental risk management strategies, and identifies the group responsible for implementing these strategies. The Profile is taken into consideration when doing the environmental analysis during the strategic planning session.
- The Commission approved the CDC's Strategic Plan for 2010-2011. The Strategic Plan is an internal document that is produced following a one-day strategic planning session that the CDC Board and management hold every year in February. It contains the goals, objectives and activities for the coming year as well as who is responsible for each objective, timelines and performance indicators. This information is used when preparing the Corporate Plan.
- The Commission approved the Annual Report and Financial Statements for dairy year 2009-2010 as well as the budget for fiscal year 2010-2011.
- Internal audits performed during the year included the purchase and disposal of hardware and software, the special milk class permit system, the management of CDC loans, and the CDC Scholarship Program.
- The Scholarship Program was the subject of a program evaluation as were the Employee Recognition Program and internal services of the CDC.
- A formal process was instituted to follow up on the implementation of recommendations resulting from internal audits and program evaluations. The Senior Management Team regularly reviews actions taken and reports back to the audit committee when all recommendations have been addressed.
- The Commission had been working closely with other government bodies to seek amendments to the *Canadian Dairy Commission Act* in order to change its governance structure. The proposed changes were to remove the CEO position from the Board, to create a part-time vice-chairman position and to create a full time CEO position that would not be a member of the Board. These recommendations have been forwarded to Government for its consideration.
- In December 2009, the CEO and Chairman attended the Crown Corporation CEO/Chairperson Workshop, an event organized by the Treasury Board Secretariat. They received an update on the amendments to the Financial Administration Act, the Budget Implementation Act, financial reporting requirements, financial risk management, trade issues, and the appointment and remuneration process for Crown corporation appointees.

ACTIVITIES

Nicole Bilodeau, Pooling and Treasury Officer

The mandate of the Canadian Dairy Commission (CDC) includes the development of dairy policy, the monitoring of demand and adjustment of supply in the dairy sector, the facilitation of industry discussions, and the pooling of milk revenues and markets.

CHAIRING THE CANADIAN MILK SUPPLY MANAGEMENT COMMITTEE (CMSMC)

The CMSMC is the key national body for policy development and discussions in the sectors of dairy production and processing. It includes representatives of producers and governments from all provinces and non voting representatives of national consumer, processor and producer organizations. As chair of the CMSMC, the CDC provides ongoing leadership, advice and analysis to the Canadian dairy industry while operating in close co-operation with national and provincial stakeholders and governments.

At the CMSMC meeting held on July 21, 2010, members renewed the Domestic Dairy Product Innovation Program for one year and accepted that the quota increases associated with this program be shared nationally at the end of the 2010-2011 dairy year. At the same meeting, they asked the CDC to lead discussions for the creation of a national all milk pool with representatives of provincial boards, provincial governments and Dairy Farmers of Canada. The CDC will first establish, in collaboration with these partners, a work plan and a schedule that will frame discussions.

DETERMINING AND ADJUSTING QUOTAS

The Commission monitors trends in Canadian requirements (demand) and industrial milk production (supply) on a monthly basis. Canadian requirements are defined as the butterfat required to fulfill domestic demand and planned exports for industrial dairy products.

The national production target for industrial milk is called the Market Sharing Quota (MSQ). The MSQ is based on Canadian requirements. Demand is constantly monitored and, every two months, the MSQ is adjusted under the authority of the CMSMC to reflect changes in the domestic demand for industrial milk products, as well as changes in planned export activity.

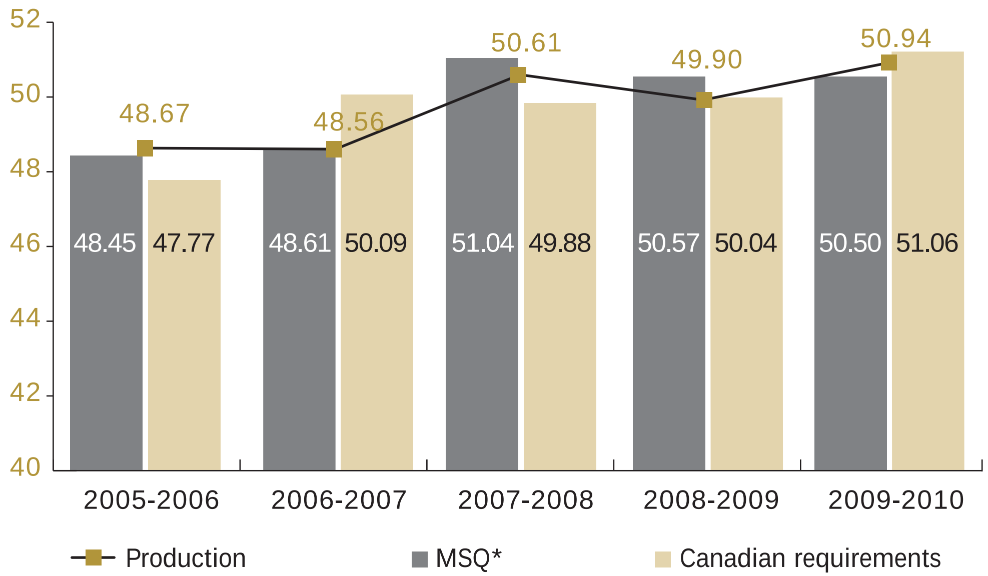
Because it is expressed on a butterfat basis, the MSQ also takes into account the fact that a portion of the butterfat from the fluid milk market will be used in the industrial milk market (skim-off). The objective when establishing the

MSQ is to minimize the possibility of shortages or surpluses in the domestic market. Any surplus that occurs is managed by adjusting the Market Sharing Quota, by temporarily storing surpluses at the expense of producers or, in exceptional circumstances, by exporting within Canada's trade commitments.

Over the course of the 2009-2010 dairy year, Canadian requirements were 51.06 million hl, up 2.04% from the previous year. A decrease in fluid skim-off created additional need for industrial milk. Growth at the retail level also played a role with yogurt and cheese sales increasing by 4.6% and 1.7%, respectively. In addition, households have changed their habits since the recession ended and sales of dairy products in the food service sector are improving.

During the same period, industrial milk production increased to 50.94 million hl compared to 49.90 million hl a year earlier. Heat waves during the summer slowed down production, which had been on an upward trend until that point. A return to growth is expected in the fall. National quota should be higher than ever, forage should be of a good quality in most regions, and incentives have already been put in place in some provinces to increase production. Butter stocks are expected to increase in the spring of 2011 even though quota was capped during the last six months of the 2009-2010 dairy year.

INDUSTRIAL MILK PRODUCTION, CANADIAN REQUIREMENTS AND MSQ (million hl)



*Weighted average MSQ, including the Domestic Dairy Product Innovation Program

PROVINCIAL SHARES OF MSQ* – JULY 31, 2010

	Butterfat (million kg)	Milk (million hl)	%
Newfoundland and Labrador	0.51	0.14	0.3
Prince Edward Island	3.08	0.85	1.7
Nova Scotia	2.14	0.60	1.2
New Brunswick	2.25	0.62	1.2
Quebec	81.58	22.66	45.3
Ontario	56.57	15.72	31.4
Manitoba	6.62	1.84	3.7
Saskatchewan	4.86	1.35	2.7
Alberta	12.04	3.34	6.7
British Columbia	10.42	2.90	5.8
Total	180.08	50.02	100

*Before sharing of markets

POOLING OF MARKETS AND PRODUCER RETURNS

For dairy producers, pooling agreements are a good tool to manage the financial risks associated with the evolution of the domestic market. In its role as a national industry facilitator, the Canadian Dairy Commission administers these pooling agreements on behalf of the dairy industry.

Comprehensive Agreement on Pooling of Milk Revenues

Under the Special Milk Class Permit Program implemented in 1995, competitively priced industrial milk is made available for use in dairy products and products containing dairy ingredients. The Comprehensive Agreement on Pooling of Milk Revenues provides a means for the market returns from the sale of milk to processors for special class purposes to be shared among all dairy producers.

Agreement on the Eastern Canadian Milk Pooling

Since 1996, the Agreement on All Milk Pooling has provided a means for revenues from all milk sales (fluid and industrial) and transportation costs, along with markets and the responsibility for skim-off, to be pooled among dairy producers in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island (the P5). The CDC chairs the Supervisory Body of the pool, administers the pooling agreement, does the pooling calculations and provides technical expertise and secretariat services to the pool.

On March 15, 2010, all P5 signatories signed the revised P5 Agreement named Agreement on the Eastern Canadian Milk Pooling. The revised version provides the P5 Supervisory Body with greater flexibility to adapt and respond to ongoing challenges faced by the dairy industry. Part two of the new Agreement is continuously updated to take into account new decisions of the P5 Supervisory Body. This way, the agreement better reflects the changing environment.

The Ontario and Quebec bilateral negotiations regarding the harmonization of plant allocation policies were suspended in 2009-2010 due to provincial legal issues. The Maritime

Milk Allocation Committee, which has the mandate to discuss plant allocation policies in the Maritime Provinces, met on several occasions. The CDC chairs these meetings and provides technical advice. Both committees will continue negotiations during the coming year.

As of August 1, 2010, all producer boards with the exception of Dairy Farmers of Prince Edward Island (DFPEI) jointly manage a common producer quota policy. DFPEI is expected to join the common policy as of September 1, 2010.

Western Milk Pooling Agreement

In 1997, the four Western provinces (Manitoba, Saskatchewan, Alberta and British Columbia) implemented an all milk pooling system where revenues and markets for all milk classes are shared. The CDC chairs the Western Milk Pool (WMP) Coordinating Committee, administers the pooling agreement, does the pooling calculations and provides technical expertise and secretariat services to the pool.

Several steps to harmonize policies among the WMP provinces were taken in the past year. The WMP provincial boards hired a consulting firm to seek ways of improving the effectiveness of milk allocation to processors and milk transportation. The recommendations of this study, released in June 2009, lead to the creation of a Steering Committee which oversees the implementation of the report's recommendations. A project manager was hired to conduct the day-to-day activities of this harmonization process. With the help of working groups on transportation, policies and information technologies, the project manager has started to examine the issues outlined in the 2009 study. Draft harmonized policies are being created and reviewed by the WMP Steering Committee.

POOLS IN NUMBERS 2009-2010

	Fluid milk produced (million hl)	Industrial milk produced (million hl)	Blend price to producer* ($/hl)
P5	22.20	41.45	$72.44
WMP	10.04	9.36	$75.67

*In-quota milk at 3.6 kg butterfat per hl

The WMP also adopted a WMP Milk Sampling Policy as well as the national standards for bacteria and inhibitor testing and the national procedure for inter-provincial loads.

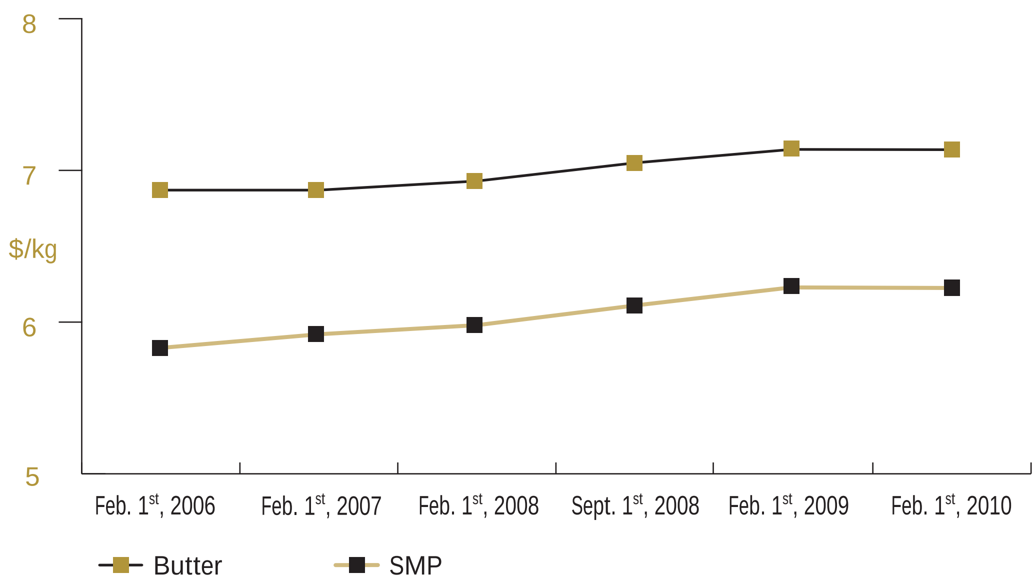
Joint efforts by the P5 and WMP to harmonize policies

The CDC has continued to promote further harmonization within and between the two regional pools. Signatories to the P5 and the WMP agreements meet jointly twice a year. These joint meetings provide opportunities to discuss common issues and to share knowledge and expertise. The two pools agreed on a methodology that would narrow the gap in component prices for fluid milk over time.

PRICING

Each year, the CDC reviews and establishes support prices for butter and skim milk powder used by the CDC when purchasing or selling these dairy products. Support prices serve as a reference for provincial milk marketing boards and agencies when they establish the prices paid by processors for industrial milk.

SUPPORT PRICES FOR BUTTER AND SKIM MILK POWDER FROM 2006 TO 2010 ($ per kg)



Two elements of the CDC's mission are taken into account in the pricing decision: providing efficient producers with an adequate return on their labour and investment, and providing Canadian consumers with an adequate supply of high quality dairy products. Each year, the CDC holds pricing consultations and the views of dairy industry stakeholders are carefully examined before making this decision.

Because input prices decreased slightly from their peak levels in 2008 and dairy producers could cover their cost of production, support prices for butter and skim milk powder were left unchanged in 2010. Since the last support price increase in February 2009, inflation of retail prices has been weaker for dairy products than for food in general.

AUDIT AND PROGRAM EVALUATION

In terms of audit, the CDC has a dual accountability:

- to the Government of Canada, given that the CDC is a Crown corporation; and
- to dairy industry stakeholders, in light of the programs administered by the CDC on their behalf.

External Audits

External audits are, in large part, performed on companies participating in the Special Milk Class Permit Program. Risk assessment is used to identify high risk companies among program participants. During the 2009-2010 dairy year 41 companies were audited, resulting in claims of approximately $430,000 from these companies.

The CDC continues to work with provincial auditors to assist in the audit of Special Class transactions. It provides advice on practices related to plant utilization audits and on the implementation of the National Audit Standards to further harmonize these audit practices across Canada.

The Commission also performs the milk plant utilization audits in Manitoba, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, New Brunswick and Saskatchewan on a cost-recovery basis. The contracts with Manitoba and Saskatchewan expired on July 31, 2010 and will be re-negotiated.

Internal Audits

As mandated by the *Financial Administration Act*, internal audits must be carried out on the systems, practices and programs of the Commission. The Internal Audit/Program Evaluation Advisory Committee, comprised of managers and directors and chaired by the CEO, reviews audit priorities, approves the annual audit plan and monitors progress of audit activities.

In 2009-2010, the following internal audit work was performed: the CDC's purchase and disposal of hardware and software was examined. The computerization of the cash book and management of CDC's loan was also audited and the new system was found to be more efficient because it eliminates certain manual accounting entries.

A consultant was hired to review the special milk class permit system which was last reviewed in 1997. Although significant changes to the program have improved controls and efficiency since then, management agreed to address certain issues. Furthermore, the CDC will require greater assurance on related special class pool transactions from plant utilization auditors.

The CDC Scholarship Program was also audited. Universities generally awarded scholarships and spent the funds as intended but could improve reporting of their activities to better comply with the written agreements. It was also agreed that the CDC should keep more formal records on the Program in the future.

An audit of travel expenses and hospitality was completed and another on the Domestic Dairy Product Innovation Program is nearing completion. The audit of the CDC's contributions to fluid milk promotion will be completed early in the next dairy year.

Program Evaluations

The three following program evaluations were completed in the last dairy year and evaluation staff worked with CDC employees and the CMSMC to implement the resulting recommendations. The CDC Scholarship Program was evaluated and recommendations (including renewal of the program) were presented to the Commission. The Employee Recognition Program was also evaluated. Recommendations were presented to an advisory committee of managers and employees, and a new program was implemented. Finally, employee satisfaction with the internal services provided by the CDC was evaluated.

IMPORTS

Under the terms of the 1994 WTO Agreement on Agriculture, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product to the food sector through butter manufacturers. This year, the tariff rate quota for butter remained at 3,274 tonnes. Of this, approximately two thirds (2,000 tonnes) is specifically allocated to New Zealand.

EXPORTS

During the 2009-2010 dairy year, the majority of dairy product exports were performed by the private sector under permits from the CDC. The main role of the CDC was to dispose of the structural surplus of solids non fat mainly in the form of skim milk powder or blends containing skim milk solids. However, for the first time in three years, the CDC had to remove surplus butterfat as well. During the 2009-2010 dairy year, Canada exported 8.7 million kg of skim milk powder. Using 5(d) permits, the CDC purchased 2.0 million kg of surplus butter of which 0.7 million kg was exported.

In regard to cheese exports, the CDC's major responsibility is to deliver certificates to Canadian exporters that give them access to the aged cheddar market in the European Union. In 1980, Canada negotiated a special access quota with the European Union. The current access level is 4,000 tonnes, but for the second year in a row, Canada was not able to take advantage of part of that access. We have partly compensated by issuing 5(d) permits for other markets. In total, Canada has exported 4,337 tonnes of cheese within the limits of Canada's export commitments under its WTO obligations.

EXPORTS LIMITS AND PRODUCTS EXPORTED

Category	Export limit (million $)	Product exported (million $)
Butter	11.025	2.321
Cheese	16.228	13.997
Skim milk powder	31.149	31.149
Others	22.505	22.505
Incorporated products	20.276	20.276

INDUSTRY SUPPORT

The CDC regularly supports a number of initiatives that benefit the entire dairy industry. One of these is the Canadian Quality Milk Program which is administered by Dairy Farmers of Canada. This HACCP-based program aims to further improve the quality of raw milk. The CDC contributes $300 for each Canadian dairy farm validation. This reduces the costs of the program for farmers and creates an incentive for them to participate. During the 2009-2010 dairy year, the CDC contributed $325,800 to this project.

The CDC also partners with Dairy Farmers of Canada to fund Project Podium, a campaign that promotes chocolate milk as a recovery drink after physical activity. CDC's contribution to this campaign in 2009-2010 amounted to about $876,200.

Finally, the CDC agreed to finance a dairy research cluster with Agriculture and Agri-Food Canada, Dairy Farmers of Canada, and the Natural Sciences and Engineering Research Council. This fund, which totals $11.8 million, will allow strategic research activities to take place. The CDC's contribution to this fund is $1.5 million over the three year period of this program.

PROGRAMS

From left to right, Jamie Stephen, Danielle Sabourin, Claudette D'Amour, Edwidge Fairweather, and Martine Leblanc, Special Milk Class Permit Program agents

The Canadian Dairy Commission administers a number of programs related to market supply and growth on behalf of the Canadian Milk Supply Management Committee (CMSMC).

DOMESTIC SEASONALITY PROGRAMS

Domestic Seasonality Programs allow the industry to cope with the seasonal demand for dairy products. The industry has mandated the Canadian Dairy Commission (CDC) to operate these programs in cooperation with the private sector. Generally, the CDC buys and stores products when consumption is low and sells to processors when consumption rises. These transactions take place at support prices.

Butter

The CDC holds a quantity of butter in storage throughout the year. The CMSMC set 12 million kg of butter as target stocks for August 1 each year. This is referred to as the normal butter inventories. The total stocks of butter are an indicator to the industry of possible surpluses or shortages of butterfat in the marketplace. This information is used to assess whether production quotas should be adjusted and indicates the need to manage surpluses.

In order to defray the costs associated with storing the normal levels of butter stocks, an amount is collected from consumers by the Commission through pooling arrangements and is adjusted as required to correspond to the actual costs associated with these stocks. The consumer levy remained unchanged in 2009-2010 at 8 cents per hl. Costs associated with butter stocks above normal inventories or with any other products under the Domestic Seasonality Programs are paid by Canadian dairy producers.

Milk Powders

The CDC operates a program for the storage of specialty types of milk powders such as low-heat skim milk powder and whole milk powder. It encourages manufacturers to make these products when the supply of milk is plentiful, thus minimizing the demand for fresh milk to make these products in the fall when demand for other products is stronger. Stocks held under this seasonality program help to balance the supply and demand of non-fat milk solids.

Concentrated Milk Assistance Program

The Concentrated Milk Assistance Program (CMAP) is used to encourage the production of evaporated and sweetened condensed milk during the period of the year when milk supply is abundant. Unlike the other Domestic Seasonality Programs where the CDC actually purchases and sells the products, the CMAP is a financial assistance program which compensates manufacturers for the carrying charges associated with additional storage time.

Carrying charges associated with the CDC's Domestic Seasonality Programs for butter and skim milk powder totalled $3.2 million in 2009-2010.

SURPLUS REMOVAL PROGRAM

The CDC administers a Surplus Removal Program on the industry's behalf. The CMSMC directs the CDC in operating the program. The program ensures that milk surplus to the domestic market is removed in the appropriate region and in a timely fashion. Under this program, the CDC buys surplus butter or skim milk solids. In the rare instances where excess butterfat occurs, the CDC buys the excess butter and may sell it on the export market. The CDC buys the surplus of skim milk solids and sells it either on the export market or in marginal domestic markets such as the animal feed market. All these exports must fall within Canada's trade commitments. Both the export and animal feed markets yield lower returns to producers than the regular domestic classes. Revenues from these markets are shared among all Canadian producers through the Comprehensive Agreement on Pooling of Milk Revenues.

Inventories

Within the framework of the Domestic Seasonality and Surplus Removal programs, the CDC must hold inventories of dairy products. The Commission began the 2009-2010 dairy year with 15,690 tonnes of butter and 34,610 tonnes of skim milk powder in inventory. During the year, the CDC purchased 27,890 tonnes of butter and 26,240 tonnes of skim milk powder. Sales of 28,420 tonnes of butter and 36,040 tonnes of skim milk powder left respective closing inventories of 15,166 and 24,814 tonnes as of July 31, 2010 (statistics include imports of butter and butteroil).

DAIRY MARKETING PROGRAM

The new Matching Investment Fund (MIF) took effect August 1, 2009. This $6 million fund provides financial assistance to encourage companies to re-formulate and innovate using Canadian dairy products and ingredients, especially solids non fat products such as skim milk powder and milk protein concentrate. More than 30 proposals were received at the CDC of which 6 have been approved. Funding committed by the CDC under the MIF for the 2009-2010 dairy year totalled $0.5 million. Approved projects include pet foods which incorporate cheese ingredients, ethnic prepared foods and nutraceutical products.

In 2009-2010, the CDC organized another successful Western Canadian dairy ingredients seminar in Manitoba. It also participated in the annual Canadian Institute of Food Technologists Suppliers Night event in Montreal and in the Baking Congress Trade Show in Toronto. The CDC partnered with INITIA in Quebec to present a seminar on the health benefits associated with milk components and with the Guelph Food Technology Centre to present a seminar/workshop on innovation, regulations and emerging trends in the Canadian dairy industry.

SPECIAL MILK CLASS PERMIT PROGRAM

The Special Milk Class Permit Program was implemented in 1995 to allow further processors to remain competitive in the marketplace. Through this system, milk components are made available at competitive prices to manufacture dairy ingredients destined for use in further processed products.

Further processors are able to access these dairy ingredients by means of a Special Milk Class permit issued by the Canadian Dairy Commission.

Class 5(a) permits are issued for cheese used as an ingredient in further processing for the domestic and export markets. Class 5(b) permits are issued for all other dairy products used as ingredients in further processing for the domestic and export markets. Class 5(c) permits cover dairy products used as ingredients in the confectionery sector destined for the domestic and export markets.

Further processors used the equivalent of 6.71 million hl of milk in the 2009-2010 dairy year, an increase of 4.8 % over the previous dairy year. The average revenues obtained for producers from these three classes amounted to $29.36/hl compared to $33.24/hl for the previous dairy year. A total of 1,514 permits were issued this year for classes 5(a), (b) and (c), most of which were class 5(b) permits. The number of further processors participating in the program rose to 1,382 in 2009-2010, up from 1,260 in the previous year.

VOLUME OF MILK SOLD (in million hl) AND AVERAGE PRODUCER REVENUES ($/hl)*

Class		2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
5(a)	Volume	1.98	2.16	2.16	2.09	2.12
	Price	$34.29	$33.63	$43.71	$36.19	$29.76
5(b)	Volume	2.27	2.66	3.09	2.97	3.31
	Price	$32.46	$31.77	$42.02	$31.67	$28.92
5(c)	Volume	1.44	1.59	1.57	1.29	1.29
	Price	$29.98	$29.90	$40.98	$29.32	$29.73
Total	Volume	5.69	6.40	6.82	6.35	6.71
	Price	$32.63	$31.76	$42.43	$33.24	$29.36

* Volumes and prices are calculated at 3.6 kg of butterfat per hl, using the latest standard tests for all dairy years.

DOMESTIC DAIRY PRODUCT INNOVATION PROGRAM

The Domestic Dairy Product Innovation Program (DDPIP) encourages the manufacture of new and innovative products on the domestic market. It allows for the addition of specific volumes of milk to provincial quotas to ensure that the milk supply needed to produce innovative products is available to successful applicants. In July 2010, the CMSMC agreed to extend the DDPIP until July 31, 2011 with the understanding that any additional milk quota resulting from the program will be shared on a national basis.

During the 2009-2010 dairy year, firms in Quebec, Ontario, Alberta, British Columbia and Prince Edward Island used 52.3 million litres of milk under the DDPIP. In 2008-2009, the total was 43.7 million litres. This represents approximately half of the maximum utilization limit which was established at 2% of the MSQ (approximately 100 million litres).

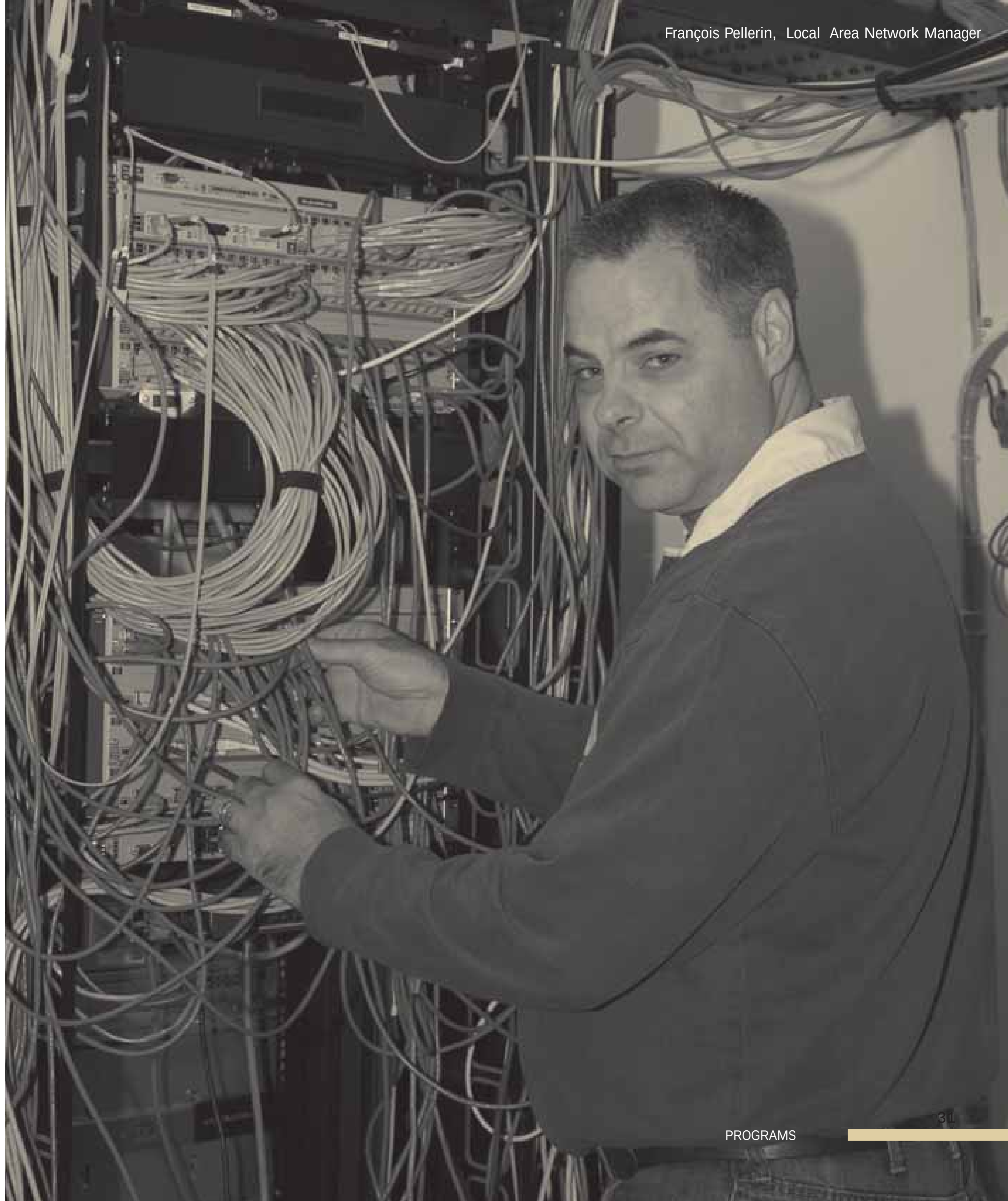
This year, the Selection Committee received 108 applications compared to 40 during the previous year. This drastic increase in the number of applications can be explained by the fact that the program was scheduled to end on July 31, 2010 before the CMSMC decided to extend it. Most applications involved new specialty cheeses. Of the 108 applications received, 60 met the program criteria and were accepted, 47 were rejected and 1 still requires additional information before a decision can be made.

SCHOLARSHIP PROGRAM

The CDC Scholarship Program was launched in June of 2006 to promote graduate studies in agricultural economics and policy, and food, dairy or animal science as these fields relate to the dairy industry. It provides $20,000 per year for up to two years to full time M. Sc. students and $30,000 per year for up to three years to full time Ph. D. students. The five-year program has a total funding commitment of $3 million to be distributed to universities across Canada as follows.

Nova Scotia Agricultural College	$200,000
Université Laval	$400,000
Novalait	$600,000
University of Guelph	$1,000,000
University of Manitoba	$200,000
University of Saskatchewan	$200,000
University of Alberta	$200,000
University of British Columbia	$200,000
TOTAL	$3,000,000

As of August 1, 2009, 37 scholarships had been granted at the Masters level and 15 scholarships had been granted for doctoral studies. Scholarships are available to Canadian citizens and landed immigrants. Institutions which benefit from the program are asked to try to match the CDC's funding and are required to provide a detailed annual report of how the funds are administered. As the initial CDC Scholarship Program is due to end in 2010-2011, the Commission will be reviewing the possibility of renewing it in the near future.


François Pellerin, Local Area Network Manager

PERFORMANCE AND GOALS

Aamir Asgarali, Economist

ACHIEVEMENTS FOR 2009-2010

This section lists the goals set by the Canadian Dairy Commission (CDC) for 2009-2010 and describes the objectives, performance indicators and results related to each.

Strategic Goals

GOAL 1. The Canadian dairy industry successfully adapts to change.

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
Key dairy industry stakeholders are discussing the evolution of the dairy industry within supply management.	• A background document on the main issues facing the dairy industry has been prepared.	• A background document outlining the main issues facing the dairy industry is being prepared internally.	100
	• Key stakeholders have been consulted.	• Consultations did not begin and the work has been postponed to 2010-2011.	0
	• Stakeholders are engaged in discussions.	• Postponed to 2010-2011.	0
The CDC is better prepared to deal with potential issues impacting the industry.	• The efficiency of tariff walls is monitored on a continuous basis and reported to the industry in collaboration with Agriculture and Agri-Food Canada (AAFC).	• A bi-weekly report is prepared for internal use and limited circulation to AAFC and Dairy Farmers of Canada (DFC).	100
	• An industry plan has been developed to face a sudden surge of imports.	• No progress on this issue so far.	0
	• The roles of the CDC, AAFC and the Canadian Food Inspection Agency (CFIA) have been clarified in the case of an industry emergency affecting domestic milk supply.	• A meeting was held to discuss the respective roles of the CDC, CFIA and AAFC in the event of an industry emergency affecting the quality of milk and as a result affecting domestic milk supply.	100
	• Regular World Trade Organization (WTO) reports are presented to the Commission and regular meetings are held with Canadian negotiators.	• Reports are presented monthly and one meeting was held.	100

GOAL 1. The Canadian dairy industry successfully adapts to change. (continued)

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
	• New communication tools are put in place to better inform the dairy industry.	• The CDC Market Bulletin was significantly improved and is now available on the CDC Internet site every month.	100

GOAL 2. The Canadian dairy industry takes a strategic approach to market development.

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
Net opening stocks of skim milk powder (SMP) equivalent on August 1, 2010 are below 20,000 t.	• The Market Committee has been advised of new market opportunities reaching 10,000 t.	• The CDC presented new market opportunities for SNF amounting to over 10,000 t.	100
	• A new pricing strategy for milk solids non fat (SNF) started on February 1, 2010.	• The CMSMC accepted a new initiative in class 4(m) recommended by the Market Committee to develop the SNF markets identified above.	100
	• A report outlining the potential means to reduce the production of milk solids non fat at the farm has been presented to the Canadian Milk Supply Management Committee (CMSMC).	• Preliminary work indicates limited potential for reduction of SNF production at the farm level.	0
	• Utilization of SMP in animal feed totals 30,000 t.	• Utilization of SMP in animal feed during the dairy year exceeded 40,000 t.	100
		• SMP stocks in class 4(m) as of August 1, 2010 were at 21,850 t.	90
The growth of the Canadian market for dairy products and components is supported by CDC initiatives.	• 5 Matching Investment Fund (MIF) projects are underway.	• The MIF received over 30 submissions of which 6 received funding.	100
	• The CDC participates on the Board of Directors responsible for the administration of the research cluster funding from AAFC.	• The CDC participates with Dairy Farmers of Canada in the research cluster approved by AAFC.	100

GOAL 2. The Canadian dairy industry takes a strategic approach to market development. (continued)

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
	• If applicable, a decision was made on CDC's participation in the research cluster funding proposal.	• The CDC's financial participation is $1.5 million.	100
	• Agreements have been signed with industry promotion organizations.	• In 2009-2010, the CDC committed $1.7 million towards a national milk promotion program which markets chocolate milk as a recovery drink after physical activity.	100

GOAL 3. The CDC is a dynamic, learning organization that lives its values.

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
CDC managers embrace creative best practices for employee attraction and retention.	• CDC managers have received training on the expectations of the various generations in the workplace.	• This training was received in October 2009. The same learning activity was offered to all other CDC staff in March 2010.	100
	• The CDC employee turnover rate is below the average of the Public Service.	• The CDC employee turnover[1] is 0% whereas the average turnover in the Public Service is 1.4%.	100
	• Within the succession plan of the CDC, potential successors for 50% of key positions have been identified.	• The key position profiles were completed. Potential successors were identified during the end of year performance evaluation of staff, in July 2010.	80
	• Development plans have been established for these successors.	• These development plans will be established as part of the development plans of employees for the new dairy year (2010-2011).	0

[1]Turnover: number of employees leaving for a position outside of the public service/total number of employees. No figure available for public service beyond March 31, 2008. Note that one year of data is relatively meaningless.

GOAL 3. The CDC is a dynamic, learning organization that lives its values. (continued)

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
CDC employees have a good knowledge of the various CDC activities and a general understanding of the dairy industry.	• 5 teams of the CDC have presented their activities to the rest of the staff.	• 5 presentations were made to the staff.	100
	• At least 20 staff members have followed a course on the processing of dairy products.	• A one-day dairy science course was presented by two University of Guelph professors to approximately 40 CDC staff and other attendees from the industry.	100
	• Staff meetings are held monthly.	• Management met with staff on a regular basis.	100
	• An orientation session on the milk supply management system has been offered to all staff.	• The orientation session for decision-makers of the industry was presented to 28 staff members on April 8.	100
	• A new orientation method has been implemented and used with new employees.	• A revised, more comprehensive orientation package was developed and will be completed shortly.	75

OUTLOOK

The Canadian dairy industry and the world market

During the 2009-2010 dairy year, the world market for dairy products has gradually improved. This is particularly true for products containing butterfat. While the price of skim milk powder (SMP) has been very volatile, the prices of butter, cheese and whole milk powder have slowly increased during the first ten months of the dairy year. Since June however, we have observed a general weakness in the price of most dairy products. One of the reasons for this recent downward trend is the weak economic recovery in many countries. Another is improved milk production in the Northern hemisphere and positive production forecasts in Oceania. New Zealand milk production should increase by about 5% compared to the previous year and a more modest 3% increase is expected in Australia. Unless the world experiences another recession, we are confident that prices on the international market will improve during the first half of the next dairy year as we do not expect global milk supply to exceed demand in the near term.

It seems unlikely that a new World Trade Organization (WTO) agreement will come into force during the 2010-2011 dairy year. However, under current trade rules dairy products could enter the country over and above the tariff rate quota given a combination of low world prices and a strong Canadian currency. Depending on volumes, such imports could disrupt milk supply management. Furthermore, Canada has entered bi-lateral trade talks with the European Union with the goal of reaching a Comprehensive Economic and Trade Agreement (CETA) by the end of 2011. The CDC continues to monitor all trade negotiations closely.

Domestic markets

The dairy market in Canada is mostly mature. Further growth is expected to be modest and opportunity for expansion to be limited at both the farm and plant level. During the recent economic slow-down, consumers bought fewer dairy products in the food service and restaurant sector and more at retail, but the overall demand continued to increase slowly. As the economy recovers, households are gradually returning to restaurants and as a consequence, the growth rate of retail sales is expected to soften. In addition, the industry faces competition from a few substitute products and the positive effect of skim-off from fluid milk on industrial milk demand may soften as well.

Harmonization

The further harmonization trend that started two years ago is still strong in both regional pools. In the WMP, provinces are following up on the report on harmonization commissioned in 2009 and several committees were created to consider and develop policies that would implement its recommendations. A WMP coordinator was hired to assist the producer boards with this process. The Eastern provinces pursued efforts to harmonize producer quota policies. Since December 1, 2009, Quebec, Ontario and Nova Scotia jointly manage their quota. They were joined on July 1, 2010 by New Brunswick, and Prince Edward Island will join in the new dairy year.

Marie Ly, Economist

At the meeting of the CMSMC in July 2010, the idea of a national pool gained momentum and the CDC was entrusted with the mandate of initiating discussions about a nationwide pool for all milk with provincial marketing boards, provincial governments and Dairy Farmers of Canada.

Trends in the workplace

Recruiting employees with specialized knowledge in the fields of agricultural economics and the dairy industry remains a challenge due to the small number of potential candidates and the situation could become worse if enrolment in some faculties of agriculture declines. Employee attraction and retention are therefore important. The CDC is aware that it will face strong competition from other government departments and the private sector to replace people who either move on or retire. The priorities of the generations now entering the work force are different from those of previous generations and the job market is such that they have alternatives. Also, in order to deal with a lean workforce and increased stakeholder demands, the CDC will continue to automate and streamline its processes to increase efficiency. These parameters will guide the CDC's management and planning of human resources.

GOALS FOR THE PERIOD 2010-2011 TO 2014-2015

The CDC has identified the following goals for the planning period, which are in line with the preceding outlook. They are the same goals as in the two previous years and remain relevant for the foreseeable future. They will be reviewed every year and are subject to change based on the policy decisions of the CMSMC, the conclusions of the various trade negotiations, and the general orientations of the federal government.

Strategic Goals

GOAL 1. The Canadian dairy industry successfully adapts to change.

OBJECTIVES	PERFORMANCE INDICATORS FOR 2010-2011
Key dairy industry stakeholders are discussing the evolution of the dairy industry within supply management.	• Consultations were held with key industry stakeholders. • A summary report and recommendations were written and circulated to stakeholders. • The Commission consulted on, and adopted a new methodology for establishing support prices.
The CDC is better prepared to deal with potential issues impacting the industry.	• A review of the current provincial and federal legal frameworks was performed and a summary was prepared and circulated to stakeholders. • Monthly reports and specific analysis on trade negotiations were presented to the Commission. • Reports on the effectiveness of the current tariffs for dairy products were prepared and circulated to the industry. • The CDC Web site was redesigned to include new interactive tools for efficient information flow.

GOAL 1. The Canadian dairy industry successfully adapts to change. (continued)

OBJECTIVES	PERFORMANCE INDICATORS FOR 2010-2011
Facilitate further harmonization within the pools and at the national level in order to be better positioned for a national pool.	• The Quebec/Ontario Milk Allocation Working group reconvened negotiations. • The Maritimes Milk Allocation Working Group has completed its analysis and prepared a report. • Harmonized policies were presented to provincial boards for approval and eventually, implementation. • A meeting of provincial auditors was held to identify differences in milk use declaration and audit procedures and to recommend best practices for harmonization. • Progress was achieved on various files such as fluid component pricing, the Domestic Dairy Product Innovation Program (DDPIP), and East-West pricing. • Reports presented to each pool were harmonized and simplified.

GOAL 2. The Canadian dairy industry takes a strategic approach to market development.

OBJECTIVES	PERFORMANCE INDICATORS FOR 2010-2011
Grow the demand for milk components.	• The new DDPIP program was agreed to and implemented by the CMSMC. • $1.5 million were allocated to projects under the Matching Investment Fund. • The CMSMC made a decision on a methodology to introduce and remove the growth allowance. • A market development committee for processors was created, held meetings and its recommendations were shared with the Market Committee and the CMSMC.
Optimize producer returns for solids non fat (SNF) and further reduce closing skim milk powder (SMP) inventories from 20,000 to 10,000 t.	• Use of milk protein concentrates in Class 4(m) has increased. • Use of SNF in class 4(a)1 went from 18,000 to 20,000 t. • Use of SNF in Special Classes went from 8,000 to 10,000 t. • Inventories of SMP are at 10,000 t on July 31, 2011.

Operational Goal

GOAL 3. The CDC is a dynamic, learning organization that lives its values.

OBJECTIVES	PERFORMANCE INDICATORS FOR 2010-2011
Continue the implementation of the succession plan.	• Potential successors were identified for each key position. • Development plans were designed for each potential successor.
Attract and retain employees.	• A framework for alternative working arrangements was established, policies modified or written accordingly and acceptable arrangements presented to CDC employees. • The Board made a decision on the renewal of the CDC Scholarship Program. • Managers and staff were made aware of the existence of “non traditional” learning activities and 10 staff members have included them in their development plans. • Scenarios were prepared and the Commission made a decision whether or not to amend the *CDC Act* to allow for increased mobility of CDC employees within the public service.
Deal with emerging and existing governance trends.	• Systems are ready to prepare financial statements using both GAAP and IFRS. • An assessment of the resources needed to comply with government security policies was prepared and submitted to the senior management team.

FINANCIAL REPORT

Guoyu Gary Wu, Programmer-Analyst and Data Administrator

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the year ending July 31, 2010 should be read in conjunction with the financial statements of the Commission enclosed herein and the annual report.

SELECTED KEY RESULTS OF OPERATIONS

Export activities

Sales

The revenue is slightly higher compared to the previous year mainly due to the fact that we not only sold skim milk powder (SMP) on the export market but also a small quantity of butter.

Skim milk powder sales for 2009-2010 amounted to 8,231 tonnes which is slightly less than the previous year when sales reached 8,860 tonnes. The average selling price per kg was similar to the previous year and translated into revenues of $21 million compared to $22.7 for 2008-2009.

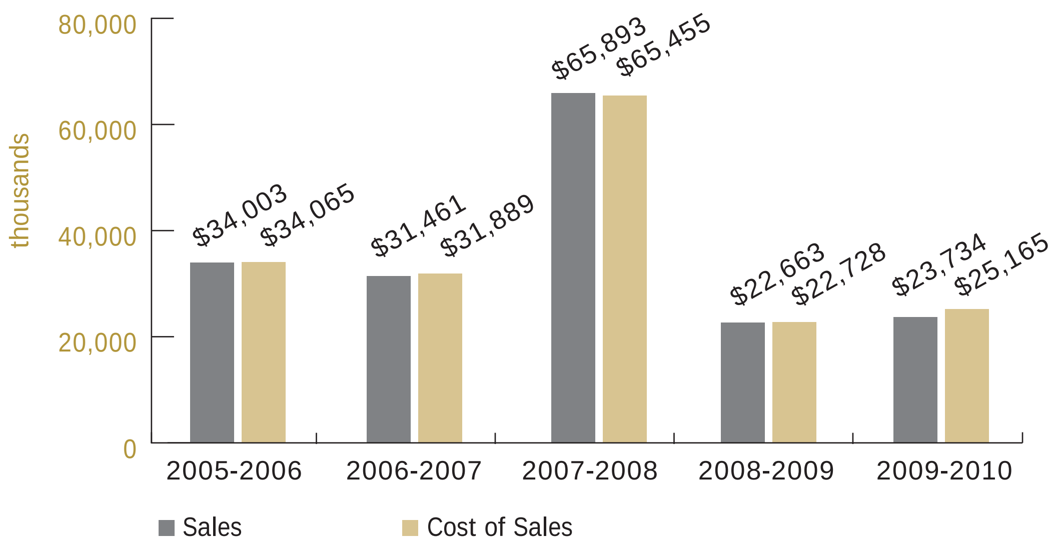
Butter sales for the year amounted to 675 tonnes which generated revenues of $2.7 million. There were no sales of butter in the previous year.

Cost of sales

The CDC purchases surplus dairy products destined for export at prices that reflect prevailing world market conditions with the intent of breaking even over the course of each dairy year. As these markets are very difficult to predict, the CDC may sometimes finish the dairy year with small gains or losses that reflect this price uncertainty.

For the dairy year ending July 31, 2010, the cost of export sales totalled $25.2 million, corresponding to sales of $23.7 million resulting in a loss of $1.5 million. Of this amount, $1.0 million is attributed to butter exports and $0.5 million to SMP exports. The more significant loss on the butter sales was due to the fact that some of the butter was initially purchased for the domestic market at the Canadian support price.

EXPORT ACTIVITIES



Domestic activities

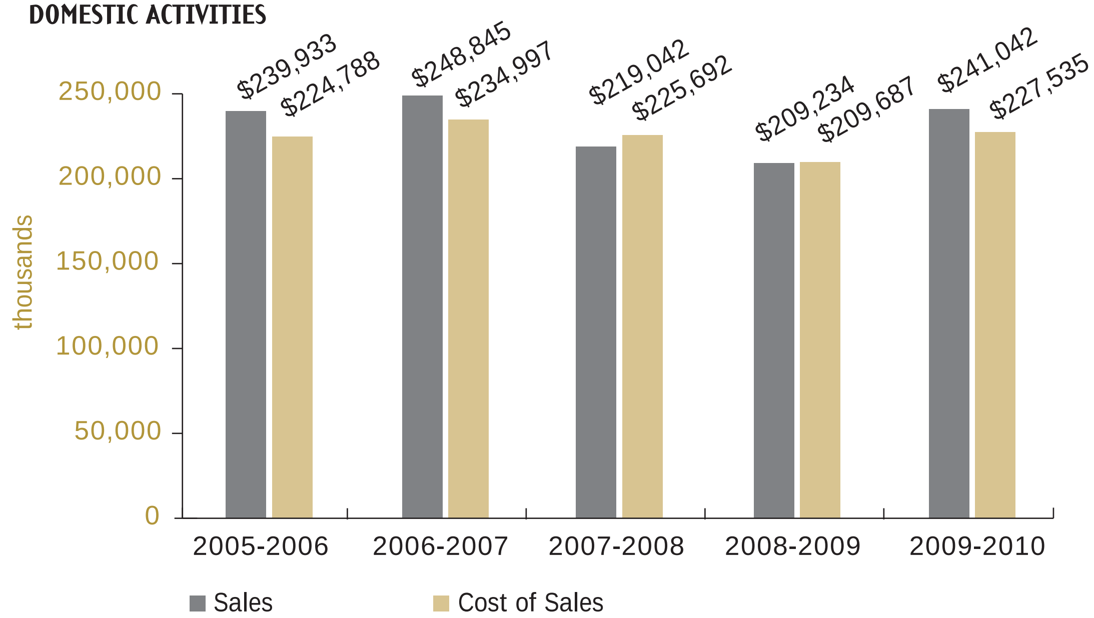
Sales

In the 2009-2010 dairy year, total revenue from domestic sales increased by $31.8 million or 15.2% compared to the previous dairy year. This is mainly due to higher sales of Plan B butter to processors and skim milk powder to Canadian animal feed manufacturers.

In the case of Plan B butter, a quantity of 22,399 tonnes was sold this year compared to 19,401 tonnes in the previous year. This increased revenues by approximately $23 million. An excess of butterfat in the marketplace required that the CDC purchase more Plan B butter this year compared to the previous year. As the Plan B program requires manufacturers to repurchase the butter within a pre-determined period of time, the increase in purchases translated into a higher volume of sales. Evidence of surplus in the marketplace was also shown in the amount of butter that was purchased and sold for export as shown in the previous section of this report.

Sales of SMP to the animal feed sector under class 4(m) amounted to 25,189 tonnes in 2009-2010, an increase of 5,631 tonnes compared to the previous dairy year. This generated additional revenues of approximately $10.7 million. The increase in sales to the animal feed sector was the result of efforts by the CDC to reduce the inventories of SMP accumulated in the previous year.

DOMESTIC ACTIVITIES



Cost of sales

For the dairy year ending July 31, 2010 the cost of domestic sales totalled $227.5 million compared to sales revenues of $241 million which translated into a profit of $14 million in domestic activities.

The increase in sales of SMP in the animal feed market, coupled with a lower purchase price, explains most of the gains achieved in the domestic activities account. The cost of butter and skim milk powder sold under Plan A and Plan B closely matched the selling prices achieved during the year as these products were purchased and sold at prevailing support prices.

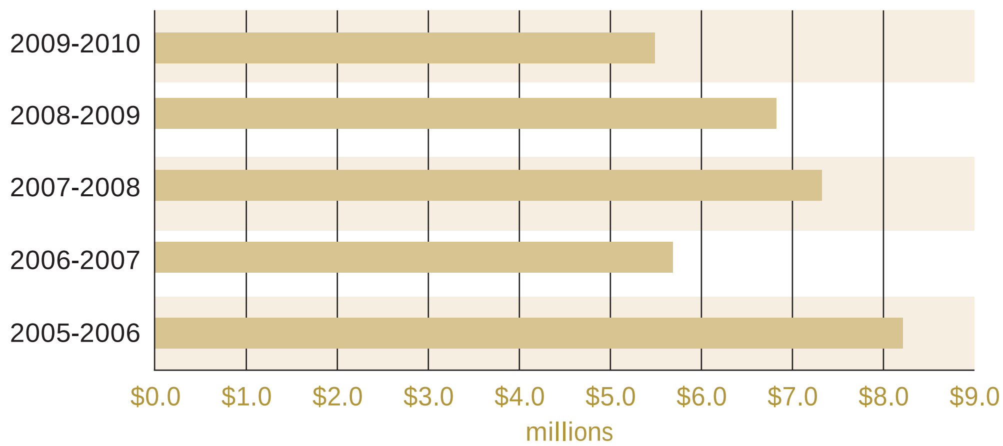
The CDC continues to import butter as part of Canada's obligations under the World Trade Organization Agreement (WTO). This butter is purchased at prevailing world prices and is directed to the further processing industry through butter manufacturers. While revenues were similar for both years, the average purchase price for butter on the world market was slightly lower this year which generated slightly better returns.

Carrying charges

Two of the major components of carrying charges are storage costs for inventory and interest expense incurred to purchase products. Carrying charges went from $6.8 million in 2008-2009 to $5.5 million in 2009-2010. This reduction of $1.3 million in the overall carrying costs is the result of continuing low interest rates. Interest rates were expected to return to more normal levels in 2009-2010, however, due to the slow economic recovery, rates remained low. Carrying charges benefited directly from these unusually low rates with interest expense for the year totalling only $0.38 million compared to $1.8 million in the previous year.

Storage costs this year have remained at the same level as the previous year at approximately $4.4 million. Low interest rates may not continue over the long term so we anticipate a gradual return to more normal levels as the economy continues to recover. As a result, future carrying charges are expected to increase even if other variables remain constant.

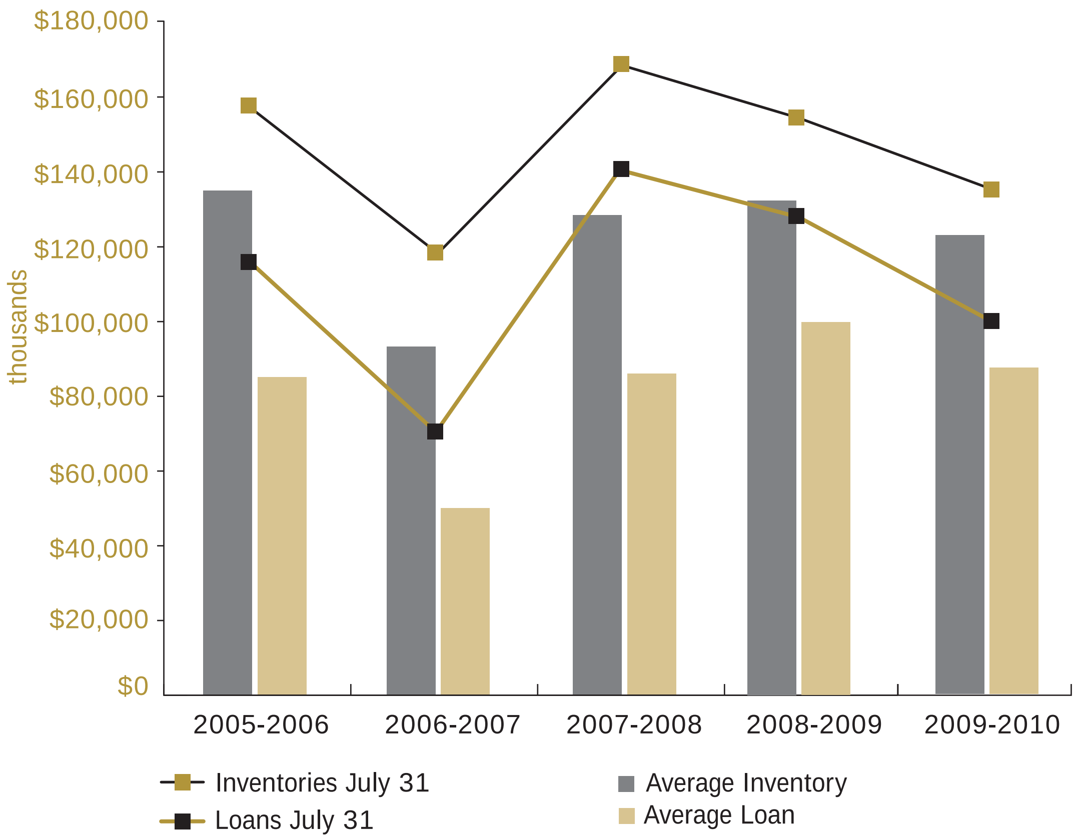
CARRYING CHARGES



Inventories and loans

Average inventory levels were 7.4% lower in the 2009-2010 dairy year compared to the previous year which resulted in a slight decrease in our average loan requirements. In spite of this decrease, the CDC requested and obtained through its Corporate Plan, the approval from the Minister of Finance to maintain the current loan limit of $175 million in order to respond to unforeseen circumstances brought on by changing market conditions.

INVENTORIES AND LOANS



Risk management

All business enterprises are subject to risks in their ongoing operations. The CDC has identified the major risk factors and has established policies and procedures to manage these risks.

The Commission has prepared a Corporate Risk Profile which is reviewed and updated at least once per year (latest review was January 2010) by CDC management. It outlines the risks identified by managers and directors as posing a threat to the core mandate of the CDC and/or to the achievement of its goals. The Profile defines each risk, describes the existing measures for managing the risk, as well as incremental risk management strategies and identifies the group responsible for implementing these strategies. The Profile is taken into consideration when doing the environmental analysis during the Commission's annual strategic planning session.

Credit risk is the exposure to financial loss due to a customer failing to meet his financial obligations to the CDC. The CDC manages this risk by selling product on a "payment first" basis, securing bank guarantees and obtaining letters of credit. Other strategies include carrying out business only with credit worthy customers.

Foreign currency risk is the potential for financial loss due to unfavourable changes in foreign currency exchange rates. The CDC has a policy of zero tolerance for foreign currency risk and therefore uses derivatives to hedge its sales and purchases in foreign currencies. No derivatives are entered into for speculative reasons and the CDC only deals with Canadian chartered banks in this regard.

Market risk is the most difficult to manage due to its unpredictability. The operations of the CDC are affected by many external factors such as world market conditions, developments in the World Trade Organization negotiations on agriculture, domestic market trends and fluctuations of supply and demand. The CDC addresses these risks by instituting sound management practices, hiring and maintaining competent staff and staying abreast of any market or political development that may affect its operations. Because the CDC deals with supply managed products such as SMP and butter, the export activity is a relatively small percentage of its overall revenues. Nonetheless, the CDC manages the volatility of world markets by strategically selling its products to reliable exporters who seek value-added products.

Administrative expenses

Funding of the Canadian Dairy Commission's administrative expenses is shared among the federal government, dairy producers, CDC's commercial operations, and the market place.

Administrative expenses for the year totalled $7.8 million. Salaries and employee benefit plans of $5.5 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

Future accounting changes

In December 2009, the Public Sector Accounting Board released an amendment to the "Introduction to Public Sector Accounting Standards" which clarified the source of generally accepted accounting principles for government organizations like the CDC. A position paper prepared by the CDC concluded that the CDC falls within the "Other Government Organizations" category which is normally directed to the Public Sector Accounting handbook but is allowed to adopt International Financial Reporting Standards (IFRS) when it is determined to be the most appropriate basis of accounting. After conducting an in-depth review of the CDC's various activities and financial statement user needs, management concluded that IFRS is the most appropriate basis of accounting for the organization. The CDC Board therefore decided to adopt IFRS as its primary basis of accounting beginning August 1, 2011, including comparative figures for the prior year.

To meet the IFRS transitional requirements, the CDC created an IFRS Working Group which is supported by external advisors to review, recommend and implement the changes required to ensure compliance with IFRS by our deadline of July 31, 2012. The working group reports to the Internal Audit /Program Evaluation Advisory Committee and also provides regular updates to the CDC Audit Committee.

The CDC's IFRS transition plan consists of three phases: the diagnostic phase, the design and development phase, and the implementation phase. In January 2009, the diagnostic was completed and identified key financial reporting areas to be potentially impacted by IFRS. The CDC is in the process of completing the design and development phase of the project which includes a detailed assessment outlining the potential impact of the transition to IFRS on accounting policies, financial reporting, business processes and information. The implementation phase will commence in the fall of 2010 with the goal of implementing the changes needed by the end of March 2011.

Management continues to evaluate the impact of transitioning to IFRS. Based on its review to date, it is not expected that the required changes will have a significant impact on CDC's financial results. Management recognizes that additional financial statement disclosure will be required under IFRS. No significant changes to information technology and data systems have been identified to date as a result of the IFRS conversion.

The International Accounting Standards Board has several projects underway, some of which may affect IFRS standards relative to the CDC. Management will continue to monitor all proposed and continuing projects, giving consideration to any changes expected to impact the CDC.

Challenges for the future

As in the past, the main factor that could affect the financial results of the Canadian Dairy Commission for the coming years is the fluctuations in world prices for dairy products. This directly affects its revenue from skim milk powder export sales and indirectly affects revenues from the sale of surplus skim milk powder in the animal feed market.

Due to a slight increase in purchases of surplus skim milk powder in the 2009-2010, inventories that had built up in prior years decreased less than expected. The CDC will continue to take measures to reduce these inventories by maintaining a high level of sales to animal feed manufacturers. However, in order to reduce the purchase of surplus skim milk powder the CDC has been working with the industry to create new domestic markets for skim milk solids. In 2009-2010, class 4(m) was expanded to make milk protein concentrate (MPC) eligible when used in cheese, nutraceuticals and pet food. If successful, this initiative has the potential to grow the use of skim milk solids in MPC thereby reducing the amount of surplus skim milk powder purchased by the CDC. This will take some time because the industry has limited capacity to manufacture MPC. The CDC will continue to work with the Market Committee (a sub-committee of the CMSMC) to analyze options for new markets for skim milk solids.

In the next three to five years, the Canadian dairy industry could be affected by the outcome of the WTO and Comprehensive Economic and Trade Agreement (CETA) negotiations on agriculture. Because the CDC's activities are so closely linked to this industry, some impacts could be expected on the Commission. However, the exact nature and magnitude of these impacts are unknown at this time. WTO negotiations have made little progress in the last year and an agreement is not expected to be concluded in the next year.

MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

The financial statements of the Canadian Dairy Commission and all information in this Annual Report are the responsibility of management. Those statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgments where appropriate. Financial information presented elsewhere in the Annual Report is consistent with the statements provided.

In discharging its responsibility for financial reporting, management maintains and relies on financial and management control systems and practices designed to provide reasonable assurance that transactions are authorized, assets are safeguarded, and proper records are maintained. These controls and practices ensure the orderly conduct of business, the accuracy of accounting records, the timely preparation of reliable financial information and the adherence to Commission policies and statutory requirements. This process includes the communication and ongoing practice of the Commission's Code of Ethics and Professional Conduct.

The Audit Committee of the Canadian Dairy Commission, made up of the Commissioners, oversees management's responsibilities for maintaining adequate control systems and the quality of financial reporting. The Commission's internal and external auditors have free access to the Audit Committee to discuss the results of their work and to express their concerns and opinions.

The transactions and financial statements of the Commission have been audited by the Auditor General of Canada, the independent auditor for the Government of Canada.

John Core, CEO

Gaëtan Paquette, Senior Director,
Finance and Operations

Ottawa, Canada
September 10, 2010

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Agriculture and Agri-Food

I have audited the balance sheet of the Canadian Dairy Commission as at July 31, 2010, and the statements of operations and comprehensive income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at July 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Commission that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canadian Dairy Commission Act* and regulations and the by-laws of the Commission.

Dale Shier, CA
Principal
for the Auditor General of Canada

Ottawa, Canada
September 10, 2010

BALANCE SHEET

July 31

(in thousands)

	2010	2009
Assets		
Current		
Cash	$ 182	$ 490
Accounts receivable		
Due from provincial milk boards and agencies (pooling)	37,330	28,053
Trade	1,148	969
Derivative asset - foreign exchange contracts	1	53
Inventories (Note 4)	135,228	154,621
	$173,889	$184,186
Liabilities		
Current		
Bank indebtedness (Note 5)	$ 2,314	$ 825
Accounts payable and accrued liabilities		
Due to provincial milk boards and agencies (pooling)	33,684	24,325
Trade	17,276	15,092
Provision for operational surplus payable to provincial milk boards and agencies	4,385	–
Other liabilities	1,209	895
Derivative liability - foreign exchange contracts	4	183
Loans from the Government of Canada (Note 6)	98,927	129,488
	157,799	170,808
Long-term		
Severance benefits (Note 12)	1,175	1,196
Equity (Note 7)		
Retained earnings	14,915	12,182
	$173,889	$184,186

Commitments (Note 14)

The accompanying notes and Detailed Schedule of Operations are an integral part of these financial statements.

Approved:

Chief Executive Officer

Chairman

Senior Director, Finance and Operations

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

for the year ended July 31
(in thousands)

	2010	2009
Sales	$264,776	$231,897
Cost of sales	(252,700)	(232,415)
Total margin (loss) on sales	12,076	(518)
Operating and administrative expenses	(16,285)	(19,501)
Pooling contributions withheld to fund operating and administrative expenses (Note 10)	7,508	7,630
Funding of administrative expenses by the Government of Canada (Note 11)	3,819	4,270
Results after Pooling contributions and Government funding	7,118	(8,119)
(Provision for operational surplus to) recovery of operational deficit from provincial milk boards and agencies	(4,385)	9,689
Results of operations and comprehensive income	$ 2,733	$ 1,570

The accompanying notes and Detailed Schedule of Operations are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

for the year ended July 31
(in thousands)

	2010	2009
Retained earnings at beginning of year	$ 12,182	$ 10,612
Results of operations and comprehensive income	2,733	1,570
Retained earnings at end of year	$ 14,915	$ 12,182

The accompanying notes and Detailed Schedule of Operations are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

for the year ended July 31
(in thousands)

	2010	2009
Cash flows from operating activities		
Cash receipts from customers	$264,599	$232,013
Cash paid to suppliers and others	(246,703)	(238,758)
Cash receipts from provincial milk boards and agencies (pooling)	207,792	165,924
Cash paid to provincial milk boards and agencies (pooling)	(200,202)	(158,023)
Cash received from provincial milk boards and agencies (operational deficit)	-	8,971
Cash receipts from the Government of Canada	3,819	4,270
Interest paid on loans	(541)	(2,537)
Cash flows from operating activities	28,764	11,860
Cash flows from financing activities		
New loans from the Government of Canada	140,805	188,575
Loan repayments to the Government of Canada	(171,366)	(175,403)
Cash flows (used in) from financing activities	(30,561)	13,172
Net (decrease) increase in cash	(1,797)	25,032
Net bank indebtedness at beginning of year	(335)	(25,367)
Net bank indebtedness at end of year	$ (2,132)	$ (335)
Components:		
Cash	$ 182	$ 490
Bank indebtedness	(2,314)	(825)
	$ (2,132)	$ (335)

The accompanying notes and Detailed Schedule of Operations are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

July 31, 2010

1. The Canadian Dairy Commission

The Canadian Dairy Commission (the "Commission") is an agent Crown corporation named in Part I, Schedule III and Schedule IV to the *Financial Administration Act* and is not subject to the provisions of the *Income Tax Act*. The objects of the Commission, as established by the *Canadian Dairy Commission Act*, are "to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality". The Commission operates on a dairy year basis which starts August 1 and ends July 31.

The Commission, in co-operation with the Canadian Milk Supply Management Committee (CMSMC), which it chairs, undertakes the management and administration of operations funded by producers. The Commission purchases all butter and skim milk powder tendered to it at either the Canadian support price or at prices established by the Commission, depending on the intended resale markets, except for a portion of butter imported by the Commission at international market price for domestic consumption in accordance with Canada's commitments to the World Trade Organization (WTO). While a major portion of the butter purchased by the Commission is later resold in the domestic market, most of the skim milk powder is in excess of manufacturers' requirements and is sold domestically in certain marginal markets or exported. The Commission exports surpluses, within Canada's permitted subsidized export limits, in the form of whole milk products, skim milk powder and butter on international markets.

The Commission administers, on behalf of the industry, a pricing and pooling of market returns system which provides milk components to further processors and exporters through processors at competitive prices. This system is administered by the Commission in accordance with the "Comprehensive Agreement on Pooling of Milk Revenues" to allow dairy producers to share revenues nationally as well as the "Western Milk Pooling Agreement" and the "Agreement on the Eastern Canadian Milk Pooling", formerly the "Agreement on All Milk Pooling", to allow dairy producers to share revenues regionally. The ten provincial milk boards and agencies represent the country's dairy producers and they provide the Commission with all the relevant data and funding for its administration of the pooling system.

2. Adoption of revised accounting standard

Effective August 1, 2009, the Commission adopted the revised section 3862 - *Financial Instruments – Disclosures* issued by the Canadian Institute of Chartered Accountants (CICA) in June 2009. These amendments enhance disclosure about fair value measurements of financial instruments and liquidity risk. The standard now requires the use of a three-level hierarchy for financial instruments measured at fair value, based on the significance of inputs used to measure the fair values. No comparative information is required in the first fiscal year of application under the transitional provisions of the standard.

These new standards have resulted in increased disclosure in the financial statements (see Note 13), but had no impact on the financial results of the Commission for the current year.

3. Significant accounting policies

Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The significant accounting policies followed in the preparation of these financial statements are summarized below.

Inventories

Inventories are recorded at the lower of cost, which is purchase cost, or estimated net realizable value. Cost is determined on a first-in, first-out basis except for Plan B inventories where cost is determined based on specific identification. Write-downs to net realizable value are reversed when there is a subsequent increase in the value of inventories, up to a maximum of the purchase cost. The reversal is recognized as a reduction to cost of sales and an increase to the net value of inventory.

Inventories exclude storage charges, which are expensed when incurred.

Revenues

Revenues from sales of product are recognized upon shipment.

Cost of sales

Goods purchased by the Commission under the Domestic Seasonality Programs, for export sales or for the animal feed market are purchased at prices established by the Commission. These costs are charged to cost of sales when the goods are shipped to customers.

Pooling of market returns activities

Contributions from and equalization payments to provincial milk boards and agencies represent a redistribution of milk revenues among provinces, which are recorded based on milk production and milk utilization reported by the provincial milk boards and agencies. A fixed portion, representing the milk boards' and agencies' share of the Commission's budgeted administrative expenses and the estimated carrying charges for normal levels of butter stocks, is withheld from the redistributions to fund these operating expenses, as well as surplus butter carrying charges and any recoverable committee expenses that may be incurred during the year (see Note 10). The fixed amount is agreed upon annually by the CMSMC.

Provision for operational surplus to/recovery of operational deficit from provincial milk boards and agencies

Operational surplus resulting from pooling and operating activities is expensed and set up as a liability in the year that the surplus is earned. Recovery of operational losses is recognized as revenue upon approval by the CMSMC

Foreign currency translation

All foreign currency transactions are translated into Canadian dollars at the exchange rate in effect on the transaction date.

Trade accounts receivable and payable in foreign currencies are adjusted to reflect the exchange rate in effect at the balance sheet date. Any corresponding gains or losses are recognized in operating expenses.

Most sales and purchases in foreign currencies have corresponding foreign exchange forward contracts (see "Derivative financial instruments" below and Note 13 - Financial Instruments – *Currency risk*).

Financial instruments

Financial assets and financial liabilities, with the exception of Loans from the

Government of Canada, a related party financial liability (see Note 15), are initially recognized at fair value. Their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Commission's designation of such instruments.

Classifications

Cash	Held for trading
Accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Loans from the Government of Canada	Other liabilities

Held for trading

Held for trading financial assets are measured at fair value at the balance sheet date with changes in fair value recorded in results of operations and comprehensive income.

Loans and receivables

Loans and receivables are recorded at amortized cost using the effective interest method.

Other liabilities

Other liabilities are recorded at amortized cost using the effective interest method and include all financial liabilities, other than derivative instruments.

Transaction costs

All transaction costs in respect of financial assets and financial liabilities classified as other than held for trading are capitalized in the period in which they are incurred. Transaction costs in respect of financial assets and financial liabilities classified as held for trading are expensed in the period in which they are incurred.

Derivative financial instruments

The Commission uses derivative financial instruments such as forward contracts to counter the adverse movements in foreign exchange related to purchases and sales denominated in foreign currencies, including anticipated transactions, as well as to manage its cash balances and requirements.

The Commission's policy is not to utilize freestanding derivative financial instruments for trading or speculative purposes.

The Commission does not designate its foreign exchange forward contracts as hedges of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, *Hedges*, and accordingly does not apply hedge accounting. As a result, foreign exchange forward contracts are recorded on the balance sheet at fair value as an asset when the contracts are in a gain position and as a liability when the contracts are in a loss position. Changes in fair value of these contracts are recognized as gains or losses within operating expenses.

Employee future benefits

Pension benefits

All eligible employees participate in the Public Service Pension Plan (the "Plan") administered by the Government of Canada. Although the Plan is a defined benefit plan, it meets the definition of a multi-employer plan, which is accounted for as a defined contribution plan, as sufficient information is not available to account for it as a defined benefit plan. The Commission's contributions reflect the full cost as employer. This amount is currently based on a multiple of an employee's required contributions and may change over time depending on the experience of the Plan. The Commission's contributions are expensed during the year in which the services are rendered and represent the total pension obligation of the Commission. The Commission is not required under present legislation to make contributions with respect to actuarial deficiencies of the Plan.

Severance benefits

Eligible employees are entitled to severance benefits as provided for under labour contracts and conditions of employment. The cost of these benefits is accrued as employees render the services necessary to earn them. The obligation relating to the benefits is calculated using the actuarially determined Government-wide severance pay liability ratio for public service employees applied to the Commission's gross salaries.

Other future benefit plans

The Commission has no liability for any other future benefits provided to employees after employment or on retirement.

Scholarship program

Scholarship program monies are expensed in the year in which educational institutions meet specified eligibility criteria and the agreements are approved.

Measurement uncertainty

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Valuation of inventories, pension and severance benefits, and derivatives are the most significant items where estimates are used. Actual amounts could differ significantly from the current estimates. These estimates are reviewed annually and as adjustments become necessary, they are recognized in the financial statements in the period in which they become known.

Future accounting standards

In December 2009, the Public Sector Accounting Board ("PSAB") issued an amendment to the Introduction to Public Sector Accounting Standards of the PSA Handbook. This amendment eliminated the Government Business Type Organization ("GBTO") classification and entities currently classified as a GBTO were required to re-assess their classification.

Following the amendment, the Commission determined that their applicable entity classification is that of an Other Government Organization ("OGO"). OGOs are required to adopt either the PSA Handbook or International Financial Reporting Standards (IFRS), whichever is determined to be the most appropriate basis of accounting on the financial statements' users needs and objectives. Based on the needs and objectives of their financial statement users, the Commission will adopt IFRS as their future basis of accounting commencing August 2011.

The Commission is in the process of completing an in-depth analysis on each of the relevant standards which could have an impact on their accounting policies, and hence financial statements, upon transition to IFRS. Based on the review to date, it is not expected that the required changes will have a significant impact on the Commission's financial results.

4. Inventories

	2010	2009
	(in thousands)	
Butter	$ 99,135	$ 108,337
Skim milk powder	36,952	49,576
	136,087	157,913
Less: allowance for inventory write-down	(859)	(3,292)
Total net realizable value	$ 135,228	$ 154,621

The Commission's inventory includes 10,905 tonnes of Plan B butter and 1,635 tonnes of Plan B skim milk powder (2009 — 11,818 tonnes and 1,260 tonnes) with a total cost of $77.45 million and $10.10 million respectively (2009 — $84.32 million and $7.78 million) that must be repurchased by the manufacturers from the Commission within the course of the next dairy year at the then prevailing support prices. While manufacturers are contractually obliged to repurchase their product, the Commission is under no obligation to sell back the product. However, the Commission has customarily always honoured repurchase requests.

The balance of the inventory is comprised of 4,261 tonnes of butter and 23,179 tonnes of skim milk powder (2009 — 3,870 tonnes and 33,354 tonnes) with a total cost of $21.68 million and $26.85 million respectively (2009 — $24.02 million and $41.80 million).

The Commission recorded a charge to cost of sales on the statement of operations and comprehensive income of $0.63 million in the current year (2009 - $3.29 million) to recognize an inventory write-down to net realizable value (NRV) primarily as a result of declining prices in the export market for skim milk powder.

A portion of the inventory for which a $3.29 million write-down was recorded as at July 31, 2009 remains on hand as at July 31, 2010. As a result of an increase in prices in the animal feed market for skim milk powder, $0.09 million of the prior year write-down was reversed in the current year. This reversal was recognized as a reduction to cost of sales on the statement of operations and comprehensive income as well as an increase to the net value of inventory on the balance sheet.

5. Bank indebtedness

To provide bridge financing and ensure the efficient operation of the pricing and pooling of market returns system, the Commission established a line of credit with a member of the Canadian Payments Association. The Commission has been granted the authority to establish this line of credit by the Minister of Finance up to a maximum of $50 million. During the dairy year, the Commission's line of credit limit remained at $5 million.

The bank indebtedness incurred under the Commission's line of credit is due on demand and bears interest at prime, which varied during the year from 2.25% to 2.75% per annum (2009 — 2.25% to 4.75%).

6. Loans from the Government of Canada (Consolidated Revenue Fund)

Loans from the Government of Canada's Consolidated Revenue Fund, to a maximum of $175 million (2009 — $150 million), are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest are repaid regularly during the year when funds are available.

Interest on the loans, which is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent, varied from 0.30% to 1.42% (2009 — 0.32% to 3.46%) during the year and totaled $0.38 million (2009 — $1.79 million).

7. Equity

The Commission indirectly collects amounts from consumers through a charge included in the retail sale price of butter. This charge is used to fund the carrying costs associated with the normal levels of butter inventory. This amount is included in contributions withheld to fund operating expenses presented in the statement of operations and comprehensive income. Retained earnings at the end of the year is made up of net accumulated surpluses of this funding and net accumulated surplus amounts relating to commercial sales and not directly payable to provincial milk boards and agencies.

There have been no transactions during the year ended July 31, 2010 resulting in other comprehensive income or losses and the Commission had no opening or closing balances for accumulated other comprehensive income or losses.

8. Capital disclosures

The Commission's capital consists of its loans from the Government of Canada (see Note 6) and retained earnings. As at July 31, 2010 these accounts totaled $98.93 million (2009 — $129.49 million) and $14.92 million (2009 — $12.18 million) respectively. The Commission is not subject to any externally imposed capital requirements.

The Commission's primary objective in managing capital is to ensure that it has sufficient liquidity in order to settle its financial obligations as they become due and to fund programs for the benefit of the dairy industry. The Commission administers its capital management approach on an ongoing basis as the amounts fluctuate during the course of the year. The Commission does not utilize any quantitative measures to monitor its capital. There were no changes in the Commission's approach to capital management or the definition thereof as compared to the previous year.

9. Foreign exchange gains and losses

Export sales include $0.01 million representing net losses (2009 — net losses of $0.54 million) arising from currency translation relating to transactions incurred in foreign currencies.

Domestic cost of sales include $0.24 million representing net losses (2009 – net losses of $0.08 million) arising from currency translation relating to import purchase transactions incurred in foreign currencies.

10. Pooling of market returns activities

During the year contributions from and equalization payments to provincial milk boards and agencies were as follows:

	2010	2009
	(in thousands)	
Contributions from provincial boards and agencies	$217,069	$164,211
Equalization payments to provincial boards and agencies	209,561	156,581
Contributions withheld to fund operating expenses	$7,508	$7,630

Contributions withheld were for budgeted administrative expenses, carrying charges for butter and reimbursement of committee meeting expenses.

11. Costs funded by the Government of Canada

Funding of the Commission's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. During the year, the Government of Canada funded $3.82 million (2009 — $4.27 million) of the Commission's administrative expenses of $7.80 million (2009 — $8.31 million).

12. Employee future benefits

Pension plan

The Commission and all eligible employees contribute to the Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. Operating expenses include the Commission's contributions to the Public Service Pension Plan during the year totaling $0.55 million (2009 - $0.58 million), which corresponds to about 1.93 times (2009 – 1.96 times) the employees' contributions to the Plan.

Severance benefits

The Commission provides severance benefits to its employees based on years of service and final salary. This benefit plan is not pre-funded and thus has no assets, resulting in a plan deficit equal to the accrued benefit obligation. Benefits will be paid from future appropriations and other sources of revenue. Information about this benefit plan, measured as at the balance sheet date, is as follows:

	2010	2009
	(in thousands)	
Accrued benefit obligation, beginning of year	$1,217	$ 819
Cost for the year	98	398
Benefits paid during the year	21	–
Accrued benefit obligation, end of year	$ 1,294	$ 1,217

Of the total year end obligation, $0.12 million (2009 - $0.02 million) is estimated by the Commission to be payable within the next year and is included in other liabilities, under current liabilities, on the balance sheet.

13. Financial instruments

In the course of carrying out its ongoing operations, the Commission faces risks to its financial assets and financial liabilities. The Commission's exposure to risk from its use of financial instruments is presented below along with the Commission's objectives, policies and processes for managing risk.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Commission's income or the value of its holding of financial instruments.

Currency risk

The Commission operates internationally, exposing itself to market risks from changes in foreign exchange rates. The Commission partially manages these exposures by contracting primarily in U.S. dollars or Canadian dollars. The Commission's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The Commission periodically enters into foreign exchange forward contracts to manage exposure to exchange rate fluctuations between Canadian and U.S. dollars.

At the end of the year, the notional value of the Commission's outstanding forward exchange contracts totaled $1.40 million Canadian equivalent (2009 — $2.72 million Canadian equivalent). These contracts will mature over the period ending October 2010. The maturity dates of the forward exchange contracts correspond to the estimated dates when the Commission expects to receive the foreign currency proceeds arising from export sales contracts or when payment for purchases in foreign currencies are due.

The fair value of the Commission's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the balance sheet date. The Commission's foreign exchange forward contracts as at July 31, 2010 are as follows:

(in thousands)

Currency sold	Currency purchased	In USD	In CAD
U.S. dollars	Canadian dollars	$1,002	$1,030
Canadian dollars	U.S. dollars	$361	$371

As at July 31, 2010, the Commission's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

(in thousands)

In CAD	2010	2009
Accounts receivable (trade)	$957	$797
Accounts payable (trade)	(357)	(434)
Net derivative liability	(3)	(130)
Net exposure	$597	$233

Based on the net exposure as at July 31, 2010, and assuming that all other variables remained constant, had the Canadian dollar appreciated 10% against the US dollar, net income for the year ended July 31, 2010 would have increased by $3,197 (2009 – decreased by $110,327). Conversely, a 10% weakening in the Canadian dollar against the US dollar would have had the equal but opposite effect for the same period.

Interest rate risk

Interest rate risk is the risk that a financial asset containing a fixed interest rate component decreases in value with a rise in interest rates or that a financial liability with a floating interest rate component results in increased cash outflow requirements as a result of an increase in interest rates. Other than the line of credit, for which interest expense varies as a function of prime, and loans from the Government of Canada, which vary as a function of the yield on comparable Treasury bills, the Commission does not have any other such financial assets or liabilities exposed to this risk. The Commission's exposure to interest rate risk is not significant given its low interest bearing loans.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or currency risk. The Commission is not exposed to this type of risk.

Liquidity risk

Liquidity risk is the risk that the Commission will not be able to meet its financial obligations as they fall due. At year-end, virtually all of the Commission's assets and liabilities were current and the Commission had a current ratio equal to 1.10 (2009 – 1.08). In managing liquidity risk, the Commission has access to additional borrowings for commercial operations from the Government of Canada in the amount of $76.07 million as of July 31, 2010 (2009 — $20.51 million) as well as $2.69 million (2009 — $4.18 million) on its line of credit for the pooling of market return activities.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the Commission. Maximum credit exposure is the carrying amount of the pooling and trade accounts receivable balances, net of any allowance for losses. The Commission manages this risk using several strategies which include selling product on a "payment first" basis, securing of bank guarantees and obtaining letters of credit. As of both July 31, 2010 and 2009, the Commission did not have an allowance for doubtful accounts and all accounts receivable are current.

The Commission is exposed to credit risk when entering into foreign exchange contracts wherein the counterparty fails to perform an obligation as agreed upon causing a financial loss. Maximum credit exposure is the carrying amount of the derivative asset. The Commission manages this exposure to credit risk by entering into foreign exchange contracts only with major Canadian financial institutions. To date, no such counterparty has failed to meet its financial obligation to the Commission.

Fair values

The carrying value of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities approximates their fair values due to the immediate or short-term maturity of these financial instruments. As of the balance sheet date, no amounts representing changes in fair value of these financial instruments have been recorded in the statement of operations and comprehensive income.

Fair value hierarchy

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy, which for the Commission is only relevant in the context of derivative financial instruments, has the following levels:

Level 1 — valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 — valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 — valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value measurement of the Commission's derivative financial instruments is classified as level 2 in the fair value hierarchy. Changes in valuation methods may result in transfers into or out of levels 1, 2, and 3. In 2010, there were no transfers between levels.

14. Commitments

Purchase commitments

As at July 31, 2010, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $0.42 million (2009 — $1.65 million) and are due to be fulfilled by September 2010.

Long-term lease

The Commission is committed under a long-term lease with Agriculture and Agri-Food Canada (AAFC) for office accommodation ending in 2012. The lease contains escalation clauses regarding maintenance costs and taxes. AAFC has notified the Commission that it intends to renew this lease for another period of 5 years with rates possibly revised in order to reflect the rental market value pursuant to Treasury Board's Policy on Real Property.

The remaining minimum lease payments totaled $0.52 million at year-end. For 2012 the rent is for 8 months, as the lease term ends March 31.

The minimum lease payments for the next two years are as follows:

2011	$0.31 million
2012	$0.21 million

Canadian Quality Milk funding

The Commission has agreed to partially fund the Canadian Quality Milk Program, a program designed to help producers prevent, monitor and reduce food safety risks on their farms. The agreement to provide this funding, which commenced August 1, 2007, was extended in the prior year to July 31, 2012. Under the terms of the agreement the Commission will contribute up to $300 per eligible farm, which translates into a maximum of $4.21 million over the life of the agreement. A total of $0.33 million (2009 — $0.17 million) has been contributed during the current dairy year.

Matching Investment Fund

The Commission administers the Matching Investment Fund which provides non-repayable contributions to Canadian registered companies or Food Technology Centres for product development, on a matching investment basis. The Commission has committed up to $2 million per year over a three year period commencing August 1, 2009 and ending July 31, 2012. A total of $0.34 million has been contributed during the current dairy year.

Promotional funding

The Commission has committed to contribute a maximum of $1.71 million for fluid milk promotion activities conditional to participating provinces providing equal funding. The Commission allocates funds to participating provinces on a pro-rata basis using their respective fluid milk sales of the previous dairy year. A total of $0.88 million has been contributed during the current dairy year. The agreement to provide this funding, which commenced August 1, 2009, was extended in the current year to October 31, 2010. For 2011, the Commission expects to contribute up to $0.60 million of the remaining $0.83 million funding available for fluid milk promotion activities.

Dairy Cluster Research Project funding

The Commission has agreed to contribute $1.5 million during the period of January 1, 2010 to March 31, 2013 towards the Dairy Farmers of Canada $11.8 million project approved under the Agriculture and Agri-Food Canada, Growing Canadian Agri-Innovations Program, Canadian Agri-Science Cluster Initiative. The purpose of this initiative is to enable key industry-led agricultural organizations to mobilize a critical mass of scientific and technical resources to support innovation strategies for enhanced profitability and competitiveness of their sector. A total of $0.5 million has been contributed during the current dairy year.

Iodine Study Project funding

The Commission has agreed to contribute a maximum of $0.34 million to the Dairy Farmers of Canada towards conducting an analysis for determining the level of iodine in bulk tank milk of individual dairy farms over a period of three years from August 1, 2010 to July 31, 2013. This funding represents one third of the approximate total project cost of $1.0 million.

WTO Import Butter Tariff Rate Quotas

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product through butter manufacturers to the food sector. The 2011 TRQ for butter remains at 3,274 tonnes. World prices at the time of purchase will determine the total financial commitment. For 2010 the total costs to purchase imported butter under the WTO requirements was $10.20 million (2009 — $10.98 million).

15. Related party transactions

The Commission is related in terms of common ownership to all Government of Canada-created departments, agencies and Crown corporations. The Commission enters into transactions with these entities in the normal course of business and at normal trade terms. These transactions such as Employee Benefit Plans, accommodations and professional services, but excluding loans from the government, are recorded at their exchange amounts and totaled $1.62 million during the year (2009 — $1.65 million).

Loans from the Government of Canada at terms available to Crown corporations (see Note 6), which are recorded at carrying value, represent the Commission's largest related party transaction.

16. Financial statement presentation

Certain comparative amounts have been reclassified to conform with the presentation adopted in the current year.

DETAILED SCHEDULE OF OPERATIONS

for the year ended July 31
(in thousands)

	2010	2009
Sales and cost of sales		
Domestic sales	$ 241,042	$ 209,234
Cost of sales (Note 9)	227,535	209,687
Margin (loss) on domestic sales	13,507	(453)
Export sales (Note 9)	23,734	22,663
Cost of sales	25,165	22,728
Loss on export sales	(1,431)	(65)
Total margin (loss) on sales	$ 12,076	$ (518)
Operating expenses and other charges		
Storage costs	$ 4,381	$ 4,383
Projects and promotional activities	2,131	3,230
Interest expense (operations)	379	1,790
Cost of production studies	817	892
Other carrying charges	718	632
Domestic dairy product assistance	351	312
Unrealized (gains) losses on derivatives - foreign exchange contracts	(127)	149
Donation	105	75
Interest expense and bank charges (pooling)	26	24
Other recoveries	(300)	(300)
Total operating expenses and other charges	$ 8,481	$ 11,187
Administrative expenses		
Salaries and employee benefits	$ 5,493	$ 5,610
Other expenses	2,458	2,804
Recovered audit services	(147)	(100)
Total administrative expenses	$ 7,804	$ 8,314
Total operating and administrative expenses	$ 16,285	$ 19,501

APPENDICES

Rachelle Richard, Financial Services Officer

APPENDIX 1

HARMONIZED MILK CLASSIFICATION SYSTEM

Class	Products
1(a)	Milk and milk beverages, partly skimmed or skimmed, whether or not treated for lactose intolerance, whether flavoured or not, with or without vitamins or minerals added, for retail and food service (egg nog, cordials, cultured milk, concentrated milk to be reconstituted as fluid milk)
1(b)	All types of cream with a butterfat content not less than 5% for retail and food service
1(b)ii	Fresh cream with a butterfat content of 32% and higher used to make fresh baked goods which are not eligible for a Class 5 permit. Any utilization of this class would require a Class 1(b)ii permit.
1(c)	New 1(a) and 1(b) fluid products for retail and food service as approved by the provincial authorities during an introductory period.
1(d)	1(a) and 1(b) fluid products marketed outside the ten signatory provinces but within Canadian boundaries (e.g. Yukon, NWT, Nunavut and cruise ships).
2	All types of ice cream, ice cream mix, yogurt, kefir, whether frozen or not, all types of sour cream, all types of milk shake mixes[1] , other frozen dairy products and the following products: fudge, puddings, soup mixes, caffeinate and Indian sweets
3(a)	All cheeses other than those identified in class 3(b), all types of cheese curds other than stirred
3(b)	All types of cheddar cheese, stirred curd, cream cheese, creamy cheese bases (cheese mixes), cheddar and cheddar-type cheeses sold fresh (see definition)[2]

[1] Milk shakes for retail sales are currently classified as a Class 1 product in the WMP and classified as Class 2 in the P5.

[2] Definition of cheddar-type cheese: a cheese of descriptive nomenclature will be recognized as a cheddar-type cheese for the purposes of classification if it is a firm or semi-soft, unripened, unwashed curd cheese, with a minimum milk fat content of 25% and a maximum moisture content of 45%.

Class	Products
4(a)	All types of butter and butteroil, all types of powder, concentrated milk as an ingredient in the food industry[3], all other products not elsewhere stated
4(a)1[4]	Milk components for the manufacture of rennet casein (dry or curd), milk protein concentrate (dry or liquid) or skim milk (dry or liquid) to be used in the manufacture of non-standardized final products in the processed cheese category.
4(b)	Concentrated milk for retail sale whether sweetened or not
4(c)	New industrial products as approved by provincial authorities for an introductory period
4(d)	Inventories and losses[5]
4(m)	Milk components for marginal markets as established from time to time by the CMSMC
5(a)*	Cheese used as ingredients for further processing for the domestic and export markets
5(b)*	All other dairy products used as ingredients for further processing for the domestic and export markets
5(c)*	Dairy products used as ingredients for the confectionery sector destined for domestic and export markets
5(d)	Planned exports and other exports approved by the CMSMC, the total of which shall not exceed Canada's WTO commitments

[3] In the Western Milk Pool, concentrated milk is used to make other dairy products. In the P5, such usage is classified on end-use.

[4] Pricing and Administration

i. Provincial boards or agencies will set the butterfat price for class 4(a)1 at the 4(a) price and will set the price for protein and other solids for class 4(a)1 at the price established by the CMSMC on a semi-annual basis (August 1st and February 1st)

ii. The CDC will receive the milk utilization declaration from the provincial boards and agencies on a monthly basis for pooling of revenue purposes. Provinces agree that the revenues from class 4(a)1 will be pooled at the P10 level.

iii. Audit of Class 4(a)1 will be performed by the usual organizations responsible for performing that task in the provinces. In the case of interprovincial movement of product, the CDC will coordinate the audit and supporting information with provincial auditors. The processor receiving the raw milk used to make rennet casein (dry or curd) or MPC under Class 4(a)1 will be responsible for providing documentation which supports the claim that the components were utilized in the manufacture of non-standardized final products in the processed cheese category. Participating provinces will undertake to implement the proper audit procedures to ensure compliance within this class.

iv. Class 4(a)1 will be renewed upon successful review and approval of the CMSMC by February 1, 2008.

[5] Losses: Explained losses (dumps, fluid returns, dead vats, etc.).

* Under class 5(a), (b) and (c) (Special Milk Class Permit Program), industrial milk is classified and made available for use in dairy products and products containing dairy ingredients at prices which vary according to end use. The volume of dairy components accessed under this class is monitored through permits issued by the Canadian Dairy Commission.

APPENDIX 2

GLOSSARY

Canadian Milk Supply Management Committee (CMSMC)
The CMSMC is the key national body for policy development and discussions respecting the sectors of dairy production and processing. It oversees the application of the National Milk Marketing Plan. The Canadian Dairy Commission (CDC) chairs and supports the CMSMC and its Secretariat, a technical committee which provides economic analysis and advice to the members of the CMSMC. The CMSMC has representation from producers and governments of all provinces. Representatives of national consumer, processor and producer organizations also participate as non-voting members. The CMSMC meets four times per year to review and consider the major economic and marketing factors affecting the dairy sector. It also reviews and monitors the CDC's marketing operations and promotional activities; the pooling systems established for market returns from certain milk sales; and provincial quota allocations and utilization. The CMSMC determines the national production target or Market Sharing Quota (MSQ).

Canadian Requirements
Total domestic consumer demand plus planned exports for all industrial milk processed into dairy products.

Dairy Producers
Dairy producers are farm owners and operators who keep a herd of cows and ship milk.

Dairy Year
The major elements of the supply management system for the Canadian dairy sector operate on a dairy rather than a calendar or fiscal year basis. Established to co-ordinate the natural patterns of milk production with market requirements, the dairy year goes from August 1 to July 31.

Domestic Requirements
Total domestic consumer demand for all industrial milk processed into dairy products.

Further Processors
Further processors use milk or other dairy products to manufacture other food products that are sold at the retail level.

Industrial Milk
Milk sold for processing into such dairy products as butter, cheese, ice cream or yogurt.

Market Sharing Quota (MSQ)
The MSQ is the national production target for industrial milk. This target is constantly monitored and adjusted when necessary to reflect changes in the domestic demand for industrial milk products, as measured in terms of butterfat, as well as changes in planned export activity. The CMSMC applies the terms of the National Milk Marketing Plan to establish the provincial shares of the MSQ. Each province allocates its share of the MSQ to its producers according to its own policies.

Milk Class
All milk in Canada is classified according to its use (for example, fluid, cheese, butter, etc.). The price paid to the producer for the milk depends on the class. This classification system is not related to milk quality.

National Milk Marketing Plan

The National Milk Marketing Plan is the federal/provincial agreement that provides the framework for the operation of the milk supply management system and is administered by the CMSMC. All Canadian provinces are signatories to the national Plan.

Processors

Processors are companies or co-operatives that buy raw milk and manufacture fluid milk and cream, or other dairy products.

Supply Management

Supply management is a system by which the production of milk is controlled by production quotas at the farm level. The size of the quota depends on the demand for milk and other dairy products.

Structural Surplus

Since milk production quotas are measured in terms of kg of butterfat, and because the demand in Canada is greater for butterfat than for the non fat portion of milk, there is a surplus of non fat milk components, mainly in the form of skim milk powder.

Support Prices

Support prices are the prices at which the CDC offers to purchase domestically produced butter and skim milk powder under its Domestic Seasonality Programs. Support prices act as reference prices in the wholesale dairy trade and indirectly affect the wholesale prices of all industrial dairy products. They are established at levels designed to generate a fair return for producers.