Canadian Dairy Commision | Commision canadienne du lait

Canadian Dairy Commission

Annual Report

10-11

Canada

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 From the Chairman

Mister Minister,

I am pleased to submit the Canadian Dairy Commission's Annual Report for the 2010-2011 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.

This year, the Commission Board received the 2011 Special Examination Report from the Office of the Auditor General (OAG). The OAG found no significant deficiencies in the Commission's systems and practices and noted good practices in a number of areas. It did, however, make certain recommendations which the CDC has already started to implement. The first was that the Canadian Dairy Commission identify and report on quantitative performance indicators that better demonstrate whether it is achieving its mandate. For the next dairy year (2011-2012), the CDC has grouped its objectives according to the two parts of its legislated mandate and tied them whenever possible to quantifiable measures. This will enable the Board to better monitor the performance of the corporation as it relates to its core mandate.

In its second recommendation, the OAG asked the CDC Board to periodically assess its skills and seek outside expertise to complement the skills of the Board members. Recognizing that some skills can be lacking in a three-member board, the CDC Board will periodically assess its skills and use outside expertise when deemed necessary for specific projects, as it did for the transition to International Financial Reporting Standards.

Finally, the OAG recommended that procedures be developed for Board members to declare and manage conflicts of interests and asked the CDC to consult with the Office of the Conflict of Interest and Ethics Commissioner. The CDC has taken steps to modify Board bylaws and to develop procedures to manage such conflicts. Furthermore, the Office of the Conflict of Interest and Ethics Commissioner indicated that a Commissioner who is also an active dairy producer is not in a conflict of interest situation as he is considered to belong to a broad class of persons as defined by the *Conflict of Interest Act*.

As we undertake a new year, I would like to take this opportunity to express my appreciation for the co-operation we receive from industry stakeholders, provincial governments, the Minister's Office and our colleagues at Agriculture and Agri-Food Canada and the other Agriculture and Agri-Food Portfolio organizations. We are also indebted to the CDC employees who run our operations with efficiency and fairness.

On behalf of the Board, I would like to thank you, Mr. Minister, for supporting the work of the CDC.

Randy Williamson

Message From the CEO

The Canadian Dairy Commission (CDC) is proud to partner in many ways with the Canadian dairy industry, an industry characterized by a spirit of collaboration, contributing $15 billion annually to Canada's economy.[1]

[1] Eco ressources consultants, 2011. Les retombées économiques de l'industrie laitière au Canada, Rapport final.

Overall, 2010-2011 has been another year of growth for the Canadian dairy industry with domestic demand for dairy products growing by 3%. Industrial milk quota was increased from 180.08 to 189.62 million kg of butterfat. However, production remained below quota in most provinces for most of the year. Private stocks of butter and cheese remain at relatively high levels but CDC stocks of butter are low. As a result of measures put in place by provincial milk marketing boards, production has been growing at a faster rate than demand since late spring 2011. This will allow supplies to meet demand in the fall 2011 and rebuild stocks during the winter 2012. As a precaution against butter shortages in the fall, the CDC decided to buy most of the mandatory imports of butter early in the fall.

World prices for skim milk powder were very volatile throughout the year. The CDC was able to take advantage of high price periods to export. Thanks to this strategy, 11,176 t of skim milk powder were exported in 2010-2011 compared to 8,700 t during the previous year. In the case of butter, world prices remained relatively high throughout the year. Besides 125 t exported in August 2010, Canada had no surplus to export in 2010-2011.

The removal of surplus milk solids non fat (SNF) from the Canadian market was very successful this year. Lower purchases coupled with sales similar to last year's allowed the CDC to reduce its class 4(m) inventories to approximately 10,000 t which was the target set for this type of inventory. Except for a few months in 2007, this is the lowest that these inventories have been since 2003, when a World Trade Organization ruling severely curtailed Canadian dairy exports, pushing inventories upwards.

Last November, the CDC announced an increase in support prices of skim milk powder and butter for February 1, 2011. The rise in the cost of producing milk in Canada warranted this modest increase of 1.5%.

The dairy industry continues to try to reduce market risks for producers. The Canadian Milk Supply Management Committee (CMSMC) therefore asked the CDC and Dairy Farmers of Canada (DFC) to undertake consultations with provincial producer organizations, provincial governments and processor representatives on the possibility of launching negotiations aimed at creating a national pool for all milk classes. The CDC and DFC presented the results of these consultations to the CMSMC in April 2011.

A mandate for a P10 Negotiating Committee was charted and endorsed by the CMSMC in July 2011.

As a result of favourable world prices for skim milk powder (SMP) and conservative purchasing practices, the CDC was able to generate a surplus of $24.6 million which will be refunded to producers through the provincial milk marketing boards and agencies. Furthermore, the CDC borrowed less money from the Government of Canada this year ($55.8 million) compared to the previous year ($98.9 million) because of relatively low butter and SMP inventories. Overall, retained earnings at year-end remained virtually unchanged from the previous year.

Dairy industry trends

Because of the supply management system, the environment in which the CDC operates is more stable than that of dairy industries in other countries or of some other agricultural industries in Canada. The support of the Canadian and provincial governments for this system bodes well for the stability of our environment and the industry generally enjoys a positive public image. The Canadian dairy industry is highly regulated and organized, and over the years, it has developed some excellent risk mitigation tools such as the pooling of markets and revenues and innovation incentives such as the Matching Investment Fund. It is also worth noting that most of the industry, from the farm to the plant, is profitable while consumers enjoy a continuous supply of quality dairy products at predictable prices.

The trend towards harmonization of policies and integration of activities among provinces which began three years ago is still strong in both regional milk pools. In the Western Milk Pool (WMP), the main areas of emphasis are milk transportation, milk receiving at plants, and policies on milk allocation to plants. A harmonized yard and lane policy was approved and implemented in 2011. In the Eastern Pool (the P5), recently created working groups will consider further harmonization of milk utilization and audit standards, milk transportation, and milk quality rules. Furthermore, the P5 is working to establish a harmonized governance structure and will be hiring a consultant to help establish a vision and propose options.

Discussions are ongoing with provincial auditors responsible for auditing milk utilization at the plant level in order to promote uniform best practices across the country during those audits. The WMP approved the interpretation guidelines that will harmonize milk utilization reporting. The CDC acts as a facilitator and a technical advisor in these discussions and negotiations. The results of greater harmonization are a simpler milk marketing system and a more level playing field for both producers and processors.

On the international front, negotiations are still ongoing at the World Trade Organization but it is unclear at this time whether or not a new trade agreement will be reached in the next dairy year (2011-2012). Furthermore, negotiations between Canada and the European Union are progressing and the impact of such an agreement on the Canadian dairy industry is not clear for the time being. The CDC continues to monitor trade negotiations and market fluctuations very closely.

Current trade rules already pose a risk to the domestic dairy market. World dairy prices and exchange rates are increasingly volatile. The tariff wall that protects domestic markets from large volumes of imports has been threatened on a few occasions in the past years. World prices are currently high enough to prevent additional imports of dairy products. Nevertheless, it is possible that at some point, world prices will be low enough that butter, for example, will be imported despite tariffs at the border and transportation costs. The risk is even higher when the Canadian dollar is strong. Depending on volumes, such imports could disrupt milk supply management significantly.

Financial trends

After several years of low interest rates, the CDC expects them to remain at historically low levels in 2011-2012. Since the CDC borrows money from the Consolidated Revenue Fund and from a line of credit to administer programs on behalf of the dairy industry, higher interest rates increase its transaction costs. However, increases in interest rates will have no impact on the financial results of the CDC because interest fees are paid either by dairy producers or by the marketplace.

Starting with dairy year 2011-2012, the CDC will adopt the International Financial Reporting Standards (IFRS) as the primary basis of accounting. The CDC's accounting systems have been gradually prepared for this change and the new standards are not expected to significantly impact the CDC's financial results.

Workplace trends

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. Employee attraction and retention are therefore important. The CDC is aware that it faces strong competition from other government departments and the private sector to replace people who move on or retire. 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.

The CDC took these trends into account when planning its activities and objectives for the 2011-2012 dairy year. These can be found in the section of this report entitled *Performance and Goals*.

John Core

The Canadian Dairy Commission

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 Canadian Food Inspection Agency, the Canadian Grain Commission, Farm Credit Canada, the Farm Products Council of Canada, and the Canada Agricultural Review Tribunal.

The federal government funds about half of the CDC's administrative costs. Other costs, including marketing activities, are funded by dairy producers and the marketplace. The CDC also borrows money from the Consolidated Revenue Fund and from a line of credit to finance the programs it administers on behalf of the dairy industry.

Since supply management was first applied to the dairy sector, the CDC has been in charge of two of the three pillars of the system: support prices[2] and industrial milk quota. Once a year, the CDC sets the support price of butter and skim milk powder following consultations with industry stakeholders. These prices are used as references by the provincial milk marketing boards to establish the price of industrial milk in each province. Through its many roles and central facilitating function in the dairy industry, the CDC ensures that Canadian dairy farmers receive sufficient revenues from the marketplace to achieve decent living standards and invest in their businesses.

The CDC also monitors national production and demand and recommends the necessary adjustments to the national production target for industrial milk. It ensures that milk production in Canada matches demand from Canadian consumers.

It is important to avoid any shortage of dairy products and just as important to avoid production surpluses that are costly to handle, store and market.

To achieve its mandate, the CDC works with provincial governments and dairy industry stakeholders such as dairy producers, processors, further processors and consumers. It supports the dairy industry in the development and implementation of major programs. On the industry's behalf, the CDC administers the Special Milk Class Permit Program[3], the Domestic Dairy Product Innovation Program, the Dairy Marketing Program as well as the pooling systems.

The CDC chairs the Canadian Milk Supply Management Committee (CMSMC)[4] and in this capacity, apprises the committee on matters of interest or concern that require resolution and, when necessary, proposes various solutions, alternatives or recommendations to enhance orderly and efficient marketing with an eye to avoiding deficit or surplus milk production. The CDC performs a similar role for the Eastern Canadian Milk Pool (P5) and the Western Milk Pool (WMP)[5].

2 Support prices are the prices at which the CDC buys and sells Canadian butter and skim milk powder under its Domestic Seasonality Programs.

3 A more detailed description of CDC's programs is presented in the section of this report entitled *Activities and Programs*.

4 The CMSMC is the main national decision-making body of the dairy industry.

5 See p.21 for more information on these pools.

CDC at a glance

Created in 1966

59 employees (as of July 31, 2011)

Location: Ottawa

Web site: www.cdc-ccl.gc.ca

Budget 2011-2012 (dairy year): $8.086 million

Dairy year: August 1 to July 31

Mission

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

The Canadian Dairy Commission achieves its mission by administering the dairy supply management system and by providing leadership and guidance to dairy industry stakeholders.

Values

Integrity, leadership, respect and dignity, and professionalism

Structure

The employees of the CDC belong to one of three sections, as illustrated in the following figure. Each section is under the responsibility of a senior director or director. About every two weeks, the CEO meets with the section heads to discuss the day-to-day operations of the CDC and make the required decisions.

The Canadian Dairy Industry

Farm cash receipts

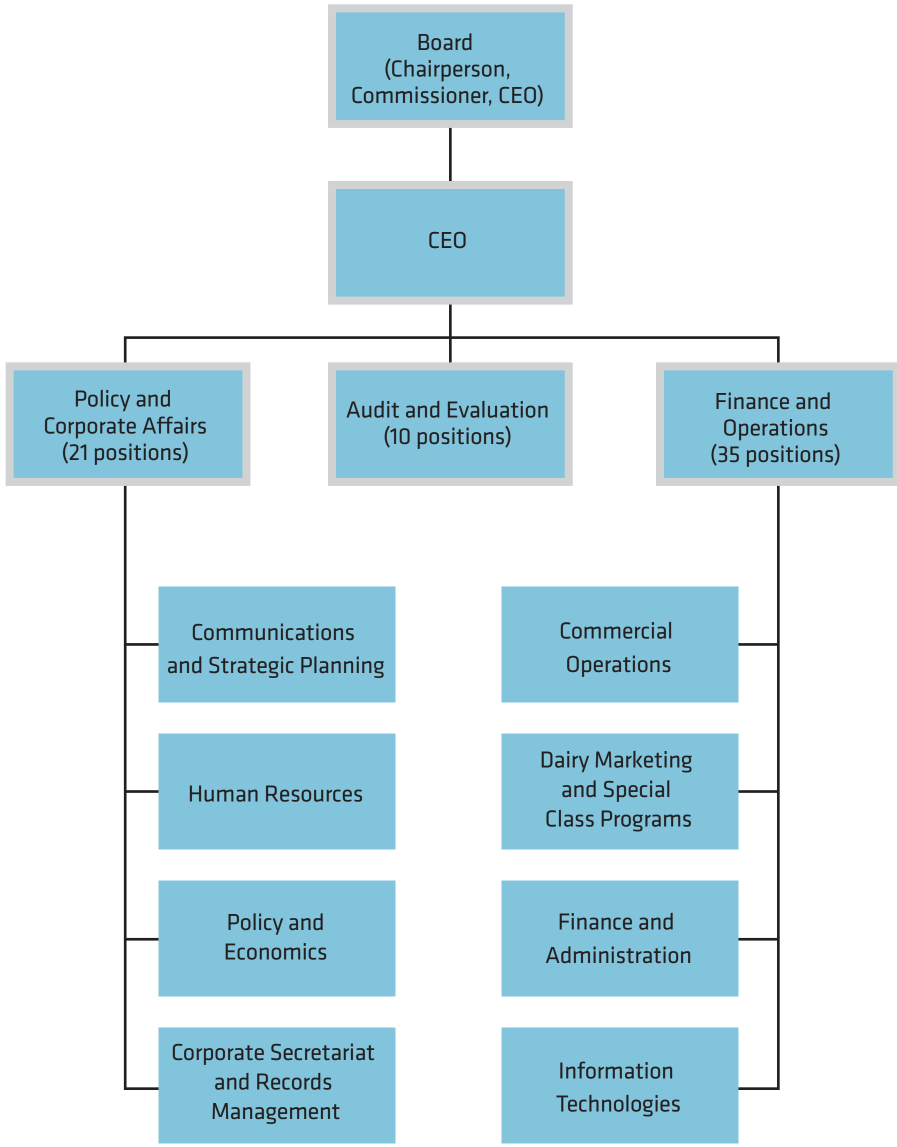
As a key contributor to the Canadian economy in the 2009 calendar year, the dairy industry ranked third behind grains and red meats, generating $5.5 billion in total net farm receipts.

Number of farms and production per farm

In the 2010-2011 dairy year, Canada had 12,965 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 2010-2011 dairy year was 6,549 hectolitres, a 3.5% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,768 kg of milk.

In the 2010-2011 dairy year, Quebec and Ontario had the greatest percentage of dairy farms at 81%, followed by 13% in the Western provinces, and 6% in the Atlantic provinces.

Structure of the Canadian Dairy Commission



Milk processing

In the 2010 calendar year, the dairy processing industry generated $13.7 billion worth of products shipped from approximately 455 processing plants (274 of which are federally registered) accounting for 15% of all processing sales in the food and beverage industry. The dairy processing sector employed 22,650 people.

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 2010-2011 dairy year, the fluid milk market accounted for approximately 39% of total producer shipments, or 118.79 million kg of butterfat[6]. The industrial milk market accounted for the remaining 61% or 186.87 million kg of butterfat of total producer shipments.

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[7]. The price paid for milk by processors varies according to the milk class. The following table shows how Canadian milk production was used in 2010-2011.

Milk utilization per class

Class	Million kg of butterfat	% of total milk
1	91.06	29.9
2	23.74	7.8
3(a) and 3(b)	103.99	34.1
4(a) and 4(a)1	55.98	18.4
4(b), 4(c), 4(d), 4(m)	3.41	1.1
5(a), 5(b), 5(c)	25.62	8.4
5(d)	0.98	0.3
TOTAL	**304.78****	**100.0**

** This figure cannot be compared to the data on page 63 because it excludes milk supplied to food banks, milk sold at fairs and losses.

6 Milk quotas and milk production in Canada are expressed in kg of butterfat.

7 Harmonized Milk Classification System (http://www.cdc-ccl.gc.ca/CDC/index-eng.php?id=3811

Governance

The CDC is governed by the *Canadian Dairy Commission Act*, the *Financial Administration Act*, and the *Public Service Labour Relations Act*. It is also governed by the following regulations:

- the Dairy Products Marketing Regulations
- the EEC Aged Cheddar Cheese Export Regulations

It reports to Parliament through the Minister of Agriculture and Agri-Food.

Governing Board

The governing board for the CDC is composed of the Chairperson, the Commissioner, and the Chief Executive Officer (CEO). The CDC board members are appointed by the Governor in Council and all three positions are part-time appointments. The Commission meets every four to six weeks.

The members of the Board have many years of dairy industry experience and together they 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 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.

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

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.

Board Committees

Audit Committee

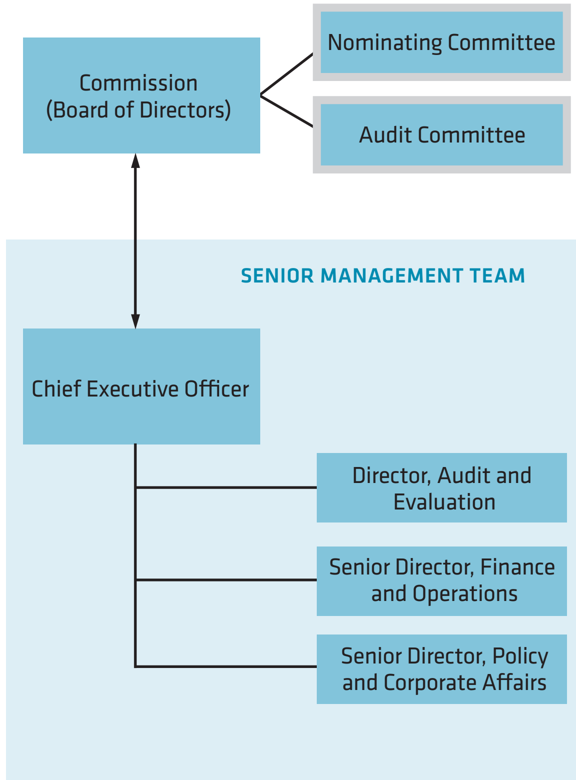
The Committee met quarterly to review the financial statements and receive internal audit and program evaluation reports. It also oversaw the transition to the International Financial Reporting Standards.

Members

Commissioner (chair)

Chairperson

Chief Executive Officer



Nominating Committee

The Committee met in April and July of 2011 and also by teleconference to discuss recommendations for the soon to be vacant CEO position.

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

As part of its overall stewardship in 2010-2011, the governing board approved the CDC's Corporate Plan for the period starting in 2011-2012 and ending in 2015-2016. The Corporate Plan contains all the major directions of the corporation as well as its forecasted budgets and borrowing plan. The Corporate Plan was approved by Treasury Board on June 16, 2011.

The Commission updated its Corporate Risk Profile. This is an internal document that is reviewed at least once per year (latest review was March 2011) 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, incremental risk management strategies and the group responsible for implementing these strategies. The Profile is taken into consideration when doing the environmental analysis during the strategic planning session.

The Board also approved the Annual Report and Financial Statements for dairy year 2009-2010 as well as the budget for fiscal year 2011-2012. It completed a process to evaluate its performance. 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. Finally, in March 2011, the Board received the report of the Special Examination conducted by the Office of the Auditor General in 2010 and started to implement its recommendations.

In addition, the CDC took the following measures to ensure good governance practices. It held the CDC's fourth Annual Public Meeting in January in Ottawa. This meeting is open to the public but is generally attended by about 50 representatives of the dairy industry. It gives the CDC the opportunity to report on its financial statements and activities for the past and current dairy years and to answer any question from participants.

As outlined in the CDC's six-year Audit Plan, internal audits performed during the year included the management of the funding given by the CDC to the Podium project and the Canadian Quality Milk (CQM) program. These two programs are managed by Dairy Farmers of Canada. An important recommendation on CQM resulted in a template being developed to ensure consistent reporting that could be cross checked against production information at the Commission. The audit of the Domestic Dairy Product Innovation Program (DDPIP) was also completed. The industry accepted two key recommendations: to harmonize the monthly reporting of DDPIP data and to obtain plant auditor reports on project activity annually. Executive summaries of internal audit reports were approved by the Audit Committee.

As outlined in the CDC's five-year Program Evaluation Cycle, program evaluations performed during the year included the management of the 4(m) class (animal feed) and external services offered to the industry and the public. These external services included support to industry committees (policy analysis, meeting logistics, translation, etc.) and audits. Executive summaries of program evaluation reports were approved by the Audit Committee. Although the Treasury Board Secretariat Policy on Evaluation does not apply to the CDC, the corporation strives to comply with its general principles.

In accordance with the requirements of the Canadian Accounting Standards Board (AcSB), the CDC will adopt International Financial Reporting Standards (IFRS) as of August 1, 2011. To meet the IFRS transitional requirements, the CDC created an IFRS Working Group in the fall of 2008 which is supported by external advisors to review, recommend and implement the changes required to ensure compliance with the new IFRS by our deadline of August 1, 2011. The CDC is currently on track with its IFRS conversion plan and will meet the implementation deadline.

Senior Management Team

The Senior Management Team is responsible for the day-to-day operations of the Canadian Dairy Commission. It includes the Chief Executive Officer (chair), the Director, Audit and Evaluation, the Senior Director, Finance and Operations, and the Senior Director, Policy and Corporate Affairs.

Director, Audit and Evaluation

Robert Hansis, CGA, MBA, CFE

Mr. Hansis has been the Director of Audit at the Canadian Dairy Commission since 1991 and assumed responsibility for program evaluations in 2009. He is responsible for updating the *Milk Utilization Audit Standards* which is the national audit manual used by all milk plant auditors.

Mr. Hansis holds a Bachelor of Science in Business Administration from Northeastern University, a Certified General Accountant designation and a Master in Business Administration from Concordia University. He is also a Certified Fraud Examiner. He was previously Audit Manager, leading the day to day audit operations of an international $2 billion sales organization involved in forest products and packaging.

Senior Director, Finance and Operations

Gaëtan Paquette

Mr. Paquette holds a Bachelor of Science in Dairy Science from the University of Guelph and an M. Sc. in Food Science from the University of British Columbia. He started his career as an agrologist with OMAFRA and subsequently worked for Agriculture and Agri-Food Canada (AAFC) in research and inspection before joining the CDC in 1987.

Mr. Paquette has been Senior Director, Finance and Operations, at the CDC since 2002. He has helped the Canadian dairy industry adapt to changes such as the 1994 WTO Agreement on Agriculture, the new export rules, and the constant challenge of disposing of structural surplus. Mr. Paquette is responsible for key programs such as the Special Milk Class Permit Program, the Dairy Marketing Program, the Domestic Seasonality Programs, the Surplus Removal Program and the Domestic Dairy Product Innovation Program. He is also responsible for the finance, administration and IT functions of the CDC. For the past 20 years, Mr. Paquette has chaired and been a member of various committees of the International Dairy Federation (IDF).

Senior Director, Policy and Corporate Affairs

Gilles Froment

Mr. Froment is an economist and professional agrologist with a B.Sc. in Economics from the University of Montreal as well as a M.Sc. in Agricultural Economics from McGill University. After gaining some experience with AAFC in Montreal and as Market Analyst with the Canadian Turkey Marketing Agency in Toronto, Mr. Froment joined the Canadian Dairy Commission in 1997 as a policy and program analyst.

Since 2002, he has been the Senior Director of Policy and Corporate Affairs, a directorate that oversees Policy and Economics, Communications and Strategic Planning, and Human Resources. Among his other duties, he is secretary to the Canadian Milk Supply Management Committee and an advisor to the P5 Supervisory Body and Western Milk Pool Coordinating Committee. He also chairs various technical committees. For the last six years, Mr. Froment has been the Canadian representative on the IDF Standing Committee on Dairy Policies and Economics and he is also vice-president of the Canadian FIL-IDF National Committee.

Gilles Froment, Senior Director, Policy and Corporate Affairs; **Robert Hansis**, Director, Audit and Evaluation; **Gaëtan Paquette**, Senior Director, Finance and Operations

Activities and Programs

The Canadian Dairy Commission (CDC) monitors demand and adjusts supply of milk, ensures a fair return to producers, and encourages market development. Its activities include the administration of several key programs related to market supply and growth on behalf of the industry.

Milk Supply

Chairing the Canadian Milk Supply Management Committee (CMSMC)

The CMSMC is a 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 in close co-operation with national and provincial stakeholders and governments.

As a result of recommendations made at the CMSMC meeting in July 2010, a nationwide consultation on the creation of a national milk pool was undertaken. Provincial boards, provincial governments, and processors were consulted, and a report was presented to the CMSMC in April 2011. This report outlined potential future risks and recommended the creation of a Negotiating Committee. A mandate for a P10 Negotiating Committee was drafted and the CMSMC endorsed it in July 2011. It outlines the main areas of negotiation, the membership, and timelines of the Negotiating Committee.

In April 2011, the CDC received the mandate from the CMSMC to add, if needed, a growth allowance to the industrial milk quota. In the past, these decisions have been taken by the CMSMC and the process was often too long to react to the market in a timely fashion. The new arrangement is a one-year trial that will start on the date of the first addition of a growth allowance. The need for a growth allowance has not been felt in this dairy year, since producers have enough quota to fulfill market needs.

Determining and Adjusting Quota

The Commission monitors trends in Canadian requirements[8] (demand) and industrial milk production (supply) on a monthly basis. This allows the CDC to adjust the market sharing quota (MSQ)[9] every two months under the authority of the CMSMC to reflect changes in the domestic demand for industrial milk products, as well as changes in planned exports. 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.

[8] The quantity of butterfat required to fulfill domestic demand and planned exports for industrial dairy products.

[9] National milk production target for industrial milk in Canada, expressed on a butterfat basis. The MSQ 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).

Over the course of the 2010-2011 dairy year, Canadian requirements were 189.49 million kg of butterfat, up 3.08% from the previous year. A strong growth in domestic demand for butter and in butterfat utilization in the further processing sector explains most of the increase in Canadian requirements. A decrease in skim-off from the fluid market also created additional need for industrial milk.

During the same period, industrial milk production increased to 186.87 million kg of butterfat compared to 183.40 million kg of butterfat a year earlier. Because of poor weather and feed quality, production was slow to pick up but started to increase rapidly during the second half of the dairy year. Most of the growth came from the Eastern provinces where weather conditions were more favourable. The growth is expected to remain strong in the fall. Butter stocks, which are currently low, are expected to return to normal levels in 2011-2012.

Domestic Seasonality Programs

Domestic Seasonality Programs allow the industry to cope with the seasonal demand of dairy products. The industry has mandated the Canadian Dairy Commission 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. Except for imported butter and butteroil, these transactions take place at support prices.

Summary of transactions under the Domestic Seasonality Programs

	Opening inventory	Purchases	Sales	Closing inventory
	Tonnes			
Butter	14,652	22,009	26,907	9,754
Skim milk powder	1,635	2,031	1,995	1,671

Data include imported butter and butteroil.

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 t. Of this, approximately two thirds (2,000 t) is specifically allocated to New Zealand.

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 may sell it on the export market. The CDC buys 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 exports must fall within Canada's trade commitments. These 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.

In 2010-2011, 59.8 t of skim milk powder equivalent were removed from the market. This quantity is broken down as follows.

Product	Market	Tonnes
CDC purchases of skim milk powder	Export	9.2
CDC purchases of skim milk powder	Animal feed	15.0
Processor sales of skim milk powder	Animal feed	15.3
Other skim milk powder and milk protein concentrate	Animal feed	2.8
Dairy blends	Export	9.4
Milk protein concentrate	Export	6.0
Other products	Export	2.1
TOTAL		**59.8**

Producer Revenues

Pricing

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

Two elements of the CDC's mandate 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.

To make their decision, Commissioners have access to the results of an annual study undertaken by the CDC and its partners on the cost of producing one hectolitre of milk in Canada. In 2010-2011, the methodology used to arrive at a single national cost of production was significantly adjusted to better respect statistical and economic methodologies.

Because of the increase in farm input costs in 2009, support prices of butter and skim milk powder were increased on February 1, 2011. The support price of butter increased from $7.1024 to $7.1922 per kg whereas the support price of skim milk powder increased from $6.1783 to $6.2721 per kg. This increase was announced at the end of November 2010.

The price paid by processors for fluild milk is established by the provinces. From 2009 to August 1, 2011, all provinces agreed to use the same fluid milk pricing formula. At the request of the regional milk pools, the CDC is administering this formula. Regional pools created a committee to review the current pricing formula, explore mechanisms to set the price of fluid milk as well as the frequency of fluid milk price adjustments. The CDC chairs this committee and provides it with technical support and expertise.

Pooling of Markets and Producer Returns

For dairy producers, pooling agreements are a good tool to mitigate the financial risks associated with the evolution of the domestic market. In its role as a national industry facilitator, the Canadian Dairy Commission administers the three federal-provincial agreements that frame the sharing of revenues and markets among Canadian milk producers 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 the dairy producers of all ten provinces.

Agreement on the Eastern Canadian Milk Pooling

This agreement provides a means for revenues from all milk sales (fluid and industrial), transportation costs, 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.

The Ontario and Quebec bilateral negotiations regarding the harmonization of plant allocation policies were suspended in 2010-2011 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 and suspended its activities in May 2011. The CDC chairs these meetings and provides technical advice. Due to the increasing level of concentration in the industry, the establishment of uniform rules to allocate milk to plants across regions and even Canada is becoming increasingly important. The CDC will continue to promote greater harmonization during the coming year.

The CDC is also assisting marketing boards in their ongoing efforts to harmonize policies. Some working groups were recently created to consider further harmonization of milk utilization audit standards and milk quality rules. The P5 Transportation Team replaced the former P5 Transportation Committee with a mandate to promote a greater integration of transportation activities among P5 provinces.

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.

Policy harmonization continues to be a high priority for the WMP. With the help of working groups on transportation, policies, and information technologies, draft harmonized policies are being created in areas benefiting from harmonization. The WMP Coordinating Committee approved the WMP Harmonized Yard and Lane Policy in April 2011, with provincial implementation scheduled for August 1, 2011 at the latest. A WMP Harmonized Milk Receiving Policy has been developed, and provincial boards have begun the advisory process with provincial processors.

The WMP has hired a WMP Innovation Champion, for a term of one year, to cultivate partnerships between small and mid-sized processors, ethnic market distributors and retailers to develop ethnic and other niche market opportunities. In addition, the WMP has asked a consultant to perform a market study of the WMP and its niche markets to better serve the dairy market.

Lastly, the WMP adopted the WMP Audit Interpretation Guidelines in the spring of 2011.

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. The CDC also audits the same companies for the Import for Re-export Program if they participate in this program, which is administered by Foreign Affairs and International Trade Canada. During the 2010-2011 dairy year 65 companies were audited compared to 41 the previous year. This resulted in claims of approximately $792,000 from these companies. The increased number of audits was made possible by using desk audits in cases that presented a lower level of risk.

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. A national meeting held in September 2010 resulted in further harmonization that was incorporated in the audit standards.

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 contract with Newfoundland and Labrador expired and will be re-negotiated.

Market Development

Dairy Marketing Program

The Matching Investment Fund (MIF) took effect August 1, 2009. An amount of $2 million in funding is offered each year on a matching basis to companies that develop new products using milk components. A total of 58 proposals have been submitted since the MIF was created. During the 2010-2011 dairy year, 19 applications were submitted of which 4 received approval, amounting to approximately $135,000 in funding. Approved projects included consultation services as well as recipe formulation issues. Cheese, fluid milk and milk protein concentrate were the main dairy ingredients involved in these projects.

In 2010-2011, the CDC organized a successful dairy and food industry seminar in Edmonton. The conference focussed on the economy, trade and increased competition from imported goods. The CDC also participated in the annual Canadian Institute of Food Technologists Suppliers Night in Toronto and

Pools in Numbers 2010-2011

	Fluid milk produced (million kg butterfat)	Industrial milk produced (million kg butterfat)	Blend price to producer* ($/hl)
P5	80.81	151.93	$74.32
WMP	36.47	34.56	$77.00

* Prices are calculated at 3.6 kg of butterfat per hl, using the latest compositional standards.

Montreal and in the Baking Congress Trade Show held in Toronto. The CDC's marketing programs and services were prominently featured in a popular food industry magazine article. The CDC was also a sponsor and a presenter at STELA's[10] conference on dairy science and innovation in Quebec City.

The CDC's Innovation Champion conducted 28 on-site visits with companies and organizations from across Canada. The CDC worked closely with two large food processing companies both of which are in the process of building new Canadian plant facilities that will see a major up-take in the use of Canadian cheese and skim milk ingredients. The CDC provided guidance and advice on the sourcing of Canadian dairy manufacturers and suppliers, understanding special class pricing, MIF funding opportunities and other government funding programs.

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. The CDC worked with the industry to redefine the program eligibility criteria. Unfortunately, the CMSMC was unable to reach consensus to extend the DDPIP program beyond July 31, 2011. Discussions are ongoing.

During the 2010-2011 dairy year, firms in Quebec, Ontario, Alberta, British Columbia and Prince Edward Island used 72.9 million litres of milk under the DDPIP compared to 52.0 million litres in 2009-2010. This volume of milk used is the highest ever since the program was put in place 20 years ago and is getting close to the maximum utilization allowed which was established at 2% of the MSQ (approximately 100 million litres). Two large contracts have started during this dairy year and another one, approved in 2010, will start this fall. Milk utilization under this program is thus expected to reach its current limit.

This year, the Selection Committee did not receive program applications until very late in the dairy year. All 55 applications for various products were received during the month of June 2011. Most applications involved new specialty cheeses. Of these 55 applications, 17 met the program criteria and were accepted, and 35 were rejected. The decision on the remaining three is pending additional information. However as the milk volume associated to the contracts already in place prior to these newly approved products totals the maximum of 2% of MSQ currently set for DDPIP, the Selection Committee has requested at the July 2011 CMSMC meeting an increase of that percentage. As this request was not agreed upon, the CDC will not be able to prepare DDPIP contracts for the 17 projects accepted until the CMSMC raises the program limit.

Special Milk Class Permit Program

The Special Milk Class Permit Program was implemented in 1995 to allow further processors to remain competitive. 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 Class permit issued by the Canadian Dairy Commission.

Further processors used the equivalent of 25.62 million kg of butterfat in the 2010-2011 dairy year, an increase of 6% over the previous year. The average revenues obtained for producers from these three classes amounted to \$36.74/hl compared to \$29.36/hl for the previous year. A total of 1,723 permits were issued this dairy year for classes 5(a), (b) and (c), most of which were class 5(b) permits. The number of further processors registered in the program on July 31, 2011 amounted to 1,478.

Although a strong Canadian dollar and a weak American economy resulted in an increase in imported prepared foods, the use of Canadian dairy ingredients in food processing still managed to

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Volume of Milk Sold (million kg butterfat) and Average Producer Prices ($/hl)*

Class		2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
5(a) (cheese)	Volume	7.76	7.78	7.54	7.62	7.85
	Price	$33.63	$43.71	$36.19	$29.76	$35.20
5(b) (other ingredients)	Volume	9.58	11.12	10.70	11.91	12.96
	Price	$31.77	$42.02	$31.67	$28.92	$38.87
5(c) (confectionery)	Volume	5.71	5.66	4.63	4.64	4.81
	Price	$29.90	$40.98	$29.32	$29.73	$37.58
Total	**Volume**	**23.05**	**24.56**	**22.87**	**24.17**	**25.62**
	Price	**$31.76**	**$42.43**	**$33.24**	**$29.36**	**$36.74**

*Prices are calculated at 3.6 kg of butterfat per hl, using the latest compositional standards for all dairy years.

grow significantly. Food processors increased their requirements for butter, cream, skim milk powder, cheddar and cream cheese. The announced expansion and construction of two further processing plants will contribute to significant growth in the demand for Canadian skim milk and cheese in the coming years.

Scholarship Program

The CDC helps introduce new products, technologies and markets to the dairy industry through its support of the CDC Scholarship Program. Launched in the fall of 2006, this program promotes 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. Between 2006 and 2011, the CDC funded 57 masters' projects and 20 doctorates. The five-year program had a total funding commitment of $3 million and ended in July 2011. The CDC announced its decision to renew the program for another five-year period at its annual public meeting held in January 2011. Three million dollars will be distributed to institutions 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**

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. During the 2010-2011 dairy year, Canada exported 11.2 million kg of skim milk powder.

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 which amounts to 4,000 t. For the third year in a row, Canada was not able to take advantage of part of that access. We have partly compensated by issuing export permits for other markets. In total, Canada has exported 4,416 t 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	0.522
Cheese	16.228	13.753
Skim milk powder	31.149	31.149
Others	22.505	22.505
Incorporated products	20.276	20.275

Industry Support

The CDC regularly supports a number of initiatives that benefit the entire dairy industry. One of these is the Canadian Quality Milk (CQM) Program which is administered by Dairy Farmers of Canada (DFC). This HACCP-based program aims to further improve the quality of raw milk. In 2010-2011, the CDC contributed $300 for each Canadian dairy farm validation for a total of $513,600. This reduced the costs of the program for farmers and created an incentive for them to participate. CDC's contribution to the CQM program will be reduced to $200 per farm in 2012-2013 and to $100 per farm in 2013-2014, and is set to expire on July 31, 2014.

The CDC also partnered 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 2010-2011 amounted to about $180,300. This was the last year of the campaign.

In 2010-2011, the CDC continued its partnership with Agriculture and Agri-Food Canada, the Natural Sciences and Engineering Research Council of Canada and DFC to fund a dairy research cluster. Under this partnership, eight research projects on the role of dairy products or key components on cardiovascular health have been initiated, three on their relationship to healthy weight and body composition, six on their role in optimal nutrition, development and maintenance, and two on the environmental footprint of the dairy sector in Canada. Furthermore, 10 research projects have started that aim at developing good environmental practices and methodologies that would improve critical points in health and breeding that limit a cow's productivity.

The CDC also collaborated with DFC, the Dairy Processors Association of Canada and FIL-IDF Canada to organize a dairy policy outlook conference in March 2011 in Montreal. The event was attended by 140 dairy industry stakeholders and focused on the world and Canadian dairy policies, marketing, and trade, as well as traceability, food safety and the priorities of academic research.

Performance and Goals

Achievements for 2010-2011

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

Objective	Performance indicators	Results	Percentage complete
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 CDC, in collaboration with Dairy Farmers of Canada (DFC) held other consultations on the implementation of a national pool for all milk, as mandated by the Canadian Milk Supply Management Committee (CMSMC).	100
	• The Commission consulted on, and adopted a new methodology for establishing support prices.	• The Commission held consultations and adopted a new methodology to calculate the cost of production used in the establishment of support prices.	100
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.	• The review of the federal legal framework is completed. A final document was circulated to CMSMC in July 2011.	100
	• Monthly reports and specific analysis on trade negotiations were presented to the Commission.	• Trade negotiations are monitored on an ongoing basis and specific analysis is done as required.	100
	• Reports on the effectiveness of the current tariffs for dairy products were prepared and circulated to the industry.	• The effectiveness of current tariffs for dairy products is monitored monthly in collaboration with AAFC.	100
	• The CDC Web site was redesigned to include new interactive tools for efficient information flow.	• A new Web site was launched in July 2010. It includes the online version of the orientation session for decision makers of the industry. Interactive tools are being developed.	100

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

Objective	Performance indicators	Results	Percentage complete
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.	• Negotiations have not reconvened due to pending interpretation of a decision by the Régie des marchés agricoles et alimentaires du Québec.	0
	• The Maritimes Milk Allocation Working Group has completed its analysis and prepared a report.	• Several meetings took place. Proposals were presented from both producers and processors. Activities were suspended in May 2011, to allow each group to explore other options.	70
	• Harmonized policies were presented to provincial boards for approval and eventually, implementation.	• In the Western Milk Pool, provisions on yards, lanes and milk receiving have been drafted and are being considered by provincial boards and stakeholders.	80
	• A meeting of provincial auditors was held to identify differences in milk use declaration and audit procedures and to recommend best practices for harmonization.	• Provincial auditors met and recommended best practices for harmonization. Revisions to the Milk Utilization Audit Standards were adopted by the CMSMC.	100
	• Progress was achieved on various files such as fluid milk component pricing, the Domestic Dairy Product Innovation Program (DDPIP), and East-West pricing.	• The industry agreed to set up a committee to review the national fluid milk pricing formula; and the CMSMC agreed to reduce the landed cost differential for industrial milk to 2% for class 2 and 1% for classes 3 and 4. A report for the renewal of the DDPIP program was presented at the July 2011 CMSMC meeting.	100
	• Reports presented to each pool were harmonized and simplified.	• The calculation of component price adjustments for milk in classes 1 to 4 was harmonized, along with reporting.	100

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

Objective	Performance indicators	Results	Percentage complete
Grow the demand for milk components.	• The new DDPIP program was agreed to and implemented by the CMSMC	• DDPIP was extended with different market sharing provisions for a one-year period to July 2011.	100
	• $1.5 million were allocated to projects under the Matching Investment Fund (MIF) (see p. 22)	• 19 MIF proposals have been submitted for review since August 2010. Four of these were approved, amounting to $135,000 in funding. The CDC will undertake an evaluation of this program in 2011-2012 hoping to find the reasons for this low uptake.	10
	• The CMSMC made a decision on a methodology to introduce and remove the growth allowance.	• The CMSMC approved a proposal on a method to introduce and remove the growth allowance.	100
	• A market development committee for processors was created, held meetings and its recommendations were shared with the Market Committee and the CMSMC	• The CDC approached the association of processors about creating such a committee but there was no appetite on their part. This project has therefore been set aside.	100
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 milk protein concentrates in class 4(m) has increased.	100
	• Use of SNF in class 4(a)1 went from 18,000 to 20,000 t.	• Utilization of SNF in class 4(a)1 for the year is 20,500 t.	100
	• Use of SNF in Special Classes 5(b) and 5(c) went from 8,000 to 10,000 t.	• The use of SNF in Special Classes 5(b) and 5(c) reached 11,200 t.	100
	• Inventories of SMP in class 4(m) are at 10,000 t.	• Inventories of SMP are at 10,000 t on July 31.	100

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

Objective	Performance indicators	Results	Percentage complete
Continue the implementation of the succession plan.	• Potential successors were identified for each key position.	• Potential successors were identified during the 2009-2010 end-of-year performance reviews.	100
	• Development plans were designed for each potential successor.	• The selection committee, which will assess the candidacies before development plans are designed, remains to be created. Other HR issues took precedence over this project.	25
Attract and retain employees.	• A framework for alternative working arrangements was established, policies modified or written accordingly and acceptable arrangements presented to CDC employees.	• Alternative working arrangements were explored. The CDC decided not to pursue them at this time.	100
	• The Board made a decision on the renewal of the Scholarship Program.	• The Board decided to renew the Scholarship Program.	100
	• 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.	• 7 staff members of the Special Milk Class Permit Program team have included job shadowing in their development plan.	70
	• 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.	• Employee mobility options were explored but not pursued as they would require amendments to the *CDC Act*.	100

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

Objective	Performance indicators	Results	Percentage complete
Deal with emerging and existing governance trends.	• The recommended governance structure of the CDC was implemented in partnership with government bodies.	• The CDC put forward its position to government bodies for consideration.	100
	• Systems are ready to prepare financial statements using both the previous Canadian accounting standards and the IFRS.	• An assessment of the potential impact of the transition to IFRS is complete. No significant impact on the existing financial and reporting systems is expected and transition to IFRS is on track for August 2012.	100
	• An assessment of the resources needed to comply with government security policies was prepared and submitted to the senior management team.	• The assessment is completed and the Health and Safety Committee of the CDC will make recommendations to management on policy changes in the fall of 2011.	80

Goals for the Period 2011-2012 to 2015-2016

Following a recommendation contained in the Special Examination report published by the Office of the Auditor General (OAG) in 2011, the CDC is changing the format and content of this section of its Annual Report. In the past, the CDC only presented objectives that were of a strategic nature; in other words, what the CDC intended to do to adapt and respond to a changing environment. According to the OAG, this method did not provide assurance that the CDC also performed its core mandate. The OAG therefore recommended that the objectives of the CDC be tied to the mandate of the organization as it is written in the *CDC Act*. To follow this recommendation, the CDC grouped all its operational activities under one or the other of the two parts of its legislated mandate. These activities are therefore found under the business segment *Producer revenue*, or the business segment *Supply of dairy products*. Each of these business segments has an overall goal that is one part of our legislated mandate. Operational objectives (expected results) are found in a table, whereas strategic activities are explained in the text that follows the table for each business segment. Initiatives related to internal services, which simply support the legislated mandate of the organization, have been grouped together under the business segment *Improve the CDC*.

Expected results, performance indicators and strategic activities will be reviewed every year and are subject to change based on the policy decisions made at the Canadian Milk Supply Management Committee, the conclusions of the current trade negotiations, and the general orientations of the federal government.

A) BUSINESS SEGMENT: PRODUCER REVENUE

Goal 1. To provide efficient producers of milk and cream with the opportunity to obtain a fair return for their labour and investment.

Activity	Expected results	Performance indicators
Pricing of industrial and fluid milk	Efficient producers of milk receive adequate revenues	• In 2011-2012, revenues from milk sales covered the cost of a reasonable percentage of the milk produced in Canada
Market development	Canadian demand for dairy products and components is sustained or increased	• 5 new projects approved under the MIF • New version of Domestic Dairy Product innovation Program (DDPIP) is up and running • CDC Scholarship Program renewed
Pool administration	Market and revenues are shared between pool partners in accordance with federal-provincial agreements	• Pooling calculation is done within 3 working days of reception of all provincial data • Funds are transferred no later than 5 working days after calculations • No requests for recalculation of pooling transfers were received from provincial marketing boards
External Audits	Milk components are paid for in accordance with their end use and products imported under the Import for Re-export Program (IREP) are re exported	• 40 audits of special class participants • 6 audits of IREP participants • Milk plant utilization audits in 6 provinces • Milk plant utilization audits are monitored and reported on twice a year in the 4 other provinces • An audit of pooling data has been performed in all 10 provinces and data have been accurately reported.

Summary of Strategic Activities

Pricing

The CDC plays two roles when it comes to the pricing of milk at the farm level. The most important is to establish support prices for butter and skim milk powder (SMP). In 2010-2011, the CDC made changes to the way it calculates the national cost of producing one hectolitre of milk. This cost is one of the main drivers of support prices.

Strategic activity: In 2011-2012, the CDC will continue to refine its calculation of the cost of production by updating the rates allocated to management time by producers.

The CDC also calculates the pricing formula for fluid milk twice a year. The current formula, which was agreed to by dairy industry stakeholders from coast to coast, expires in August 2011.

Strategic activity: In 2011-2012, the CDC will facilitate discussions with all industry stakeholders to arrive at a formula for the period after August 2011.

Market development

The CDC administers several programs aimed at expanding the market for dairy products and ingredients. Some of these programs encourage innovation and education while others involve public policy. The Domestic Dairy Product Innovation Program (see p. 23) aims at encouraging dairy processors to develop new dairy products by providing access to additional milk. The Dairy Marketing Program (see p. 22) provides expertise and easy access to programs and services that encourage the manufacture and use of dairy ingredients.

Strategic activity: 2011-2012 will be the third and final year of the Matching Investment Fund (MIF) and at least five new projects are expected to receive approval. The CDC will be reviewing the MIF to determine whether it should be renewed beyond 2012 and in what form.

Through its Scholarship Program (see p. 24), the CDC encourages graduate students to choose research topics that are related to the dairy industry.

Strategic activity: In 2011-2012, the CDC will renew its Scholarship Program for five years, from August 2011 to July 2016. Canadian establishments will receive $3 million to fund graduate studies related to the dairy industry and will continue to be encouraged to match the CDC's contribution.

The CDC also administers the Special Milk Class Permit Program (see p. 23). This program allows food manufacturers to have access to dairy ingredients at competitive prices through permits that are issued by the CDC. The administration of this program involves about one third of the CDC staff.

Strategic activity: In an effort to gain efficiency in the administration of the program (including audits and IT requirements), the CDC will conduct a business process analysis of the program from start to finish.

Pool administration

The CDC administers three federal-provincial agreements that frame the sharing of revenues and markets among Canadian milk producers (see p. 21). As the administrator of the pools, the CDC chairs the decision making bodies and provides them with technical expertise and secretariat services.

Strategic activity: In 2011-2012, the CDC will facilitate negotiations among industry stakeholders to arrive at a new federal-provincial agreement that would pool all milk from British Columbia to Newfoundland and Labrador. The CDC also aims to continue to efficiently administer the pools, ensuring the processing of data and transferring of funds within specific deadlines.

External audits

The CDC audits some of the participants to the Special Milk Class Permit Program (see p. 23) as well as companies participating in the Import for Re-export Program, which is administered by Foreign Affairs and International Trade Canada. In addition, the CDC monitors milk utilization audits in all provinces and in 6 of the provinces, performs these audits itself on a cost-recovery basis. The CDC also provides assurance on the accuracy of pooled revenues for all provinces.

Strategic activity: In 2011-2012, the CDC will seek to further harmonize audit practices in all provinces and further promote the use of software to automate the declaration of milk utilization in all provinces.

B) BUSINESS SEGMENT: SUPPLY OF DAIRY PRODUCTS

Goal 2. To provide consumers of dairy products with a continuous and adequate supply of high quality dairy products.

Activity	Expected result	Performance indicator
National industrial milk supply	The Canadian milk production matches demand Exports of solids non fat are maximized	• Milk production is between 99.5% and 100.5% of total quota • Subsidized export categories of skim milk powder and incorporated products are filled at least at 95%
Seasonality programs	Dairy products are available to Canadians all year	• Provincial milk marketing boards report no seasonal shortages of dairy products • Plan A butter stocks do not fall below 90% of normal level
Canadian Quality Milk program (CQM)	Improve the quality of milk at the farm level	• 60% of Canadian milk producers are validated under the CQM by August 1, 2012

Summary of strategic activities

Administer industrial milk supply

One of the most important roles of the CDC is to administer Canada's supply management system for milk. Under this system, Canadian milk producers only produce the volume of milk that is required to fill markets. Guiding principles of this system are included in the National Milk Marketing Plan, a federal-provincial agreement that dates back to 1983. The overall objective of this system is to ensure that domestic production is adequate to meet Canadian demand for dairy products plus allowable exports. To do so, the CDC monitors demand monthly and notifies provincial authorities if a change in demand justifies a change in the national quota for industrial milk, called the market sharing quota (MSQ). In 2010-2011, total milk production reached 99.4% of total quota and therefore was close to satisfactory.

Strategic activity: In 2011-2012, the CDC will continue discussions and technical analysis with members of the Secretariat in order to monitor potential improvements in methods to evaluate demand and adjust quota accordingly.

To balance a system which generates a surplus of milk solids non fat, the CDC administers the Surplus Removal Program (SRP) which aims to remove surpluses from the market in a timely manner, while maximizing revenues for producers. Low levels of skim milk powder inventories held by the CDC in class 4(m) are an indication of the success of the program. In recent years, the CDC has been successful in gradually reducing this inventory. This effort will continue.

Strategic activity: In 2011-2012, the CDC will reduce its class 4(m) inventories of skim milk powder to 5,000 t by the end of the dairy year.

In its administration of the industrial milk supply and as the main facilitator of the Canadian dairy industry, the CDC organizes and participates in many meetings with representatives of that industry. Travelling to these meetings is a major cost to the organization and the CDC is looking for ways to control its overall operating costs.

Strategic activity: In 2011-2012, the CDC will reduce meeting expenses by making better use of existing technologies and by implementing new ways of working with the industry.

The Canadian dairy industry largely relies on the CDC for technical advice and economic analyses. Only a few staff members are involved in these functions. Both the Commission and the industry would benefit if more people were involved in creating ideas and solutions.

Strategic activity: In 2011-2012, the CDC will hold targeted technical discussions and brainstorming sessions among its staff members. These sessions will be related to key issues of the industry and will allow different staff members to contribute opinions and solutions. If this format of discussions seems to be beneficial, people from outside the CDC, including experts from AAFC, may be invited from time to time, depending on the issue to be discussed.

Seasonality programs

To ensure an adequate supply of dairy products year round, the CDC operates Seasonality Programs. Under these programs, the CDC buys some dairy products in the spring, when consumption tends to fall, and sells them back into the market in the fall when consumption increases. It purchases products that can withstand storage, like butter and skim milk powder at support prices. To ensure an adequate supply of butterfat all year, the CDC aims to keep a certain quantity in stock. This quantity varies depending on the time of year. At any point in time, the target stock is called the normal butter stocks.

Strategic activity: In 2011-2012, the CDC will continue to administer the Seasonality Programs.

C) BUSINESS SEGMENT: IMPROVE THE CDC

Internal Services

Internal Services are activities that support the needs of programs and other corporate obligations of an organization. In the case of the CDC, they include Communications, Corporate Services, Finance and Administration, Human Resources, IM/IT, Internal Audits and Program Evaluations.

The CDC plans to undertake the following strategic initiatives during dairy year 2011-2012.

Complete the transition to IFRS

CDC financial systems will be compliant with IFRS on August 1, 2011. Financial statements of dairy year 2011-2012 will be prepared using IFRS and will be audited by the Office of the Auditor General (OAG) as part of CDC's next annual financial audit.

Implement the recommendations contained in the OAG Special Examination Report

In its Special Examination of the CDC, the OAG recommended that the Commission's Board periodically assess its collective skills and that if the Board identifies a gap in its skills, it should seek outside expertise. The OAG further recommended that the Commission Board develop procedures for members to declare and manage conflicts of interest.

Strategic activity: In 2011-2012, the Commission Board will periodically assess its collective skills and continue to seek outside expertise when deemed necessary for specific projects such as IFRS and it will continue to explore possible approaches with federal government central agencies.

Strategic activity: In 2011-2012, the Commission Board will create a provision in its by-laws that will require each member to put on record any existing (potential, real or perceived) conflict under the *Conflict of Interest Act*, and will develop procedures to manage such conflicts. The CDC will discuss specific issues with the Privy Council Office and the Office of the Conflict of Interest and Ethics Commissioner in an attempt to find workable solutions.

Align the CDC Annual Report to the guidelines of the Treasury Board Secretariat (TBS)

Last fall, TBS circulated new guidelines on Crown Corporations Annual Reports. Although the version circulated was not quite final, the CDC undertook to examine the changes that would be required to comply with these new guidelines. In January 2011, the CDC decided that its next Annual Report would comply with the draft guidelines and that adjustments would be made later if the final version of the guidelines differed from the draft.

Strategic activity: In 2011-2012, the CDC will produce the annual report on dairy year 2010-2011[11] using the draft TBS guidelines.

[11] As the information in this annual report is dated July 31, 2011, this activity was completed when this annual report was printed.

Adopt the government fiscal year for all activities

Decades ago, the CDC decided to use a dairy year that started on August 1 for some of its activities. This made sense, considering the seasonal nature of milk production. This seasonality in production has almost disappeared and with the adoption of the continuous quota management policy in 2008, it seems that the last reason to hold on to our dairy year may have disappeared. Keeping two different years for different purposes complicates the operations and reporting of the Corporation.

Strategic activity: In 2011-2012, the CDC will identify and analyze the repercussions of planning all activities and reporting on them on a fiscal year basis only. This analysis will include consultations with the industry and central government agencies.

Prepare and post unaudited quarterly financial statements

In accordance with the amendments to the *Financial Administration Act*, the CDC has to prepare unaudited quarterly financial statements. These must be posted on the CDC Internet site and sent to the Minister of Agriculture and Agri-Food and Treasury Board Secretariat within 60 days of the end of each quarter.

Strategic activity: In 2011-2012, the CDC will prepare quarterly financial statements, post them on its Internet site and send them to TBS within 60 days of the end of each quarter.

Program evaluations

Every year, the CDC performs a certain number of program evaluations to ensure that the programs achieve their objectives and are still relevant to their target audience.

Strategic activity: In 2011-2012, as part of its 5-year Program Evaluation Cycle, the CDC will conduct a program evaluation on the Matching Investment Fund to provide input to decision makers regarding its renewal.

Internal audits

The CDC also performs internal audits to examine CDC's programs, systems, practices and procedures. These audits ensure that CDC's assets are safeguarded, that decisions are informed and that controls are in place.

Strategic activity: In 2011-2012, as part of its 6-year Audit Plan, the CDC will conduct internal audits on the following activities: Business continuity plan (monitoring), threat risk assessments (monitoring), financial statements and responsiveness of management accounting to accountability needs, freight and warehousing, Matching Investment Fund and a peer review of the internal audit function.

Appointment of a CEO

The mandate of the current CEO, Mr. John Core, will expire in October 2011. The Minister of Agriculture and Agri-Food is responsible for recommending a candidate to the Governor in Council. A process to find a new CEO is already underway, led by the Privy Council Office (PCO) and including the CDC, Agriculture and Agri-Food Canada, and the office of the Minister of Agriculture and Agri-Food.

Strategic activity: Once the new CEO is appointed by the Governor in Council, the CDC's Corporate Services staff, the Senior Management Team and the other two board members will ensure that he or she gets all the training and orientation required to fully participate in board activities and efficiently lead the CDC towards the accomplishment of its goals.

Implement a new code of values and ethics

TBS requires that all organizations that are part of the federal government adopt and implement a new values and ethics code. This new code will replace the current one and will be based on TBS's new model once approved. TBS's code applies to all public servants, heads of departments and separate agencies. Its adherence continues to be a condition of employment for all public servants including employees of Crown corporations.

Strategic activity: In 2011-2012, the CDC will implement a new code of values and ethics based on the model provided by TBS.

Increase the efficiency of CDC's operations

The CDC has vast amounts of valuable data in its possession. In the past years, the CDC has put a lot of effort into presenting this information to the industry. As there is an increasing number of requests from the industry, there is now an even greater demand for more analysis of the data. This presents a problem for the IT section as it has to prioritize these demands.

Strategic activity: In 2011-2012 the CDC will create an internal committee to prioritize the reporting and analysis needs of the CDC, so that the IT section is able to respond to the most important requests.

Certain administrative functions at the CDC are performed by several staff members in various teams. It might be more efficient for the CDC to centralize some of these functions, to automate certain steps of these functions or to review some of the processes.

Strategic activity: In 2011-2012, the CDC will create a small internal task force that will be mandated to study how to make some administrative functions, such as travel claims and bill payment, more efficient. This group will report to the Senior Management Team.

Financial Report

Management 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, 2011 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

Export sales revenues were higher compared to the previous year mainly due to the fact that the CDC exported more skim milk powder (SMP) at higher prices.

The quantity of skim milk powder sold in 2010-2011 amounted to 10,828 t compared to 8,231 t for the previous dairy year. This increased revenues by $13.88 million.

Butter sales for the year decreased from 675 t in 2009-2010 to 125 t, generating $0.52 million in revenue.

Cost of goods sold

The CDC purchases surplus dairy products destined for export at prices that reflect the 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 minimal gains or losses that reflect this price volatility.

For the dairy year ending July 31, 2011, the cost of goods sold totalled $36.2 million compared to sales revenues of $37.6 million, resulting in a gross profit before transport and carrying charges of $1.4 million compared to a deficit of $0.9 million in the previous dairy year.

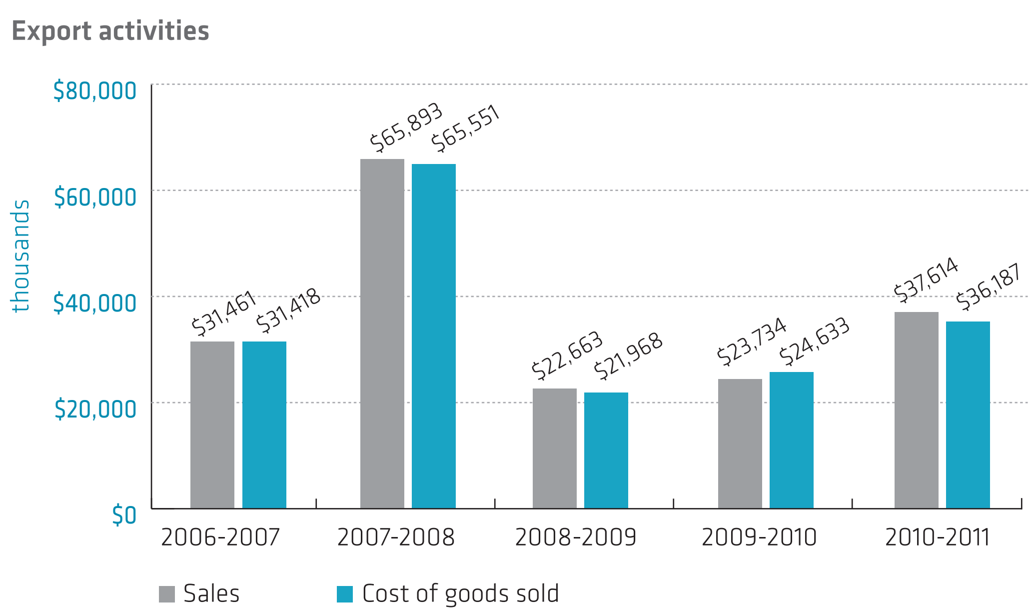
Domestic activities

Sales

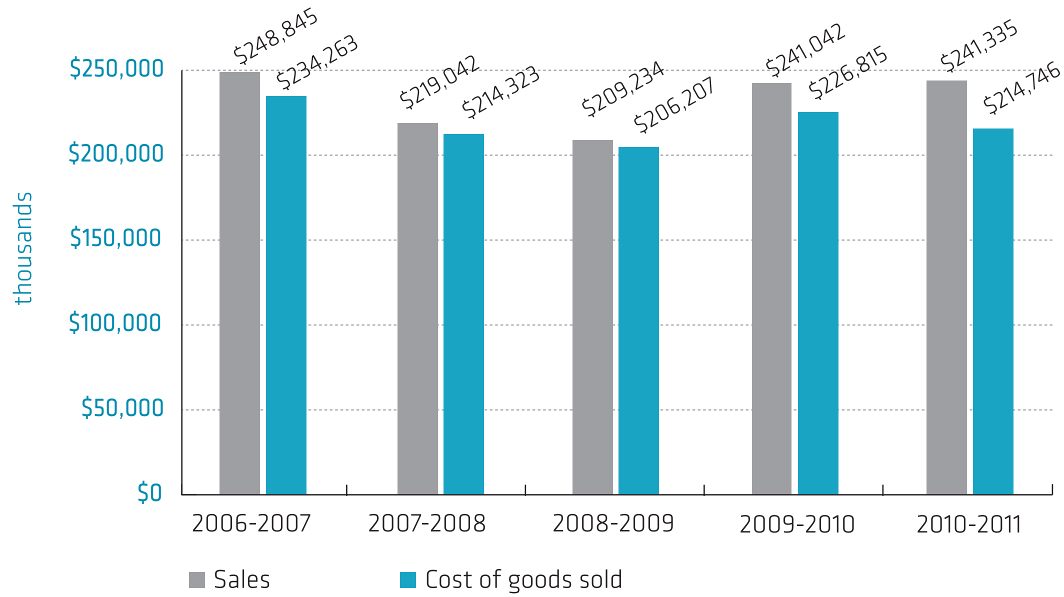
In the 2010-2011 dairy year, total revenues from domestic sales were similar to the previous year's result. Revenues for Plan B butter and SMP decreased by $36.7 million as result of less product being sold compared to the previous dairy year. This decrease was offset by an increase in revenues mainly generated from Plan A butter and 4(m) SMP.

The CDC purchases Plan B butter and SMP from processors with the requirement that processors repurchase the product within a pre-determined period. A decrease in the resale of these products by the CDC compared to the 2009-2010 dairy year translated into lower revenues.

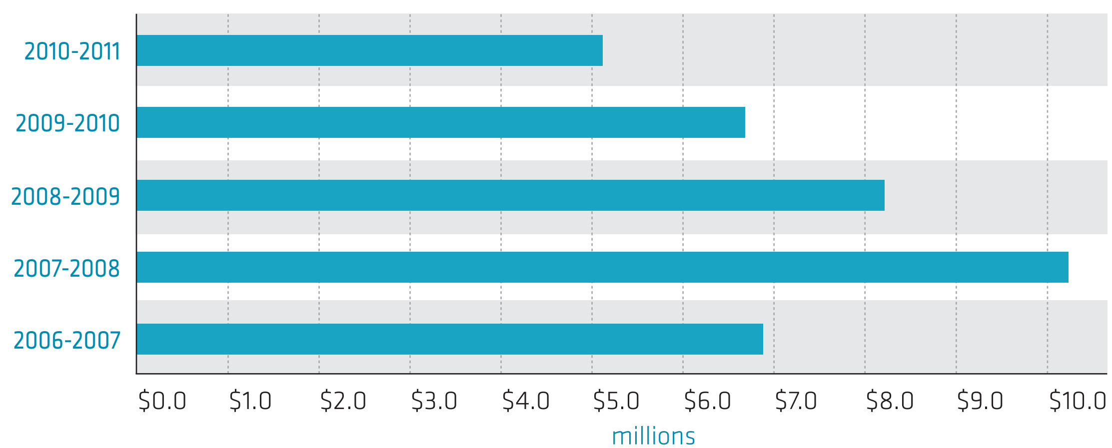
An increase in sales of imported butter, combined with higher sale prices, generated an increase of $7 million in revenues compared to the previous dairy year. As for Plan A butter, the volume sold increased by approximately 131% compared to the previous dairy year, generating additional revenues of $22 million. SMP sold to the animal feed sector under class 4(m) amounted to 25,325 t which is comparable to last year's results. However, the revenues generated by this product increased by $7.7 million due higher selling prices.



Domestic activities



Transport and carrying charges



Cost of goods sold

For the dairy year ending July 31, 2011 the cost of goods sold amounted to $214.7 million compared to sales revenues of $241.3 million. This resulted in a gross profit before transport and carrying charges of $26.6 million for domestic activities.

Over 70% of the domestic gross profit before transport and carrying charges is due to activities in the animal feed market ($19.1 million out of $26.6 million).

Plan A butter revenues are normally equal to the cost of goods sold because the CDC purchases and sells this product at the prevailing support price. This year the cost of goods sold was significantly lower than the revenues because a portion of the Plan A butter originally destined for exports was purchased at world prices, and subsequently sold on the domestic market at the Canadian support price. The redirection of that product into the domestic market increased the gross profit by $5.8 million.

The cost of butter and skim milk powder sold under Plan B was almost equal to the selling prices obtained 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.

Transport and carrying charges

Transport and carrying charges are mainly comprised of transportation expenses, interest expenses on loans, handling and storage charges, and insurance.

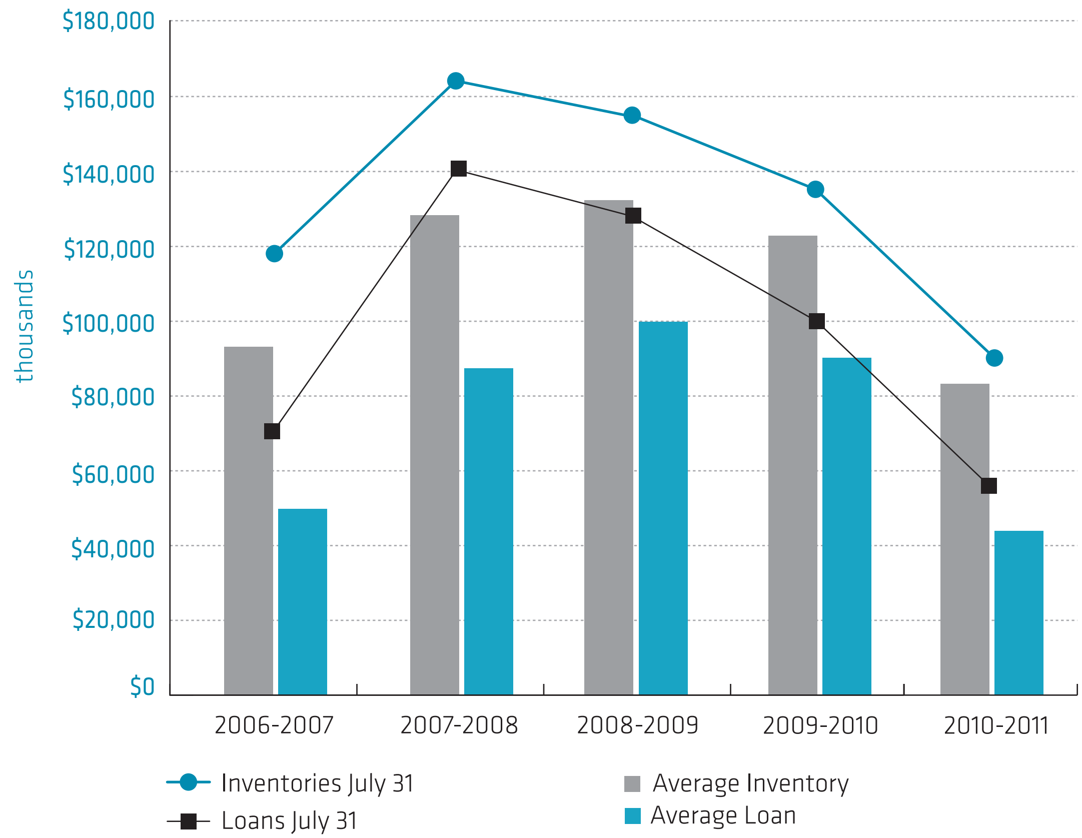
Transport costs remained relatively constant compared to those of 2009-2010, totalling approximately $1.2 million for the current year. Interest expenses were slightly higher at $0.5 million compared to $0.4 million, but still much lower than average because of continued low borrowing rates. These rates are expected to remain at historically low levels well into 2012.

The major factor responsible for the decrease in transport and carrying charges year over year are storage charges. These fell from $4.4 million in 2009-2010 to $2.8 million in 2010-2011. This decrease in storage costs was directly attributable to significantly lower inventory levels throughout 2010-2011.

Inventories and loans

Average inventory levels were 32.7% lower in the 2010-2011 dairy year compared to the previous year, resulting in a significant decrease in our average loan requirements. Butter stocks were lower than normal and inventory levels of skim milk powder (SMP) for the animal feed market were 12 million kg lower than the previous dairy year. During the year milk production has been lower than expected in many provinces due to the poor quality of the feed produced last summer. As a result, the CDC butter

Inventories and loans



stocks have been drawn upon to fill the market. Because of recent initiatives by the provinces to increase production levels, the CDC expects to rebuild its butter stocks to normal levels in the coming dairy year. In 2010-2011, our butter and SMP stocks were lower than normal. Therefore the CDC, in consultation with the Minister of Finance, agreed to decrease its loan limit for 2011-2012. This reduction from $175 million to $165 million will be relatively modest because the CDC anticipates a return to normal inventories and it should maintain its capacity to respond to unforeseen circumstances brought on by changing market conditions.

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 March 2011) 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 mostly by tenders to reliable exporters who seek value-added products, ensuring best returns for its commercial operations.

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 $7.7 million. Salaries and employee benefit plans of $5.7 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

Future accounting changes

In accordance with the requirements of the Canadian Accounting Standards Board (AcSB), the CDC will adopt International Financial Reporting Standards (IFRS) as of August 1, 2011 and will present comparative figures accordingly. A position paper was prepared and concluded that the CDC falls in the Other Government Organizations (OGOs) classification which are normally directed to the Public Sector Accounting (PSA) Handbook but are allowed to adopt the International Financial Reporting Standards when these are determined to be the most appropriate basis of accounting. After an in-dept analysis of the CDC's various activities and user needs it was concluded that the CDC adopt IFRS as its primary source of accounting.

To meet the IFRS transitional requirements, the CDC created, in the fall of 2008, an IFRS Working Group that is supported by external advisors to review, recommend and implement the changes required to ensure compliance with the new IFRS by our deadline of August 1, 2011. The working group reports to the Internal Audit and Program Evaluation Advisory Committee and also provides regular updates to the CDC Audit Committee. The CDC's transition plan consists of three phases: the diagnostic phase, the design and development phase, and the implementation phase. The CDC is currently on track with its IFRS conversion plan and will meet the implementation deadline.

Although changing from the previous Canadian accounting standards to IFRS has been a significant undertaking for the CDC, this will not affect the CDC's financial position and results. Key financial reporting issues have been analyzed in the Component Evaluations. All Component Evaluations have been reviewed and approved by the Internal Audit and Program Evaluation Advisory Committee and the Office of the Auditor General.

The total impact to the CDC's retained earnings at the transition date is expected to be $0. There will be changes to the financial statements but the main impact for the CDC will be additional note disclosure to provide greater transparency in accordance with IFRS.

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 on the animal feed market.

Although the CDC has succeeded in reducing its inventory of SMP to a reasonable level in the past year, the quantity of SMP expected to be offered to the CDC may increase again due to increased milk production forecasted next year. The CDC will resume its efforts to increase sales to animal feed manufacturers. Furthermore, in order to reduce the purchase of surplus skim milk powder, the CDC will continue to work with the industry to create 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 the conclusion of an agreement in the next year is uncertain.

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 Interim 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 29, 2011

Auditor General of Canada
Vérificateur général du Canada

Independent Auditor's Report

To the Minister of Agriculture and Agri-Food

Report on the Financial Statements

I have audited the accompanying financial statements of the Canadian Dairy Commission, which comprise the balance sheet as at 31 July 2011, and the statement of operations and comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Canadian Dairy Commission as at 31 July 2011, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, I report that, in my opinion, Canadian generally accepted accounting principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Canadian Dairy 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 Canadian Dairy Commission.

Dale Shier, CA
Principal
for the Interim Auditor General of Canada

29 September 2011
Ottawa, Canada

Balance Sheet

as at July 31, 2011
(in thousands)

	2011	2010
Assets		
Current		
Cash	$ 146	$ 182
Accounts receivable		
Provincial milk boards and agencies (pooling) receivable	33,462	37,330
Trade	6,340	1,148
Derivative asset - foreign exchange contracts	67	1
Inventory (Note 3)	94,322	135,228
	$ 134,337	$ 173,889
Liabilities		
Current		
Bank indebtedness (Note 4)	$ 1,154	$ 2,314
Accounts payable and accrued liabilities		
Provincial milk boards and agencies (pooling) payable	31,236	33,684
Trade	14,563	17,276
Distribution to provincial milk boards and agencies payable	14,573	4,385
Other liabilities	1,254	1,209
Derivative liability - foreign exchange contracts	294	4
Loans from the Government of Canada (Note 5)	55,848	98,927
	118,922	157,799
Long-term		
Severance benefits (Note 11)	643	1,175
Equity (Note 6)		
Retained earnings	14,772	14,915
	$ 134,337	$ 173,889

Commitments (Note 13)

The accompanying notes 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)

	2011	2010
Sales and Cost of Sales		
Domestic sales revenue	$ 241,335	$ 241,042
Cost of goods sold domestically	214,746	226,815
Transport and carrying charges	4,199	5,927
Gross profit on domestic sales	22,390	8,300
Export sales revenue	37,614	23,734
Cost of goods exported	36,187	24,633
Transport and carrying charges	919	803
Gross profit (loss) on export sales	508	(1,702)
Total gross profit	22,898	6,598
Other revenues		
Pooling contributions witheld to fund operating expenses (Note 9)	6,419	7,508
Funding from the Government of Canada (Note 10)	4,031	3,819
Audit services	124	147
	10,574	11,474
Total	**33,472**	**18,072**
Operating Expenses		
Industry initiatives	426	2,131
Concentrated Milk Assistance Program	109	351
Cost of Production study	824	817
Other charges / (recoveries)	(43)	(296)
	1,316	3,003
Administrative Expenses		
Salaries and employee benefits	5,683	5,493
Other administrative expenses	2,043	2,458
	7,726	7,951
Total	**9,042**	**10,954**
Results of operations before distribution to provincial milk boards and agencies	**24,430**	**7,118**
Distribution to provincial milk boards and agencies	24,573	4,385
Results of operations and comprehensive income	**$ (143)**	**$ 2,733**

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

Statement of Changes in Equity

for the year ended July 31
(in thousands)

	2011	2010
Retained earnings, beginning of year	$ 14,915	$ 12,182
Results of operations and comprehensive income	(143)	2,733
Retained earnings, the end of the year	$ 14,772	$ 14,915

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

Statement of Cash Flows

for the year ended July 31
(in thousands)

	2011	2010
Cash flows from operating activities		
Cash receipts from customers	$ 273,833	$ 264,761
Cash paid to suppliers and others	(226,593)	(246,865)
Cash receipts from provincial milk boards and agencies (pooling)	191,102	207,792
Cash paid to provincial milk boards and agencies (pooling)	(183,264)	(200,202)
Cash paid to provincial milk boards and agencies (operating surplus)	(14,385)	-
Cash receipts from the Government of Canada	4,031	3,819
Interest paid on loans	(521)	(541)
Cash flows from operating activities	44,203	28,764
Cash flows from financing activities		
New loans from the Government of Canada	157,921	140,805
Loan repayments to the Government of Canada	(201,000)	(171,366)
Cash flows used in financing activities	(43,079)	(30,561)
Net increase (decrease) in cash	1,124	(1,797)
Net bank indebtedness at beginning of year	(2,132)	(335)
Net bank indebtedness at end of year	$ (1,008)	$ (2,132)
Components:		
Cash	$ 146	$ 182
Bank indebtedness	(1,154)	(2,314)
	$ (1,008)	$ (2,132)

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

Notes to Financial Statements

July 31, 2011

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. 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.

Inventory

Inventory is 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 inventory, 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.

Inventory excludes storage charges, which are expensed when incurred.

Sales revenue

Domestic and export sales revenue are recognized when product is shipped.

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.

Distribution to 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 12 - 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 14), 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

Substantially all of the employees of the Commission are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the

Government of Canada. Contributions are required by both the employees and the Commission to cover current service cost. Pursuant to legislation currently in place, the Commission has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service 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.

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

International Financial Reporting Standards

Effective January 1, 2011, the Canadian Institute of Chartered Accountants adopted International Financial Reporting Standards (IFRS) as Canadian GAAP for publicly accountable enterprises. The Commission will adopt IFRS for its dairy year beginning August 1, 2011.

The preparation and audit of an IFRS opening balance sheet as at August 1, 2010 will be required in order to produce comparative IFRS balance sheet elements for 2010-2011, which will be used as the comparative numbers in the 2011-2012 financial statements.

The Commission has completed 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, however, there will be expanded financial statement note disclosure.

3. Inventory

	2011	2010
	(in thousands)	
Butter	$ 70,159	$ 99,135
Skim milk powder	24,163	36,952
	94,322	136,087
Less: allowance for inventory write-down	-	(859)
Total net realizable value	$ 94,322	$ 135,228

The Commission's inventory includes 9,650 tonnes of Plan B butter and 1,671 tonnes of Plan B skim milk powder (2010 – 10,905 tonnes and 1,635 tonnes) with a total cost of $69.52 million and $10.48 million respectively (2010 – $77.45 million and $10.10 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 104 tonnes of butter and 11,059 tonnes of skim milk powder (2010 – 4,261 tonnes and 23,179 tonnes) with a total cost of $0.64 million and $13.69 million respectively (2010 – $21.69 million and $26.85 million).

4. Bank indebtedness

The Commission has 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 for the pricing and pooling of market returns system. During the dairy year, the Commission's available line of credit limit can vary up to $25 million (2010 – $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 2.75% to 3.00% per annum (2010 – 2.25% to 2.75%).

5. 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 (2010 – $175 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 0.39% to 1.13% (2010 – 0.30% to 1.42%) during the year and totaled $0.52 million (2010 – $0.38 million).

6. 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, 2011 resulting in other comprehensive income or losses and the Commission had no opening or closing balances for accumulated other comprehensive income or losses.

7. Capital disclosures

The Commission's capital consists of its loans from the Government of Canada (see Note 5) and retained earnings. As at July 31, 2011 these accounts totaled $55.85 million (2010 – $98.93 million) and $14.77 million (2010 – $14.92 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.

8. Foreign exchange gains and losses

Export sales include $0.20 million representing net gains (2010 – net losses of $0.14 million) arising from currency translation relating to transactions incurred in foreign currencies.

Domestic cost of sales include $0.14 million representing net losses (2010 – net losses of $0.24 million) arising from currency translation relating to import purchase transactions incurred in foreign currencies.

9. Pooling contributions

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. The fixed amount is agreed upon annually by the CMSMC.

The pool operates on a two month lag where contributions from and equalization payments to provincial milk boards and agencies that were not disbursed or collected at year-end are reported respectively as payables and receivables on the Balance Sheet.

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

	2011	2010
	(in thousands)	
Contributions from provincial boards and agencies	$187,235	$217,069
Equalization payments to provincial boards and agencies	180,816	209,561
Pooling contributions withheld to fund operating expenses	$ 6,419	$ 7,508

10. 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 $4.03 million (2010 – $3.82 million) of the Commission's administrative expenses of $7.73 million (2010 – $7.95 million).

11. Employee future benefits

Pension plan

Substantially all of the employees of the Commission are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the Commission. The President of the Treasury Board of Canada sets the required employer contributions based on a multiple of the employees' required contribution. The general contribution rate effective at year end was 1.90 times (1.93 times for the prior year). Total contributions of $0.55 million ($0.55 million in prior year) were recognized as expense in the current year.

The Government of Canada holds a statutory obligation for the payment of benefits relating to the Plan. Pension benefits generally accrue up to a maximum period of 35 years at an annual rate of 2 percent of pensionable service times the average of the best five consecutive years of earnings. The benefits are coordinated with Canada/Québec Pension Plan benefits and they are indexed to inflation.

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:

	2011	2010
	(in thousands)	
Accrued benefit obligation, beginning of year	$ 1,294	$ 1,217
(Recovery) cost for the year	(80)	98
Benefits paid during the year	131	21
Accrued benefit obligation, end of year	$ 1,083	$ 1,294

Of the total year end obligation, $0.44 million (2010 - $0.12 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.

12. 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 only 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 $18.12 million Canadian equivalent (2010 – $1.40 million Canadian equivalent). These contracts will mature over the period ending October 2011. 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, 2011 are as follows:

(in thousands)

Currency sold	Currency purchased	In USD	In CAD
U.S. dollars	Canadian dollars	$4,521	$4,320
Canadian dollars	U.S. dollars	$14,439	$13,796

As at July 31, 2011, the Commission's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

In CAD	2011	2010
	(in thousands)	
Accounts receivable (trade)	$5,632	$957
Accounts payable (trade)	-	(357)
Net derivative liability	(227)	(3)
Net exposure	$5,405	$597

Based on the net exposure as at July 31, 2011, 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, 2011 would have increased by $1.74 million (2010 – decreased by $3 thousand). 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 1.13 (2010 – 1.10). In managing liquidity risk, the Commission has access to additional borrowings for commercial operations from the Government of Canada in the amount of $119.15 million as of July 31, 2011 (2010 – $76.07 million) as well as $3.85 million (2010 – $2.69 million) on its line of credit for the pooling of market returns 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, 2011 and 2010, the Commission did not have an allowance for doubtful accounts and all accounts receivable were 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 (2010 – 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 2011, there were no transfers between levels.

13. Commitments

a) Industry Initiatives

	Canadian Quality Milk	Matching Investment Fund	Dairy Research Cluster	Iodine Study	Scholarship Program	Total
			(in thousands)			
Total commitment	$ 2,953	$ 6,000	$ 1,500	$ 340	$ 3,000	$ 13,793
Distributed:						
Prior year(s)	678	340	500	-	-	1,518
Current year	514	99	-	109	-	722
Commitment remaining	$ 1,761	$ 5,561	$ 1,000	$ 231	$ 3,000	$ 11,553

Canadian Quality Milk

This program is designed to help producers improve the quality of raw milk on their farms. The Commission has agreed to partially fund this program under an agreement that commenced August 1, 2007 and was extended to July 31, 2014.

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 CDC has committed $6 million over a three-year period commencing August 1, 2009 and ending July 31, 2012.

Dairy Research Cluster

This Dairy Farmers of Canada 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. The Commission has agreed to partially fund this project under an agreement that commenced on January 1, 2010 and expires on March 31, 2013.

Iodine Study

The Dairy Farmers of Canada are conducting an analysis to determine 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. The Commission has agreed to partially fund this study.

Scholarship Program

The Commission will fund a graduate Scholarship Program as of August 1, 2011. The CDC will grant $3.00 million in scholarships over five years to participating institutions across Canada.

b) Purchase Commitments

As at July 31, 2011, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $4.88 million (2010 – $0.42 million) and are due to be fulfilled by September 2011.

c) WTO Tariff Rate Quotas for Butter

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 2012 TRQ for butter remains at 3,274 tonnes. World prices at the time of purchase will determine the total financial commitment. For 2011 the total cost to purchase imported butter under the WTO requirements was $14.47 million (2010 – $10.20 million).

d) Operating Lease

Agriculture and Agri Food Canada has notified the Commission through a letter of intent that it will renew the lease for the Commission's offices accommodations for another period of 5 years commencing April 1, 2012 with revised rates reflecting the rental market value pursuant to Treasury Board's Policy on Real Property. The remaining payments under the current lease agreement, which expires March 31, 2012, are $0.31 million.

14. 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 $1.64 million during the year (2010 – $1.62 million).

Loans from the Government of Canada at terms available to Crown corporations (see Note 5), which are recorded at carrying value, represent the Commission's largest related party transaction.

15. Financial statement presentation

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

Tables and Data

Industrial Milk Production, Canadian Requirements and MSQ (million kg butterfat)

	Production	MSQ*	Canadian requirements
2006-2007	174.80	175.00	180.35
2007-2008	182.21	183.75	179.57
2008-2009	179.66	182.08	180.14
2009-2010	183.39	181.80	183.82
2010-2011	186.87	188.73	189.49

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

Production of Milk* (million kg butterfat)

Province	2009-2010			2010-2011		
	Fluid	Industrial	Total	Fluid	Industrial	Total
Newfoundland and Labrador	1.37	0.49	1.86	1.52	0.38	1.90
Prince Edward Island	0.56	3.44	4.00	0.56	3.42	3.98
Nova Scotia	3.97	2.66	6.63	4.00	2.75	6.75
New Brunswick	2.57	2.62	5.19	2.63	2.67	5.30
Quebec	25.90	89.35	115.25	26.32	90.68	117.00
Ontario	46.91	51.15	98.06	47.30	52.41	99.71
Manitoba	4.88	7.06	11.94	4.97	7.06	12.03
Saskatchewan	2.59	5.79	8.38	2.59	5.96	8.55
Alberta	14.22	10.47	24.69	14.76	10.35	25.11
British Columbia	14.45	10.37	24.82	14.15	11.19	25.34
Total	**117.42**	**183.40**	**300.82**	**118.80**	**186.87**	**305.67**

* Before pooling

Number of Farms and Cows, and Total Production 2006-2007 to 2010-2011

	Number of farms	Number of cows (thousands)	Total production (million kg butterfat)
2006-2007	14,660	1,004.8	290.78
2007-2008	14,036	998.5	300.17
2008-2009	13,587	978.4	298.41
2009-2010	13,214	981.0	300.82
2010-2011	12,965	987.0	305.67