



Canadian Dairy Commission
Commission canadienne du lait

40
YEARS
1967-2007

CANADIAN DAIRY
COMMISSION
ANNUAL REPORT

06
07

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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This publication is also available in libraries across Canada
Catalogue No.: A88-2007E-PDF
978-0-662-46764-9

Design and production:
Element Design and Communications

Printing: Tri-Graphic Printing,
printed in Canada

Photo on page 4: Agropur Cooperative

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LETTER TO THE MINISTER

Minister,

I am pleased to submit the Canadian Dairy Commission's Annual Report for the 2006-2007 dairy year. As we finalize the year, the Canadian Dairy Commission (CDC) is in good financial position and close to achieving 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 of its issues, or because circumstances required a change in direction. Overall, the CDC continued to help the Canadian dairy industry respond positively to the many challenges that arise.

On the world stage, a generalized reduction in available milk for export sent prices for products such as skim milk powder soaring. As a result, domestic prices in the milk classes that follow world prices have gone up for Canadian manufacturers. In the new

year, this increase in world prices should enable Canada to export a larger quantity of surplus milk powder while still respecting the limits imposed by the World Trade Organization (WTO).

The world trade negotiations continue to raise concerns and uncertainties in the Canadian dairy industry. In our view, better harmonization of the dairy policies within Canada is a good way to prepare for whatever results these negotiations will have. I am happy to report that a major initiative was undertaken by the two major dairy provinces, Quebec and Ontario, under the auspices of the CDC. These two provinces are discussing how to harmonize the allocation of milk to dairy plants on their respective territories. We are hoping that this new set of rules can then be extended to the Maritime provinces.


Demand for dairy products has risen slightly in 2006-2007 and last year's reduction in demand was therefore short lived. However, industrial milk and cream production remained almost unchanged at 48.6 million hl compared to 48.7 million hl a year earlier. In an attempt to restrict the structural surplus of skim milk powder, the Canadian Milk Supply Management Committee reached a new agreement on the ratio of solids non fat to butterfat in raw milk.

Last December, the CDC announced an increase in the support price of skim milk powder while the support price of butter remained unchanged. This 1.06% increase, equivalent to 0.75 cent per litre of milk leaving the farm, took into account both the rising costs of producing milk and the market situation.

This year brought major changes to the structure of the Commission. On April 27, 2007, the *Canadian Dairy Commission Act* changed as per the provisions of the *Federal Accountability Act*. As a result, the three members of the Commission are now the Chairperson, the CEO, and the Commissioner. Following these changes, the Governance Rules of the Commission were changed. Mr. Carl Harrison's term as Vice-chairman ended on April 27, 2007, and Mr. Jean Grégoire's term as Acting Chairman ended on July 31, 2007. On August 1, 2007, Mr. Randy Williamson was appointed Chairman and Mr. Gilles Martin was appointed Commissioner.

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

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



John Core
Chief Executive Officer



THE CDC FROM THEN TO NOW

On February 15th, the CDC launched the book "The Canadian Dairy Commission: A 40-year Restrospective". Written by journalist Erin Scullion, this book recounts the changing roles of the CDC during its 40 years of existence. What follows is an excerpt.

The CDC started in 1966 as a leader, developer and manager—a trailblazer, in fact, for Canadian industrial milk. It paid out direct subsidies to producers. It set the support prices—with Cabinet approval—for skim milk powder and butter, bought these products from processors, stored them and exported the surplus. It implemented Subsidy Eligibility Quotas which were phased out in favour of Market Sharing Quota (MSQ) in the 1970s. It handled exports of butter and skim milk powder and small amounts of condensed, evaporated milk and casein. In short, it consolidated the federal government's dairy support programs, exported surplus product, and helped create a framework for a new system of orderly marketing for the industrial milk sector.

In the 1970s, the Interim Comprehensive Milk Marketing Plan—which all provinces except Newfoundland signed on to by 1974—created the Canadian Milk Supply Management Committee (CMSMC). As chair and secretary to the CMSMC, the CDC

played a collaborative and facilitative role. The CMSMC took on the task of setting national MSQ and distributing it among the provinces based on historical shares outlined in the Interim Plan, which brought quotas in line with demand and basically launched supply management. The CDC made the calculations and forecasts of Canadian requirements and provided technical support to the CMSMC on MSQ, cost of production, and many other issues.

In the 1980s, the National Milk Marketing Plan replaced the Interim Comprehensive Milk Marketing Plan and became the official federal-provincial agreement. The CDC's dual role was solidified. On one hand, it still managed the major elements of the federal government's dairy support programs, distributing the subsidy payments and setting the support prices. It bought and sold skim milk powder and butter, administering the federal government's offer-to-purchase program (Plans A and B), which was a component of setting support prices. Not

only did the CDC export surplus products, it developed new international markets for whole milk products like evaporated milk and instant whole milk powder. In its other role, as chair of the CMSMC, the CDC oversaw, developed and carried out various programs and activities on behalf of, and at the direction of, the CMSMC. By the end of the 1980s, though, the CDC role as a trailblazer for the industry was in sharp decline.

In the 1990s, the three pooling agreements, new WTO and NAFTA rules, and a move to less government intervention in Canada's agriculture sector (including the dairy industry) meant another shift in the role of the CDC. The CDC had always supported the underpinnings of the supply management system. Many had considered the CDC a 'mover and shaker' in the dairy industry. But when the dairy supply management system had to reinvent itself because of the WTO, it wasn't the CDC's job to lead the charge. It was the industry's. To that end, the CDC helped co-ordinate and facilitate the many options and the hard work that lay ahead.

Today, the CDC sets support prices for butter and skim milk powder which it buys from or sells to processors under the Seasonality Programs (Plan A and Plan B) and the Surplus Removal Program. The CDC still estimates, and recommends to the CMSMC, the amount of milk needed to supply the Canadian industrial market. The CDC continues to chair the CMSMC, providing it with technical and policy advice as it is requested.

The CDC also ensures that Canada lives within its WTO export commitments by monitoring export volumes and the value of the accompanying subsidy. It exports small amounts of skim milk powder to Cuba and issues export permits at the request of the export and processing industry while managing the butter imports which are allowed into the country. The CDC handles the structural surplus of skim milk powder and still has the authority it was given in 1966, to buy, store, process or sell dairy products.

With the advent of the three pooling agreements—the Comprehensive Agreement on Pooling of Milk Revenues (P9), the Western Milk Pooling Agreement (WMP),

and the All Milk Pooling Agreement (P5)—the CDC took on several new administrative roles but without any decision-making power. It chairs meetings and facilitates discussions surrounding the harmonization of provincial policies. It calculates the blend price of the pools, manages pool revenues, provides technical support and issues permits under the Special Milk Class Permit Program.

The future of the Canadian dairy supply management system, as is the way with futures, remains unknown. What is known is that the CDC has played an important role in the evolution of the Canadian dairy supply management system. The Commission has often gone above and beyond the call of duty in the name of providing "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," as outlined in the Act that created the CDC in 1966.

THE CANADIAN
DAIRY INDUSTRY



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

KEY HIGHLIGHTS OF 2006-2007

- The Minister of Agriculture and Agri-Food established the Dairy Industry Working Group in April 2006 to bring producers and processors together to discuss challenges to the dairy industry. Its moderator presented his recommendations to the Minister in October 2006. In February 2007, the Minister announced that he would invoke Article 28 of GATT to restrict imports of dairy protein concentrates and instructed the Canadian Food Inspection Agency to harmonize the Dairy Products Regulations and the Food and Drug Regulation.
- Discussions were undertaken in September 2006 to harmonize the allocation of milk to plants across Quebec and Ontario.
- In October 2006, the CMSMC approved a set of standards by which milk utilization will be audited in all 10 provinces.

- In May 2007, the Canadian Milk Supply Management Committee modified special milk class 4(a)1 to include weight/muscle gain formulations, meal replacement products, medical and sports recovery drinks and infant food formulations. The Committee also extended the eligibility of ice cream novelties in class 5(c)* until July 31, 2008.
- Demand for dairy products recovered in 2006-2007. At the end of the dairy year, Canadian requirements were at 50.09 million hl, up 4.8% from last year.
- Milk marketing boards in Ontario, Quebec, Nova-Scotia, and New-Brunswick introduced measures to limit the price of milk quota.

*A description of milk classes is included in Appendix 1.

MILK PRODUCTION

Farm cash receipts

As a key contributor to the Canadian economy in the 2006 calendar year, the dairy industry ranked fourth behind grains, red meats and horticulture, generating \$4.8 billion in total farm cash receipts.

Number of farms and production per farm

In the 2006-2007 dairy year, Canada had 14,660 dairy farms. Although there has been a decline in the number of dairy farms in Canada, the individual farming units have grown in size and have increased their efficiency. The average production per farm in the 2006-2007 dairy year was 5,511 hectolitres (hl), a 6.1% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,481 kg of milk.

In the 2006-2007 dairy year, Quebec and Ontario had the greatest percentage of dairy farms at 81%, followed by 14% in the Western provinces and 5% in the Atlantic provinces.

NUMBER OF FARMS, COWS AND TOTAL PRODUCTION

2002-2003 to 2006-2007

	Number of farms	Number of cows (million)	Total production* (million hl)
2002-2003	17,931	1.06	78.6
2003-2004	16,970	1.06	81.6
2004-2005	16,224	1.06	81.5
2005-2006	15,522	1.05	80.6
2006-2007	14,660	1.04	80.8

* At 3.6 kg of butterfat per hl. This total does not take into account skim-off and therefore cannot be compared to the data on page 10.

NUMBER OF DAIRY FARMS IN 2006-2007

Newfoundland and Labrador	38
Prince Edward Island	234
Nova Scotia	279
New Brunswick	254
Quebec	7,162
Ontario	4,688
Manitoba*	455
Saskatchewan	243
Alberta	692
British Columbia	615
TOTAL	14,660

*Includes one cream farm

MILK PROCESSING

In the 2006 calendar year, the processing industry generated \$13.0 billion* worth of products shipped from approximately 450 processing plants (282 of which are registered with the Canadian Food Inspection Agency), accounting for 16.8% of all processing sales in the food and beverage industry. In the same year, the dairy processing sector employed almost 26,000 people.

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

MILK MARKETS

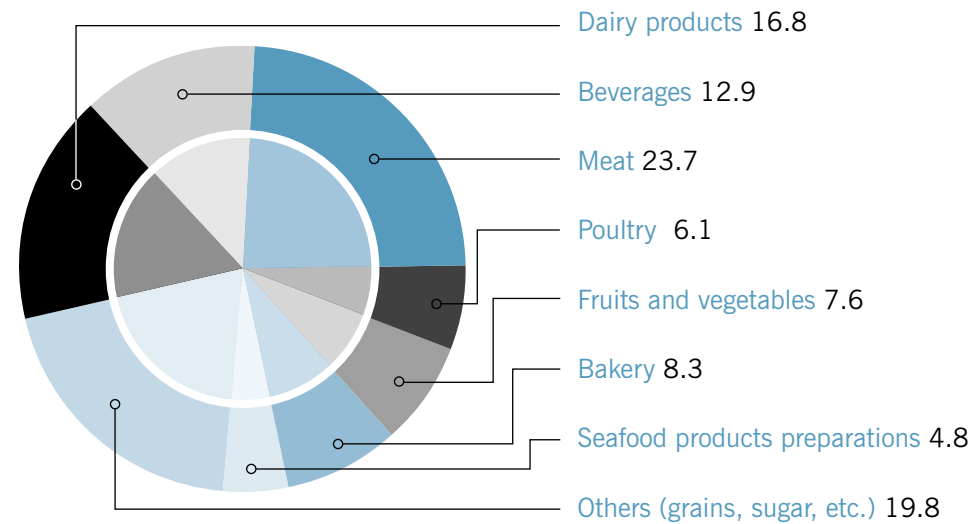
Canadian dairy producers supply two main markets:

- 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 2006-2007 dairy year, the fluid market accounted for approximately 40% of total producer shipments of milk, or 32.2 million hl*. The industrial market accounted for the remaining 60% or 48.6 million hl* of total producer shipments.

* At 3.6 kg of butterfat per hl

SHARE OF MANUFACTURED SHIPMENTS IN CANADA - VALUE BASIS (2006)



Ingredients market

Milk and dairy products are widely used as ingredients in the manufacture of further processed products. While the ethnic foods category continues to thrive in Canada, the same can be said about the high-end desserts, soups, and premium frozen entrées. A growing interest in the use of Canadian manufactured milk protein concentrate in nutraceutical type products points to a variety of new applications for both traditional and new dairy ingredients.

Indeed, strong demand for dairy products such as cream, cheddar cheese and liquid milks contributed to a growth of 12.6% in the special milk classes 5(a), (b) and (c) in the 2006-2007 dairy year over the previous year. Continued interest on the part of dairy and food processors for the CDC's Innovation Support Fund, Domestic Dairy Product Innovation Program, and other recently introduced support programs should contribute to further growth in the use of Canadian dairy products and ingredients in further processing.

MILK UTILIZATION BY CLASS

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

Class	Million hl	% of total milk
1	23.9	29.64%
2	5.5	6.82%
3(a) and 3(b)	28.0	34.76%
4(a) and 4(a)1	15.1	18.72%
4(b), 4(c), 4(d), 4(m)	1.1	1.35%
5(a), 5(b) and 5(c)	6.4	7.94%
5(d)	0.6	0.78%
TOTAL	80.6	100%



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 important 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 Grain Commission, the Canadian Food Inspection Agency, Farm Credit Canada and the National Farm Products Council.

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

The Commission employs 67 people who work in its offices which are located in Ottawa, Ontario. The success of the CDC depends largely on its employees and on their pursuit of excellence in the services that they offer.

GOVERNING BOARD

Following the enactment of the *Federal Accountability Act* in December 2006, the *CDC Act* underwent some legislative amendments which altered the structure of the Commission's governing board. On April 27, 2007, the functions of chairperson and CEO were split and the position of vice-chairperson ceased to exist. This change clarifies accountabilities: the Board is accountable to the Minister for the stewardship of the corporation, and the chief executive officer is accountable to the Board for the management and performance of the corporation. The Commission updated its Governance Rules and the work descriptions of the three member positions to reflect these changes.

Effective April 27, 2007, the governing board for the CDC is composed of the Chairperson, the CEO and the Commissioner, collectively known as the Commission. As part of its overall stewardship, the governing board

- reviews financial statements of the CDC on a quarterly basis;
- establishes and approves the CDC's strategic directions, Corporate Plan and budgets with input from senior management;
- approves the financial statements which are audited by the Auditor General of Canada, and the Annual Report;
- ensures proper accountability through internal audits and evaluations of CDC's systems, practices and programs;



- reports on CDC activities and services to the industry as they relate to its legislated mandate and presents the related financial statements to the CMSMC at least four times a year; and,
- receives and follows up on the annual audit report of the Commission's financial statements and on the Special Examination report of the Auditor General, which is carried out every 5 years.

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

The CEO makes recommendations in the areas of planning and is responsible for the implementation of the Corporate Plan once it is approved by Treasury Board, for the strategic plan, and for the policies and programs of the CDC. The CEO is also the primary liaison between the CDC and the dairy industry stakeholders and governments.

The Commissioner assists the Chairperson in ensuring that the Commission functions properly, meets its obligations and respon-

sibilities, and fulfills its mandate. The Commissioner also acts as Chairperson in the absence of the Chairperson and, while doing so, has all the powers and duties of the Chairperson.

The members of the Commission have many years of dairy industry experience and their backgrounds as former producers or processors bring a balanced approach to satisfying the often conflicting objectives of the stakeholders.

On August 1st 2007, Randy Williamson was appointed Chairman and Gilles Martin was appointed Commissioner for a three year term.

COMMISSIONERS

Chairman and CEO (October 2005 to April 27th 2007) and CEO (April 28th 2007 to present)

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.

Vice-chairman (April 2004 to April 27th 2007)

Carl Harrison

Prior to being appointed to the Commission, Mr. Harrison was a Director of the Ontario Dairy Processors Council, a founding Director of the Ontario Dairy Council (ODC) and also served as ODC President. In addition, Mr. Harrison has many years of service with the National Dairy Council of Canada, serving as Director from 1973 until 1998, as a member of their Executive Committee from 1994 until 1997, and was the organization's Chairman in 1996-1997.

Commissioner (May 2004 to April 27th 2007) and Acting Chairman (April 28th to July 31st 2007)

Jean Grégoire

A former President of Dairy Farmers of Canada and of the Fédération des producteurs de lait du Québec, Mr. Grégoire has been involved in various dairy producer groups

since 1975, when he became administrator of the Syndicat des producteurs de lait de transformation de Saint-Hyacinthe.

Chairman (Appointed August 1st 2007)
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, to Dairyworld Foods in 1992, and to Saputo in 2001, where he remained until his retirement in 2006.

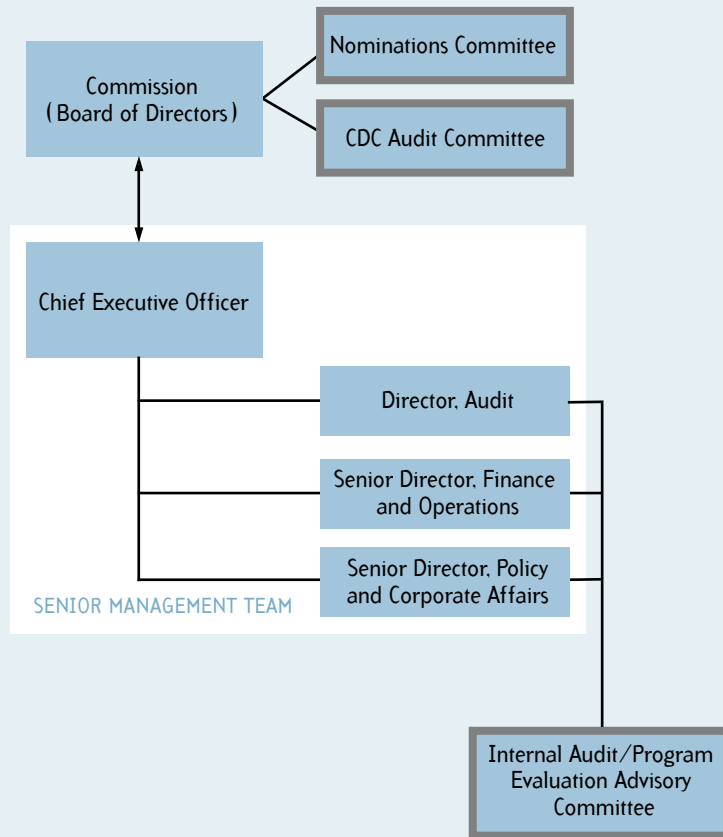
Mr. Williamson also has extensive board experience as Director of the National Dairy Council (1990-2006), Director of the Nova Scotia Dairy Council (1998-2005), and President of the British Columbia Dairy Council (1994-1996).

Commissioner (Appointed August 1st 2007)
Gilles Martin

Mr. Martin has a post-secondary degree in Zootechnology from the Institute of Agricultural Technology in La Pocatière. He has been involved in the dairy producing industry since 1977, and co-owns a dairy farm with his brother 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 as President of his regional farmers' union, the Fédération de l'Union des producteurs agricoles de la Côte-du-Sud, and as a member of the board of directors of the Syndicat des producteurs de lait de la Côte-du-Sud. Presently, he is also the President and a founding member of the Centre de développement bioalimentaire du Québec, an agri-food research and development centre, a board member of the agri-food co-operative of the Groupe Dynaco as well as a member of the board of the regional agricultural education centre, Ferme-École la Pokita.

COMMITTEES



Commission Board of Directors

Members

- Chairperson
- Commissioner
- Chief Executive Officer

Activities

The Commission Board of Directors met monthly to review CMSMC documents, make decisions on pricing, and address dairy policy issues.

CDC Audit Committee

Members

- Commissioner (chair)
- Chairperson
- Chief Executive Officer

Activities

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

Internal Audit/Program Evaluation Advisory Committee *(membership effective April 27th 2007)*

Members

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

Activities

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

Nominations Committee

Members

- A member of the Commission Board of Directors (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 CMSMC

Activities

This year, the positions of Chairperson and Commissioner became vacant. The Committee met in January and March and sent recommendations to the Minister in April 2007 for the positions of Chairperson and Commissioner.



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

Senior Management Team

Members

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

Activities

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

1.



2.



3.



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

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

3. Audit Section, from left to right:
 Robert Hansis, Director, Audit; Indira Gangasingh, Audit Manager;
 Hossein Behzadi, Audit Manager

CORPORATE GOVERNANCE

In 2006-2007, the Commission took the following measures to improve accountability.

- The Commission approved the CDC's Strategic Plan for 2007-2008.
- An internal audit was conducted to review the systems and procedures in place to compile production data and calculate solids non fat (SNF)/butterfat (BF) ratios. CDC management has accepted recommendations to investigate significant variances between production data and sales revenue (pooling) data. Reasonability checks will also be established for elements deducted from production that determine milk marketed. The SNF/BF ratios were accurately calculated.
- The Seasonality Programs and the Surplus Removal Program underwent an evaluation during the previous year. The evaluation report was presented to the CMSMC in 2006-2007 and implementation of its recommendations will be monitored by the Internal Audit/Program Evaluation Advisory Committee.
- The Commission updated its Integrated Risk Management Plan.
- The Commission approved the amended Governance Rules and work descriptions made necessary by legislative amendments which came into force on April 27, 2007 pursuant to the *Federal Accountability Act*.
- The Commission approved a new structure for the Audit section.
- Various training sessions were held for management on subjects such as employee coaching.
- The Commission convened its Nominations Committee to recommend candidates to the positions of Chairperson and Commissioner, for which mandates terminated on April 27, 2007. These positions were advertised in French and English dailies and in the Canada Gazette.
- The CEO and managers successfully completed the four modules required under the *Policy on Learning, Training and Development* of Treasury Board to maintain their delegation of signing authority.
- The Commission implemented its Classification Action Plan in response to the recommendations of the Canada Public Service Agency report.
- The Commission finalized an MOU with Agriculture and Agri-Food Canada for the provision of informal conflict management services to CDC employees.

ACTIVITIES AND PROGRAMS

Main Activities

As a national facilitator and chief administrator for the dairy industry, the CDC undertakes a number of activities and programs:

- Through its chairmanship and work for the Canadian Milk Supply Management Committee (CMSMC), the CDC provides ongoing leadership, advice and analysis to the Canadian dairy industry while operating in close co-operation with national and provincial stakeholders and governments;
- It acts as a facilitator and provides secretariat services and advice to the revenue pooling and market sharing systems. Provisions for these functions are set out in the All Milk Pooling Agreement, the Western Milk Pooling Agreement, and the Comprehensive Agreement on Pooling of Milk Revenues. The CDC also administers the financial mechanisms required by these agreements;
- It calculates and recommends to the CMSMC the national production target for industrial milk, or Market Sharing Quota;
- It has the authority to purchase, store, process, or sell dairy products on the domestic or export market, within Canada's World Trade Organization (WTO) commitments. The CDC also imports and redistributes tariff rate quota butter on behalf of the industry;
- The Commission establishes support prices at which it will purchase butter and skim milk powder. These support prices are used as references by provinces to establish prices for milk used to manufacture products such as butter, cheese, and ice cream;
- It administers the Special Milk Class Permit Program through which it issues permits allowing further processors to have access to competitively priced dairy ingredients, and allowing exporters to export dairy products within Canada's WTO commitment levels;
- It develops and implements marketing programs and services aimed at encouraging dairy and food processors to maintain or increase their use of dairy ingredients in their various products. These activities are guided by the objectives set out in the Dairy Marketing Program;
- The CDC carries out internal audits of its systems and practices as well as external audits, which are in large part performed on companies participating in the Special Milk Class Permit Program;
- It acts as a facilitator in advancing the harmonization of audit procedures for dairy plants and dairy policies in general;
- It performs plant audits for the provinces of Manitoba, Nova Scotia, Prince Edward Island and Newfoundland and Labrador.

NATIONAL DAIRY POLICY

Canada's supply management system for the dairy industry is the foundation of current policies in this sector. Supply management in dairy was adopted in the early 1970s and is used to manage and administer the supply of milk used to make products like butter, cheese and yogurt.

In this context, the role of the Canadian Dairy Commission is to act as a facilitator within the various forums, such as the Canadian Milk Supply Management Committee (CMSMC), that are involved in dairy policy. The CDC acts as chair, advisor, and secretariat to the CMSMC. It provides many economic and policy analyses to help the Committee make dairy policy decisions.

The CMSMC is a permanent body created by the National Milk Marketing Plan (NMMP). Its mandate is to determine policies and to supervise the provisions of the NMMP and of the Comprehensive Agreement on Pooling of Milk Revenues. The National Milk Marketing Plan is a federal/provincial agreement that

governs the supply management system for dairy in Canada. The CMSMC has representation from dairy producers, processors and governments from all provinces. Representatives of dairy producer, processor, and consumer national organizations also participate on the committee as non-voting members.

PRODUCTION OF MILK AND CREAM* (millions of hectolitres)

Province	2005-2006			2006-2007		
	Fluid	Industrial	Total	Fluid	Industrial	Total**
Newfoundland and Labrador	0.4	0.1	0.5	0.4	0.1	0.5
Prince Edward Island	0.2	0.9	1.1	0.2	0.9	1.1
Nova Scotia	1.1	0.6	1.7	1.1	0.7	1.8
New Brunswick	0.7	0.7	1.4	0.7	0.7	1.4
Quebec	7.4	23.6	31.0	7.4	23.6	31.0
Ontario	12.6	13.8	26.4	12.6	13.8	26.4
Manitoba	1.3	1.9	3.2	1.3	1.9	3.2
Saskatchewan	0.7	1.6	2.3	0.7	1.6	2.3
Alberta	3.8	2.6	6.4	3.9	2.6	6.5
British Columbia	3.8	2.8	6.6	3.9	2.7	6.6
Total	32.0	48.6	80.6	32.2	48.6	80.8

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

** This total does not take into account skim-off and therefore cannot be compared to the data presented on page 10.

DETERMINING AND ADJUSTING QUOTAS

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

Over the course of the 2006-2007 dairy year, Canadian requirements started to

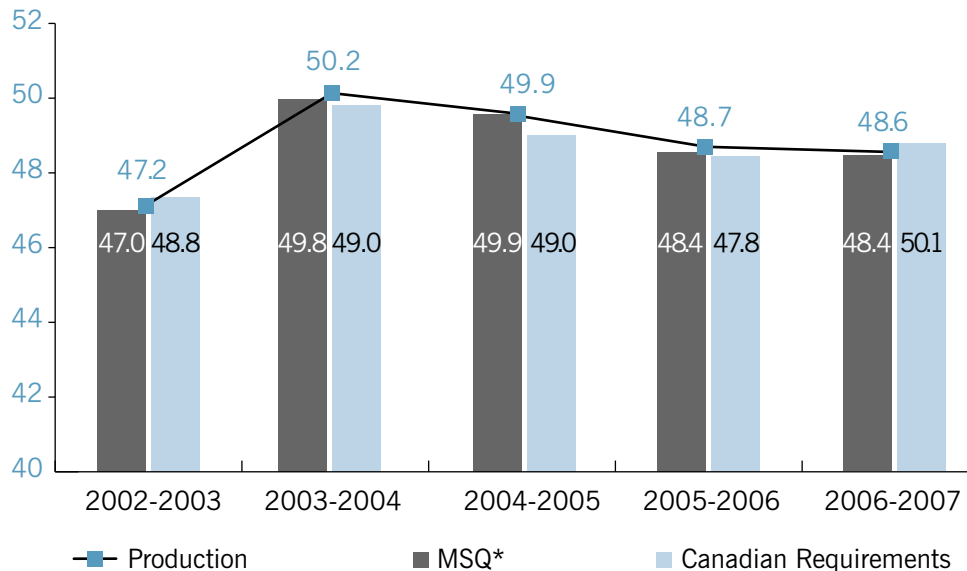
rebound and reached 50.09 million hectolitres, up 4.8% from the previous dairy year. During the same period, industrial milk and cream production remained almost unchanged at 48.6 million hl compared to 48.7 million hl a year earlier. To meet the rapid increase in demand, dairy products from the CDC stocks were released into the market.

On a regular basis, the CMSMC reviews the national production target for industrial milk, called the Market Sharing Quota (MSQ). The MSQ is based on Canadian requirements.

Demand is constantly monitored and, when necessary, the MSQ is adjusted to reflect changes in the domestic demand for industrial milk products, as well as changes in planned export activity. Because it is expressed on a butterfat basis, MSQ also takes into account the fact that a portion of the butterfat from the fluid milk market will be used in the industrial milk market (skim-off). The objective of determining MSQ is to minimize the possibility of shortages or surpluses on the domestic market.

As demand for dairy products recovered and started to grow throughout the year, the CDC recommended quota adjustments and the implementation of a 1% temporary growth allowance to the CMSMC. As a result, the national market sharing quota was cut only once, but increased 5 times in the 2006-2007 dairy year, starting the year at 48.14 million hectolitres and standing at 49.60 on July 31, 2007, an increase of 3%. In addition, a growth allowance of 1% was implemented from April 1st to July 31st 2007 to help rebuild Plan A butter inventories and reduce the risk of a shortage in the fall.

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



*Weighted average MSQ, including Domestic Dairy Product Innovation Program

PROVINCIAL SHARES OF MSQ* - JULY 31, 2007*

	Butterfat (million kg)	Milk (million hl)	%
Newfoundland and Labrador	0.65	0.18	0.36
Prince Edward Island	3.07	0.85	1.72
Nova Scotia	1.98	0.55	1.11
New Brunswick	2.30	0.64	1.29
Quebec	80.87	22.47	45.29
Ontario	56.41	15.67	31.59
Manitoba	6.37	1.77	3.57
Saskatchewan	4.70	1.30	2.63
Alberta	11.60	3.22	6.50
British Columbia	10.61	2.95	5.94
Total	178.56	49.60	100.0

*Before sharing of markets

Even if the supply of milk is carefully managed throughout the year, surpluses can occur due to fluctuations in milk production or demand. These are managed by adjusting the Market Sharing Quota or the stocks, or by exporting surpluses within Canada's trade commitments. Surpluses are managed through the Surplus Removal Program, with revenues from these activities being returned to producers through pooling.

POOLING OF PRODUCER RETURNS

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

Comprehensive Agreement on Pooling of Milk Revenues

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

Agreement on All Milk Pooling

Since 1996, the Agreement on All Milk Pooling has provided a means for revenues from all milk sales (fluid and industrial) and transportation costs, along with markets and the responsibility for skim-off, to be pooled among dairy producers in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island (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.

Discussions amongst P5 signatories regarding the redrafting of the agreement are in their final stage and the new agreement will allow P5 provinces to adapt collectively to today's new reality. The P5 Technical

Committee undertook a complete review of the calculations of the interprovincial movement of milk. A number of changes which significantly simplify these calculations have been approved.

In 2006-2007, the P5 Supervisory Body finalized details of the program for the development of new dairy market opportunities in classes 1(c) and 4(c). Since then, several processors have successfully applied to the program. The P5 Supervisory Body also decided to halt negotiations for Newfoundland and Labrador to join the All Milk Pooling Agreement.

A great deal of time and energy was also devoted to the negotiation of a harmonized milk allocation policy. At the request of stakeholders, the CDC is chairing ongoing meetings between producers and processors from Quebec and Ontario.

POOLS IN NUMBERS 2006-2007

	Fluid milk produced (million hl)	Industrial milk produced (million hl)	Blend price to producer* (\$/hl)
All Milk Pool	22.1	39.7	\$68.93
Western Milk Pool	9.8	8.7	\$68.23

*In-quota milk at 3.6 kg butterfat per hl

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.

During the 2006-2007 dairy year, the stakeholders of the WMP pursued negotiations on fluid milk pricing and discussed the possibility of harmonizing milk metering, inhibitor testing and milk quality standards. In June 2007, the Western Milk Pool agreed on a common position regarding these matters which was presented to provincial governments for consideration.

The WMP Transportation Committee and the CDC organized a pandemic and disaster planning workshop for dairy industry stakeholders. The workshop proved useful to participants and generated a Pandemic Planning Guide which can be used as a planning tool by dairy producers.

Finally, the Class 1(c) and 4(c) program which offers a reduced price on milk used in innovative products has accepted one successful applicant from the WMP this year.

SPECIAL MILK CLASS PERMIT PROGRAM

The Special Milk Class Permit Program was implemented in 1995 to allow processors, exporters and food manufacturers to remain competitive on international and domestic markets. Through this system, milk components are available to manufacture dairy products for use in products containing dairy ingredients at competitive prices.

Processors, exporters and further processors can access certain quantities of dairy components through permits issued by the Canadian Dairy Commission. There are three types of permits. The first type (permit 5(a), 5(b) or 5(c)) is issued to food manufacturers who use dairy products as ingredients.

The second type of permit (permit 5(d)) is issued to exporters for individual transactions. The exporter's permit specifies the maximum quantity of dairy products that may be exported according to the volume of milk identified as available for export. Permits are issued under Class 5(d) for the volume of milk covered under planned

exports incorporated into the MSQ, as well as other exports, the total of which must fall within Canada's WTO commitment levels.

The third type of permit is issued under Class 4(m). This class is mainly used to sell surplus solids non fat for animal feed.

Further processors used the equivalent of 6.4 million hl of milk in the 2006-2007 dairy year. A total of 1,416 permits were issued this year for Classes 5(a), (b) and (c), the majority of which were Class 5(b) permits. The number of businesses participating in the program rose to 1,141 in 2006-2007, up from 1,011 in the previous year.

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. As well, the support prices serve as a reference for agencies and provincial milk marketing boards when they establish the prices paid by processors for milk.

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

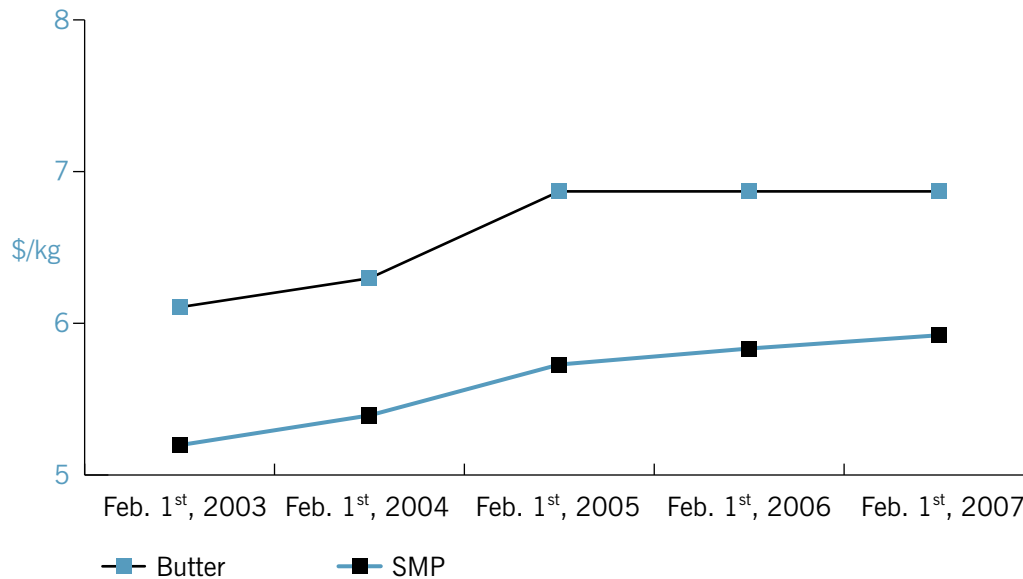
The pricing decision announced by the CDC in December 2006 was effective on February 1, 2007. The support price for skim milk powder rose from \$5.8337 to \$5.9212 per kg, and the support price of butter remained unchanged at \$6.8695 per kg. This represents an increase of 1.06% in the price of raw milk. Following advice from the industry, the Commission decided to increase only the support price of skim milk

VOLUME OF MILK SOLD (in million hl) AND PRODUCERS' AVERAGE REVENUES (\$/hl)*

Class		2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
5(a)	Volume	1.881	1.954	1.955	1.979	2.156
	Price	\$33.15	\$39.91	\$41.85	\$34.29	\$33.64
5(b)	Volume	1.042	1.872	2.088	2.274	2.662
	Price	\$35.19	\$32.86	\$36.74	\$32.48	\$31.79
5(c)	Volume	1.361	1.548	1.566	1.436	1.585
	Price	\$29.98	\$29.99	\$29.78	\$30.00	\$29.92
Total	Volume	4.284	5.374	5.609	5.689	6.403
	Price	\$32.65	\$35.10	\$37.03	\$32.64	\$31.77

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

SUPPORT PRICES FOR BUTTER AND SKIM MILK POWDER FROM 2003 TO 2007 (\$ per kg)



powder in order not to affect the fragile butter market. The assumed processor margin included in the support prices remained at \$11.00/hl. Carrying charges were increased from \$0.07/hl to \$0.10/hl.

BUTTER IMPORTS

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are 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.

This year, the Tariff Rate Quota for butter remained at 3,274 tonnes. Of this, approximately two thirds (2,000 tonnes) is specifically allocated to New Zealand.

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 supply needed to produce an innovative product is available to a successful applicant.

During the 2006-2007 dairy year, Canadian firms in Quebec, Ontario, Alberta and British Columbia used 14.9 million litres of milk under the DDPIP. In 2005-2006, the total was 12.4 million. The maximum utilization limit was established at 2% of the MSQ, which is approximately 100 million litres.

This year, the Selection Committee received 38 applications compared to 34 during the previous year. Following the trend, most applications involved new specialty cheeses. Of the 38 applications received, 25 applications met the program criteria and were accepted, 7 were rejected and 6 require additional information before a decision can be made.

DAIRY MARKETING PROGRAM

Promoting information, interaction and innovation remains the guiding objective of the Dairy Marketing Program (DMP). Through the DMP, the CDC has provided over \$166,000 in funding to dairy and food processors deemed eligible under the Direct Access and Innovation Support Funds.

Dairy marketing agents conducted approximately 110 on-site visits with dairy and food processing companies to promote CDC programs and other related programs which encourage product development and innovation. They participated in several major food industry events such as the Annual Baking Congress, the Ethnic and Specialty Foods trade show and the Canadian Health Food Association trade show. The CDC's involvement in all these initiatives helps to reinforce its efforts to promote the use of Canadian dairy products and ingredients and to attract new companies to the various programs it offers.

A new marketing initiative was implemented to encourage the manufacture of milk protein concentrates and their use in various nutraceutical products. With industry partners, the DMP is finalizing the details of three new dairy ingredients seminars

which will be offered in the fall and winter in Vancouver, Montreal and Charlottetown. The MILKingredients.ca Web site carried several new articles and essays developed by our marketing staff to promote Canadian dairy ingredients and product innovation. In the coming year, the DMP will continue to strengthen relations with nutraceutical and functional food companies and the industry associations which support them.

DOMESTIC SEASONALITY PROGRAMS

Although milk production is relatively stable throughout the year, demand for dairy products such as butter and cheese is highest in the fall and early winter months, decreasing after the Holiday period.

Domestic Seasonality Programs allow the industry to cope with the seasonal demand of dairy products. The industry has mandated the CDC to operate these programs, in cooperation with the private sector. Generally, the CDC buys and stores products when consumption is low and sells these inventories to processors when consumption rises. These transactions take place at support prices. The CDC also operates the Canadian Milk Assistance Program (CMAP), a storage assistance program for concentrated milk.

Carrying charges associated with the CDC's Domestic Seasonality Programs for butter, skim milk powder and concentrated milk totalled \$12 million in 2006-2007. In order to defray the costs associated with storing the normal levels of butter stocks, an amount is collected from consumers by the Commission through pooling arrangements and is adjusted as required to correspond to the actual costs associated with these stocks. This amount increased from \$0.07 per hl of industrial milk to \$0.10 per hl during the 2006-2007 dairy year. Costs associated with butter stocks above normal inventories or with any other products under the Domestic Seasonality Programs are covered by Canadian dairy producers.

Butter

The CDC holds a predetermined quantity of butter in storage throughout the year. The Canadian Milk Supply Management Committee (CMSMC) kept 12 million kg of butter as target stocks for the 2006-2007 dairy year. This is referred to as the normal butter inventories. These stocks are considered necessary to ensure that the domestic market has a constant supply throughout the year. In addition to the normal butter inventories, when necessary, the Commission purchases butter that is surplus in the marketplace to balance the system.

The total stocks of butter are an indicator to the industry of possible surpluses or shortages of butterfat in the marketplace. This information is used to assess whether production quotas should be adjusted and indicates the need to manage surpluses. In 2006-2007, the CDC sold the butter purchased for export resulting from the over-production of butter during the previous year.

Milk Powders

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

Concentrated Milk Assistance Program

The Concentrated Milk Assistance Program (CMAP) is used to encourage the production of evaporated and sweetened condensed milk during the period of the year when milk supply is abundant. Unlike the other Domestic Seasonality Programs where the CDC actually purchases and sells the products, the CMAP

is a financial assistance program to compensate manufacturers for the carrying charges associated with additional storage time.

Inventories

The Commission began the 2006-2007 dairy year with 19.1 million kg of butter and 18.9 million kg of skim milk powder in inventory. During the year, the CDC purchased 22.2 million kg of butter and 26.2 million kg of skim milk powder. Sales of 29.8 million kg of butter and 34.5 million kg of skim milk powder left respective closing inventories of 11.5 and 10.6 million kg as of July 31, 2007 (butter statistics include imports and butteroil).

SURPLUS REMOVAL PROGRAM

The CDC administers a Surplus Removal Program (SRP) on the industry's behalf. The program ensures that milk that is surplus to the domestic market is removed in the appropriate region and in a timely fashion. The CMSMC directs the CDC in operating the SRP. Following the evaluation of the Domestic Seasonality Programs and the Surplus Removal Program in 2005-2006, the Commission agreed to consider certain recommendations to better respond to the needs of processors.

EXPORTS

During the 2006-2007 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. During the 2006-2007 dairy year, the CDC exported 10.1 million kg of skim milk powder and 2.1 million kg of butter. This butter was excess production from 2005-2006.



In regard to cheese exports, the CDC's major responsibility is to deliver certificates to Canadian exporters that give them access to the aged cheddar market in the European Union. In 1980, Canada negotiated a special access quota with the European Union. The current access level is 4,000 tonnes, which allows Canada to continue to market its finest aged cheddar to the United Kingdom. All this volume, as well as the exports associated with the 5(d) permits issued by the CDC to trading companies amounted to 6,852 tonnes of cheese and is accounted for against Canada's export commitments to the WTO.

AUDIT

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

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

Internal Audits

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

The CDC auditors work with management in order to ensure that operations are carried out economically, efficiently and effectively. They also co-operate with the Office of the Auditor General of Canada during its annual audit by providing relevant reports and information on CDC practices.

External Audits

External audits are, in large part, performed on companies participating in the Special Milk Class Permit Program. Risk assessment is used to identify high risk companies among program participants. During the 2006-2007 dairy year, 43 companies were audited, resulting in claims of approximately \$1.5 million from companies whose usage of dairy products in the manufacture

of eligible products could not substantiate the total purchases made under permit. This money was returned to Canadian dairy producers.

The CDC establishes mandates and reviews the work contracted with professional audit firms as they review the milk plant revenues based on records maintained in each province. This provides assurance on the reliability of revenues reported to the Commission within the national pooling agreement, which shares these revenues among producers of all provinces.

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 of milk plant utilization auditors was held during the year and revisions to the National Audit Standards were approved.

The Commission also performs the milk plant utilization audits in Prince Edward Island, Nova Scotia, Newfoundland and Labrador, and Manitoba on a cost-recovery basis.

PERFORMANCE
AND GOALS



ACHIEVEMENTS FOR 2006-2007

The goals set by the Canadian Dairy Commission (CDC) for 2006-2007, along with a brief summary of the status of achievement of each goal, are described below.

Strategic Goals

GOAL 1. Provide leadership to the Canadian dairy industry

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Facilitate the creation of a national all milk pool	<ul style="list-style-type: none"> Timely pooling scenarios were provided. A process was established by the regional pools for further action. One pooling model was accepted by the CMSMC. 	<ul style="list-style-type: none"> A detailed presentation outlining market and revenue sharing scenarios was prepared by the CDC and presented to the meeting on the convergence between the P5 and the WMP on February 16, 2006. A follow-up meeting was held in May 2006 but some provinces were not prepared to join in a national all milk pool at that point. Dairy Farmers of Canada has taken over the project and the CDC has had no involvement since May 2006. 	<p>100%</p> <p>0%</p> <p>0%</p>
Encourage the harmonization of provincial dairy policies	<ul style="list-style-type: none"> The Milk Utilization Audit Standards were revised, approved by the CMSMC and issued. An automated system for milk utilization reporting was implemented in Ontario and/or other provinces. A pooled allocation model was approved by the Eastern Pool. Pooling models for transport were provided when required. A harmonized approach to the collection of pooling data was discussed in the Western Pool. 	<ul style="list-style-type: none"> Completed Ontario needs to change its billing system before implementing the software used in Quebec. The CDC is currently facilitating discussions between Quebec and Ontario to arrive at a harmonized milk allocation model. Completed Discussions took place in June and processors will present a proposal in the next dairy year. 	<p>100%</p> <p>10%</p> <p>75%</p> <p>100%</p> <p>50%</p>

GOAL 1. Provide leadership to the Canadian dairy industry (continued)

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
After consultation with the industry, adopt and implement an interim pricing methodology for the next 2 years	<ul style="list-style-type: none"> • A consultation document was prepared and circulated to stakeholders. • Consultations were held involving all dairy industry stakeholders. • The CDC communicated its decision to stakeholders. • The interim pricing methodology was implemented. 	<ul style="list-style-type: none"> • Completed • The completion of this objective was put on hold pending the outcome of the Doha round of negotiations. • On hold • On hold 	<p>100%</p> <p>0%</p> <p>0%</p> <p>0%</p>
Improve the working relationship between producers and processors	<ul style="list-style-type: none"> • Discussions were held with producers and processors on the need for a forum. • If agreeable, regular meetings have been scheduled. 	<ul style="list-style-type: none"> • Not in the CDC's hands at this point. The Minister created the Dairy Industry Working Group (DIWG). The CDC is closely monitoring the implementation of Article 28 for milk protein concentrates and the cheese standard regulations. 	<p>0%</p>
Investigate the need for a strategy on traceability and emergency planning	<ul style="list-style-type: none"> • Agriculture and Agri-Food Canada (AAFC) made a presentation to the Commission on traceability and emergency planning. • The Commission provided direction to staff to develop a strategy on traceability and emergency planning in cooperation with AAFC and CFIA. • The Western Pool revised its Disaster Plan and the P5 initiated discussions on a similar plan. 	<ul style="list-style-type: none"> • Completed. Presentations were also made to the CMSMC in October 2006. • Completed • The Western Pool held a workshop on pandemic planning. The Eastern Pool started discussions and a workshop is planned in the Maritimes in early 2008. 	<p>100%</p> <p>100%</p> <p>100%</p>

GOAL 1. Provide leadership to the Canadian dairy industry (continued)

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Facilitate the creation of a 5 to 10 year plan for the Canadian dairy industry, based on the results of the WTO Doha round of negotiations	<ul style="list-style-type: none"> • Monthly trade reports were provided to commissioners. • A report assessing the impacts for the Canadian dairy industry was provided to the Commission. • A policy discussion on planning for the future with producer and processor input was sponsored by the CDC. 	<ul style="list-style-type: none"> • Completed 	100%
		<ul style="list-style-type: none"> • The completion of this objective was put on hold pending the outcome of the Doha round of negotiations. 	0%
			0%

GOAL 2. Increase the utilization of Canadian milk components

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Improve the effectiveness of the Special Milk Class Permit Program (SMCPP)	<ul style="list-style-type: none"> • The Market Committee's current mandate was completed and recommendations were presented to the CMSMC. • The Market Committee's recommendations were approved by the CMSMC and implemented as required. • Appropriate administrative changes to the SMCPP were implemented. 	<ul style="list-style-type: none"> • A renewed mandate for the Market Committee was approved by the CMSMC in May. 	100%
		<ul style="list-style-type: none"> • CMSMC approved a new 5(c) price, inclusion of ice cream novelties in that class, and 4(a)1 pricing. 	100%
		<ul style="list-style-type: none"> • Completed 	100%
Develop further strategies for the marketing of dairy ingredients and components	<ul style="list-style-type: none"> • An internal technical group was created to develop and recommend options and strategies. • A decision was made whether or not to reconvene a meeting of the Ingredients Committee and that decision was acted on. 	<ul style="list-style-type: none"> • CDC technical staff presented options and strategies to the Market Committee and to the CMSMC for approval. Agreement to include milk protein concentrates and skim milk powder for use in nutraceutical products in class 4(a)1 was reached. 	100%
		<ul style="list-style-type: none"> • A decision was made not to reconvene the Ingredients Committee. 	100%

GOAL 3. Contribute to an increased knowledge of the Canadian dairy industry

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Improve the understanding of the Canadian dairy system	<ul style="list-style-type: none"> • Two workshops were given. 	<ul style="list-style-type: none"> • A training plan has been submitted to Directors. Workshops are scheduled to start in September 2007. 	40%
Communicate information about the Canadian dairy industry to the public	<ul style="list-style-type: none"> • Information about the relative importance of the dairy industry and some comparisons were added to the CDC Web site and the information kits. • The Chairman was listed on a speakers' bureau. • MILKingredients.ca Web site was updated. 	<ul style="list-style-type: none"> • Partially completed. Information proves difficult to find. • No speakers' bureau is interested. • Regular updates were performed. • A book on the history of the CDC was circulated to agriculture libraries. 	<p>60%</p> <p>0%</p> <p>100%</p> <p>100%</p>
Develop technical expertise in agricultural economics and policy, food science and animal science in Canada	<ul style="list-style-type: none"> • Funding agreements between the CDC and university scholarship administrators were signed. 	<ul style="list-style-type: none"> • Completed. All provinces are covered by these agreements. 	100%

Operations Goals

GOAL 4. Effectively manage human resources

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Develop and implement a succession plan	<ul style="list-style-type: none"> • A report on retiring staff was written. • Key positions were identified. • Competency profiles of key positions were developed. • A succession plan was developed. • Adequate career training was reviewed and recommended by HR Services. 	<ul style="list-style-type: none"> • Completed • Completed • Ongoing • Ongoing • Ongoing 	<p>100%</p> <p>100%</p> <p>50%</p> <p>75%</p> <p>0%</p>
Ensure HR services to CDC employees are current and effective	<ul style="list-style-type: none"> • Relevant TBS policies and guidelines were communicated to staff. • The CDC-PSMA committee made recommendations to the Directors. • An action plan on classification was developed and implemented. • A 3-year MOU for compensation and job classification was signed with AAFC. 	<ul style="list-style-type: none"> • Ongoing • All CDC employees completed the course offered by AAFC on conflict management. The CDC signed a MOU with AAFC for Conflict Resolution. • The Plan is completed and the Canada Public Service Agency was notified. • The CDC ran a competitive process and signed a 3-year MOU with a classification consultant. A CDC Classification Committee was created. • Ongoing 	<p>100%</p> <p>100%</p> <p>100%</p> <p>100%</p> <p>25%</p>
Promote a learning culture	<ul style="list-style-type: none"> • Agreed training plans were included in performance evaluations for all employees. • 9 team presentations were made. • 5 dairy industry updates were given by the Chairperson or CEO to staff. 	<ul style="list-style-type: none"> • Overall training budget still under-utilized • 8 presentations made in total. 4 in the 2006-2007 dairy year • Completed 	<p>75%</p> <p>50%</p> <p>100%</p>

GOAL 5. Maximize the efficiency of CDC operations and services

OBJECTIVES	PERFORMANCE INDICATORS FOR 2006-2007	RESULTS	PERCENTAGE COMPLETE
Document practices and procedures	<ul style="list-style-type: none"> • Responsible coordinators in each section were identified. • Key functions and activities were identified. • Assessment of the current situation was completed. • An execution plan which included timelines was developed. • Practices and procedures were documented and centralized. 	<ul style="list-style-type: none"> • Completed • Completed • Completed • Completed • Ongoing. 242 procedures have been started or completed. 62 have been translated. Completion is on pace to have all procedures completed by December 31, 2007. 	<p>100%</p> <p>100%</p> <p>100%</p> <p>100%</p> <p>80%</p>
Implement an integrated risk management framework	<ul style="list-style-type: none"> • A training session on risk management was offered to Managers, Directors and Commissioners. • A facilitated workshop was held to identify risks within each section. • A draft document on integrated risk management was circulated to Senior Management. 	<ul style="list-style-type: none"> • Completed • This work was done by a sub-committee. • A final plan was adopted by Commissioners. The Plan was reviewed and updated by CDC management in January 2007. 	<p>100%</p> <p>100%</p> <p>100%</p>
Automate and streamline internal and external reports	<ul style="list-style-type: none"> • A review of activities was completed. • A list of tasks to be automated was established and prioritized. • 5 reporting tasks were automated. 	<ul style="list-style-type: none"> • Review of financial and operational activities is completed. • Completed • 8 financial reports on inventory completed. Most CMSMC reports completed. 	<p>100%</p> <p>100%</p> <p>100%</p>

OUTLOOK

World Trade Organization Negotiations

For several years now, the Canadian dairy industry has been waiting to see what would be the impact of a new agreement on agriculture at the World Trade Organization (WTO). The delays in achieving an agreement and the suspension of negotiations in the summer of 2006 have prolonged the general climate of uncertainty in the industry. Although talks resumed last January, the outcome of the negotiations remains unknown.

Traditionally the role of the CDC has been to buy surplus products and dispose of them on markets such as the export market or on low return markets such as animal feed. Dairy producers receive the lower returns associated with this Surplus Removal Program. For that reason, it is necessary to continue to seek other markets for solids non fat and pursue policies to decrease the ratio of solids non fat to butterfat in milk at the farm level. Unfortunately, any increase in the imports of products such as milk protein concentrates and milk protein isolates negates the efforts that are made domestically to curb the surplus of milk solids non fat.

In the meantime, the CDC is working on trying to harmonize dairy policies across the country, the ultimate goal being to create a national all milk pool. This would result in a more level playing field for both producers and processors and a more adaptable industry.

Furthermore, the CDC believes that, in order to prepare for the changes ahead, it is important that the current players of the industry understand better how it works.

Demand for Dairy Products

Since the beginning of the 2006-2007 dairy year, demand for dairy products has stopped declining and has shown a modest and steady increase. Since part of the CDC's mandate is to ensure that Canadian consumers have access to an adequate supply of dairy products, the organization will encourage the industry to implement policies that are adapted to this growth. The CDC recommended to the industry that a temporary growth allowance of 1% be added to the national quota for industrial milk. The CMSMC agreed to implement this allowance until the end of the dairy year (July 31st).



Divergence between producers and processors

As international market pressures increase on the Canadian dairy industry, a schism remains between producers and processors. This could have negative consequences on the industry because these two sectors need to work together constantly on sensitive issues. This underpins the need for an increased leadership role for the CDC as it is perceived by both sides to be a neutral and knowledgeable facilitator.

Accountability

Inside government, the trend towards more rigorous accountability continues. Measures

put in place by the CDC, such as risk management and learning policies, mean that our workforce will better adapt to the new challenges of working in the public service. These initiatives must continue.

In addition, since April 27, 2007, the Commission implemented a new governance structure, following the changes that the *Federal Accountability Act* brought to the *CDC Act*. The meetings of the Commission are now focussed on governance issues. Audit Committee meetings are held quarterly to receive the financial statements, monitor administrative expenses versus the budget, and be apprised of internal audit and program activities. Executive summaries of

final reports and progress on the audit plan are provided to the Audit Committee. Operation and management issues, as well as issues related to the industry, are dealt with by the CEO and the Senior Management Team, who hold meetings every two weeks. The CDC's Internal Audit/Program Evaluation Advisory Committee continues to approve the audit and program evaluation plans and monitor progress and results.

GOALS FOR THE PERIOD 2007-2008 TO 2011-2012

The following goals are derived from the above outlook on the industry and its forecasted impact on the CDC.

Strategic Goals

GOAL 1. The Canadian dairy industry is in a position to successfully adapt to change

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008
An active negotiation on harmonization issues in preparation for a national pool negotiation (revenue and market sharing).	<ul style="list-style-type: none"> • A milk allocation agreement between Quebec and Ontario • An agreement on Class 1 pricing and other policies in the West • Negotiations for Newfoundland and Labrador to join the Eastern Milk Pool have resumed • A motion from CMSMC to develop a national pool model
An active and ongoing industry discussion on the future of pricing is underway.	<ul style="list-style-type: none"> • Stakeholders have agreed to participate in a taskforce on pricing
The CDC is prepared to deal with a completed Doha Round.	<ul style="list-style-type: none"> • Trade reports to the Commission are timely • Regular meetings are held with AAFC's Chief Trade Negotiator • Impacts of the new trade rules have been evaluated as needed
Knowledge of the Canadian dairy industry is enhanced.	<ul style="list-style-type: none"> • Two orientation sessions were offered to decision makers and two workshops were offered to technical advisors

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008
A renewed strategy to encourage the use of Canadian dairy ingredients has been agreed at CMSMC.	<ul style="list-style-type: none"> • Revised terms of reference for the Market Committee have been approved by the CMSMC • A renewed strategy has been approved by CMSMC • An increased utilization of Canadian milk protein concentrates and milk protein isolates
New marketing initiatives for the restaurant and food services sectors.	<ul style="list-style-type: none"> • A report containing recommendations was presented to CMSMC
An adequate supply of cream across Canada.	<ul style="list-style-type: none"> • Supply of cream is properly matched to demand throughout the year

Operations Goals

GOAL 3. The CDC as an organization adapts successfully to change

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008
Tools are in place to support a continuous learning environment.	<ul style="list-style-type: none"> • More resources are spent on professional development • Positive feedback from employees
The new governance structure is functioning effectively.	<ul style="list-style-type: none"> • Regular Commission meetings are held and decisions are made promptly • Monthly Senior Management Team meetings • Regular CEO reports on management and operations are presented to the Commission • A new delegation of authority has been adopted • Healthy working atmosphere
CDC practices and procedures are completely documented and regularly updated.	<ul style="list-style-type: none"> • Procedures are 100% documented and current

GOAL 3. The CDC as an organization adapts successfully to change (continued)

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008
Succession planning is complete.	<ul style="list-style-type: none">• Competency profiles are written• Potential candidates are identified• Professional development plans are in place
A CDC that is more attractive to potential employees.	<ul style="list-style-type: none">• Hire on first competition• Candidates accept offers
The human resources of the CDC are used efficiently.	<ul style="list-style-type: none">• Reviews of documents and attendance have been conducted and proposals presented to relevant committees



FINANCIAL
REPORT



MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the year ending July 31, 2007 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

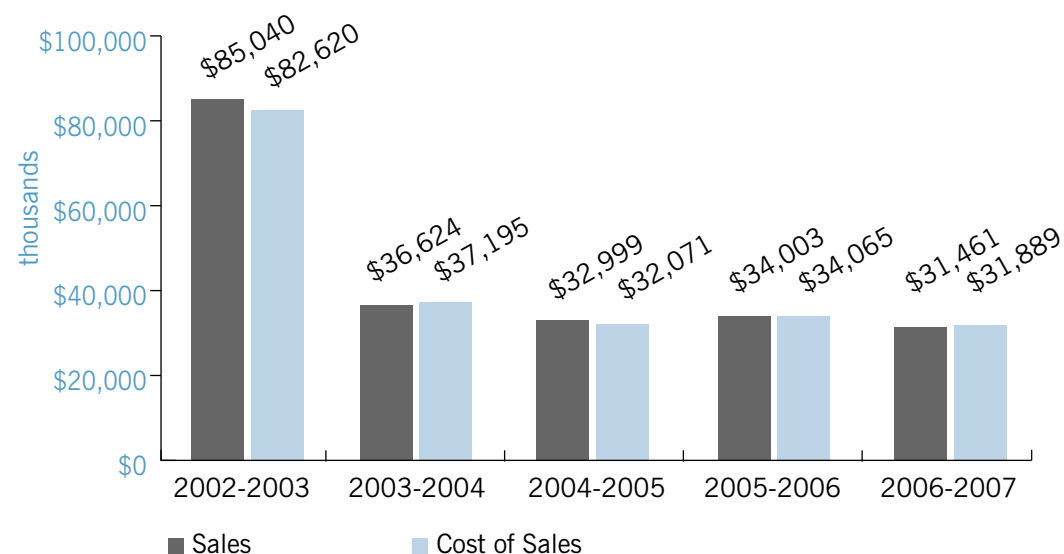
Sales

Overall export sales revenue fell slightly in relation to the previous dairy year. Butter sales for the year finished at 2,346 tonnes for revenues of \$4.7 million compared to

4,093 tonnes with revenues of \$8.8 million for last dairy year. While the need to reduce excess stocks of butter for 2005-2006 resulted in higher export sale, this year's volume was comprised of the surplus butter generated the previous year as there was no surplus butter purchased in 2006-2007.

Skim milk powder sales quantities amounted to 10,013 tonnes which is slightly less than the previous year's results of 10,041 tonnes. However, despite the stronger Canadian dollar, revenues were up due to better unit sale's prices translating into revenues for the year of \$26.7 million versus \$25.2 million for 2005-2006.

EXPORT ACTIVITIES



Cost of sales

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

For the dairy year ending July 31, 2007 cost of sales for export totalled \$31.9 million, corresponding to sale values of \$31.5 million. This small loss was compensated by important profits generated from domestic activities.

Domestic activities

Sales

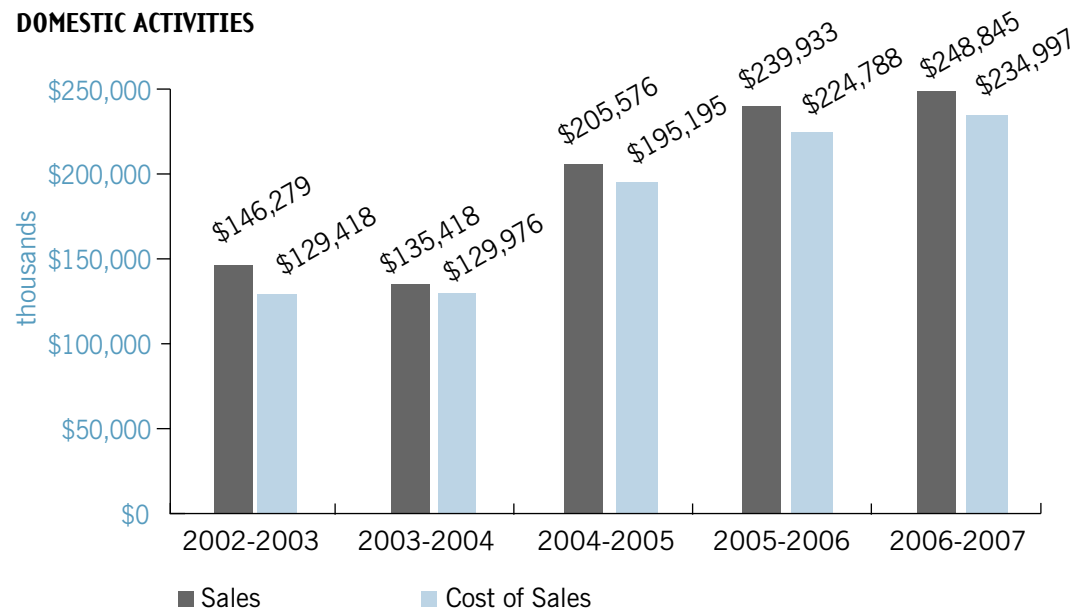
Total revenue from domestic sales increased by \$8.9 million or 3.7% over the 2005-2006 dairy year. The largest contributors to the increase in both volume and revenues were Plan A butter and Plan B skim milk powder. Plan A sales went from 1,425 tonnes in 2005-2006 to 3,461 tonnes in 2006-2007. The increase in domestic demand, coupled with the CDC reaching its WTO export limits, required that butter that was originally purchased for the export market be sold domestically. This butter, which was purchased at the world price and was subsequently sold at the domestic price, produced a significant profit as compared to the normal sales pattern for Plan A butter i.e.: purchased and sold at support price.

The CDC purchases Plan B skim milk powder (SMP) from processors with the requirement that processors purchase the product back within a year. Usually, the purchases occur during the spring and summer, when milk consumption is at its lowest and the product is repurchased by processors in the fall, when milk consumption is high. Sales to the CDC are determined by the quantity of product that processors

expect to have to supply to their customers in the fall. This year there was a greater demand for SMP in the fall which resulted in greater purchases of Plan B SMP by the CDC in the spring and summer with subsequent sales back to processors. The year over year increase of 3,279 tonnes of Plan B skim milk powder sold at the support price increased revenues for this product by \$19.5 million. However, this increase in sales had little effect on net income because purchase and resale of the product were made at support price.

Skim milk powder sold to the animal feed industry decreased from 25,141 tonnes in 2005-2006 to 17,468 tonnes in 2006-2007. The previous year was exceptional in that surplus production resulted in greater purchases of 4(m) skim milk powder which was eventually sold at very favourable prices to animal feed manufacturers. This year, increased demand for solids non-fat in the domestic market reduced the quantity of surplus skim milk powder purchased in class 4(m). This trend should continue as the industry finds new markets for skim milk solids. Purchase costs as well as sales prices

DOMESTIC ACTIVITIES



in this category were stronger this year as the shortage of skim milk powder on the world market coupled with an increase in the price of skim milk powder substitutes for animal feed drove up prices.

Cost of sales

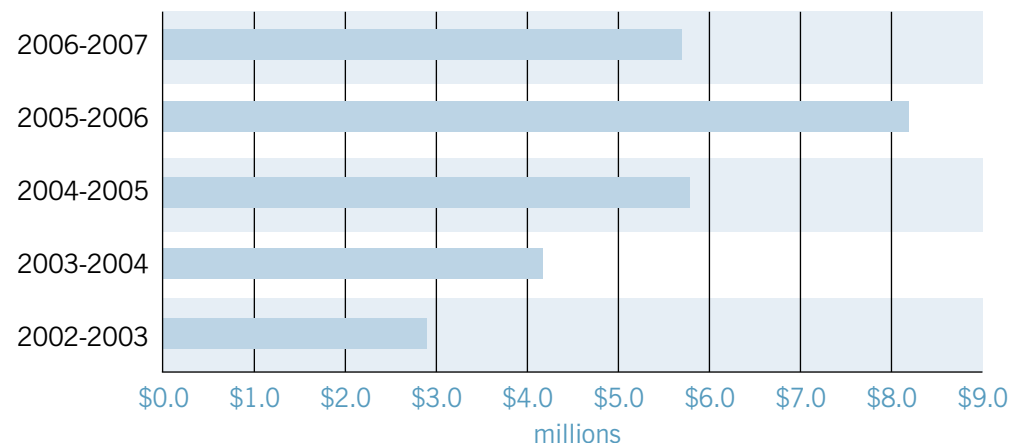
Canada continued to fulfill its obligation under the WTO agreement to import 3,274 tonnes of butter each dairy year. The Commission has been allocated this import quota since 1995. This butter is purchased at prevailing world prices and is directed to the further processing sector through butter manufacturers.

Cost of goods sold for Plan B butter and Plan B skim milk powder matched closely the sales prices during the year as these products are purchased and sold at the prevailing support prices. As mentioned in the Sales section, cost of goods sold as Plan A butter was significantly lower than the sale price due to the fact that a quantity of butter previously purchased for the export market was converted and sold on the domestic market at support price. The other cost of sales item is skim milk powder purchased in class 4(m) as mentioned above.

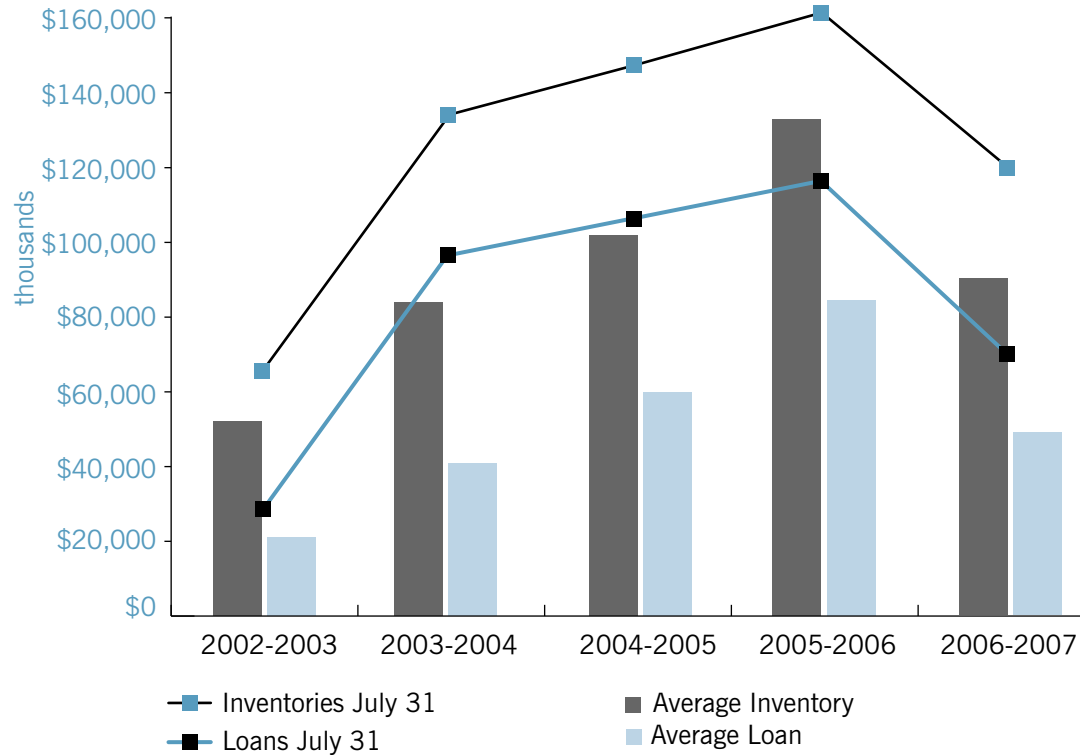
Carrying charges

Two major components in carrying charges are storage costs for inventory and interest expense on the loan from the Government of Canada. As a direct result of lower inventory levels during the year, carrying charges went from \$8.2 million for 2005-2006 to \$5.7 million for 2006-2007. This reduction in average inventory levels directly impacted interest costs on loans from the Government of Canada. Even though interest rates increased during the year from a July 31, 2006 rate of 3.77% to a July 31, 2007 rate of 4.57%, overall interest cost declined from \$2.90 million for 2005-2006 to \$2.28 million for 2006-2007.

CARRYING CHARGES



INVENTORIES AND LOANS FROM THE GOVERNMENT OF CANADA



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.

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 carrying out business only with credit worthy customers. Other strategies include selling product on a "payment first"

basis, securing of bank guarantees and obtaining letters of credit.

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 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, WTO developments, 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 developments that may affect its operations. Recent initiatives to manage internal risk include the creation of an employee succession plan and writing of procedures to assist in maintaining corporate memory and to help ensure continuity of operations.

Administrative expenses

Administrative expenses for the year totalled \$6.9 million. Salaries and employee benefit plans of \$5.2 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

Since April 1st, 2007, for the sake of transparency, the CDC administrative expenses include expenses that are recoverable from the milk pools or commercial operations. A major part of these expenses are the ones associated with the Dairy Marketing Plan, which total approximately \$566,000. The effect of this decision will be more noticeable in the 2007-2008 dairy year.

Challenges for the future

Market developments that may affect the financial results of the Canadian Dairy Commission include rising world prices for dairy products as a result of global shortages and the continued strengthening of the Canadian dollar. However, since losses are covered by Canadian milk producers, there is no risk for the Government of Canada.

In the longer term, world trade talks could have an influence on the financial performance of the CDC. New international trade deals may further limit the ability of the CDC to export surplus dairy products and could also allow a greater quantity of foreign dairy

products into Canada. Although these outcomes would have a serious impact on the dairy industry, their effect on the CDC's financial results would likely be minor. If a new trade agreement was to be signed, it would probably include an implementation period that would allow the CDC to prepare for the new trade rules.

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 judgements where appropriate. Financial information presented elsewhere in the Annual Report is consistent with the statements provided.

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

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

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



John Core, CEO



Gaëtan Paquette, Senior Director,
Finance and Operations

Ottawa, Canada
September 14, 2007

AUDITOR'S REPORT

To the Minister of Agriculture and Agri-Food

I have audited the balance sheet of the Canadian Dairy Commission as at July 31, 2007, and the statements of operations and surplus and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at July 31, 2007 and the results of its operations and its cash flows for the year then

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

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

A handwritten signature in black ink, appearing to read 'Dale Shier', with a stylized flourish at the end.

Dale Shier, CA

Principal
for the Auditor General of Canada

Ottawa, Canada
September 14, 2007

BALANCE SHEETas at July 31
(in thousands)

	2007	2006
Assets		
Cash	\$ 392	\$ 53
Accounts receivable		
Due from provincial milk boards and agencies (pooling)	29,037	20,045
Trade	180	1,491
Inventories (Note 3)	118,471	159,942
	<u>\$148,080</u>	<u>\$181,531</u>
Liabilities		
Bank indebtedness - pooling account (Note 4)	\$ 959	\$ 1,549
Accounts payable and accrued liabilities		
Due to provincial milk boards and agencies (pooling)	26,828	17,077
Trade	16,795	9,186
Provision for margin payable to provincial milk boards and agencies (operational surplus)	8,370	8,506
Other liabilities	1,924	2,511
Loans from the Government of Canada (Note 5)	70,178	116,739
	<u>125,054</u>	<u>155,568</u>
Surplus (Note 6)	23,026	25,963
	<u>\$148,080</u>	<u>\$181,531</u>

Commitments (Note 11)

Approved:



Chief Executive Officer



Chairman



Senior Director, Finance and Operations

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

STATEMENT OF OPERATIONS AND SURPLUS

for the year ended July 31
(in thousands)

	2007	2006
Sales and cost of sales		
Domestic sales	\$248,845	\$239,933
Cost of sales	234,997	224,788
Margin on domestic sales	13,848	15,145
Export sales (Note 7)	31,461	34,003
Cost of sales	31,889	34,065
Loss on export sales	(428)	(62)
Total margin on sales	13,420	15,083
Pooling of market returns activities		
Contributions from provincial milk boards and agencies	136,212	115,046
Equalization payments to provincial milk boards and agencies	129,612	107,182
Contributions withheld to fund operating expenses	6,600	7,864
Provision for margin payable to provincial milk boards and agencies (operational surplus)	8,370	8,506
Results before net operating expenses	11,650	14,441
Operating expenses (Schedule of Operations by Product)	18,691	17,664
less: funding of administrative expenses by the Government of Canada (Note 8)	4,104	3,572
Net operating expenses after funding by the Government of Canada	14,587	14,092
Results of operations after funding by the Government of Canada	(2,937)	349
Surplus at beginning of year	25,963	25,614
Surplus at end of year	<u>\$ 23,026</u>	<u>\$ 25,963</u>

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

STATEMENT OF CASH FLOWS

for the year ended July 31

(in thousands)

	2007	2006
Cash flows from operating activities		
Cash receipts from customers	\$281,675	\$274,715
Cash paid to suppliers and others	(234,164)	(291,293)
Cash receipts from provincial milk boards and agencies (pooling)	127,220	119,638
Cash paid to provincial milk boards and agencies (pooling)	(119,861)	(111,904)
Cash paid to provincial milk boards and agencies (operational surplus)	(8,506)	(3,568)
Cash receipts from the Government of Canada	4,104	3,672
Interest paid on loans	(2,978)	(2,209)
Cash flows from (used in) operating activities	47,490	(10,949)
Cash flows from financing activities		
New loans from the Government of Canada	124,278	161,547
Loan repayments to the Government of Canada	(170,839)	(150,934)
Cash flows from (used in) financing activities	(46,561)	10,613
Net increase (decrease) in cash	929	(336)
Net bank indebtedness at beginning of year	(1,496)	(1,160)
Net bank indebtedness at end of year	\$ (567)	\$ (1,496)
 Components:		
Cash	\$ 392	\$ 53
Bank indebtedness - pooling account	(959)	(1,549)
	\$ (567)	\$ (1,496)

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

NOTES TO FINANCIAL STATEMENTS

July 31, 2007

1. The Commission

The Canadian Dairy Commission (the "Commission") is an agent Crown corporation named in Part I, Schedule III 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, 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 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. Accordingly, 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 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

Inventories

Inventories are valued at the lower of cost or estimated net realizable value. Cost is determined on a first-in, first-out basis.

Revenues

Revenues from sales of product are recognized upon shipment.

Cost of sales

Goods purchased by the Commission for export sales are purchased at prices established by the Commission.

Pooling of market returns activities

Contributions from provincial milk boards and agencies and equalization payments to provincial milk boards and agencies represent a redistribution of milk revenues among provinces. A portion is withheld from the distributions to fund operating expenses.

Foreign currency translation

Most sales and purchases in foreign currencies are hedged by forward exchange contracts and are translated into Canadian dollars at the exchange rates provided therein. To be accounted for as a hedge, a forward exchange contract must be designated and documented as a hedge, and must be effective at inception and on an ongoing basis. If the hedge

criteria were not met, the forward exchange contracts would be accounted for on the balance sheet at fair value, with the initial fair value and subsequent changes in fair value recorded in earnings in the period of change. The Commission's forward exchange contracts are hedges and are therefore not recognized in the balance sheet but are only disclosed in Note 10.

Some of the trade accounts receivable are in foreign currencies and their Canadian dollar value has been determined using the rate to be paid under forward exchange contracts for those being hedged, as further explained in Note 10, or at the rate of exchange at year end.

Sales and purchases in foreign currencies that are not hedged are translated into Canadian dollars at the exchange rate in effect on the transaction date. Foreign currency gains and losses are included in the operating results of the year in which they occurred.

Derivative financial instruments

The Commission uses derivative financial instruments such as forward contracts to hedge 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 free-standing derivative financial instruments for trading or speculative purposes.

All designated hedges are formally documented as to the Commission's risk objective and strategy, the specific item being hedged, and the method in which effectiveness is measured. The settlement method of accounting is used by the Commission to account for its hedges.

Under the settlement method, gains and losses on hedges are deferred and recognized in the period of settlement as a component of the related transaction. In order to determine the effectiveness at offsetting changes in cash flow of the hedged item, the Commission assesses both at inception and over the term of the hedging relationship, whether the critical terms of the hedge and hedged item match or the cumulative change in fair value of the hedge and hedged item remain within an acceptable range. If a hedge ceases to be effective or is terminated, hedge accounting is discontinued.

Employee future benefits

Pension benefits

All eligible employees participate in the Public Service Pension Plan administered by the Government of Canada. The Commission's contributions reflect the full cost as employer. This amount is currently based on a multiple of an employee's required contributions and may change over time depending on the experience of the Plan. The Commission's contributions are expensed during the year in which the services are rendered and represent the total pension obligation of the Commission. The Commission is not required under present legislation to make contributions with respect to actuarial deficiencies of the Public Service Pension 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 earned by employees is calculated by management and is comparable to the results that would have been derived using the actuarially determined liability for employee severance benefits for the Government as a whole.

Other future benefit plans

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

Capital assets

All acquisitions less than \$10,000 are expensed in the year incurred.

Scholarships Program

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

Measurement uncertainty

The preparation of financial statements in accordance with Canadian generally accepted accounting principles 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 is the most significant item 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 changes

In January 2005 the Canadian Institute of Chartered Accountants (CICA) issued the following three accounting standards that will impact the Commission:

Section 3855 – Financial Instruments – Recognition and Measurement – This standard establishes criteria for the recognition, derecognition, measurement and classification of financial instruments. The Commission will be required to categorize its financial assets as held for trading, held to maturity, available for sale, or as loans and receivables. The related accounting treatment will be dependent on the classification. Financial assets categorized as held for trading or available for sale are to be measured at fair value while financial assets held to maturity, and loans and receivables are to be measured at amortized cost. Unrealized gains and losses for available-for-sale assets will be recognized in other comprehensive income.

Section 1530 – Comprehensive Income – This standard requires certain gains and losses such as those arising from the valuation of financial instruments that would otherwise be recorded as part of net income, be presented in other comprehensive income until such time as it is considered appropriate for them to be

recognized in net income. A new financial statement entitled Comprehensive Income may be required in order to record such amounts until they are realized.

Section 3865 – Hedges – Derivatives will be classified as held for trading unless designated as hedging instruments. All derivatives will be measured at fair value. For derivatives that hedge the changes in the fair value of an asset or liability, changes in the derivatives' fair value will be reported in the net income and offset by changes in the fair value of the hedged asset or liability. For derivatives that hedge variability in cash flows, the effective portion of changes in the derivatives' fair value will be initially recognized in other comprehensive income, and will subsequently be reclassified to net income in the periods affected by the variability in the cash flows of the hedged item.

These new standards will come into effect for the Commission's 2008 fiscal year, however early adoption provisions exist. The Commission is in the process of determining the impact that these standards will have on its financial reporting.

3. Inventories

	2007	2006
	(in thousands)	
Butter	\$ 78,432	\$ 111,613
Skim milk powder	40,039	48,329
Total	\$ 118,471	\$ 159,942

The Commission's inventory includes 11,223 tonnes of butter and 2,744 tonnes of skim milk powder (2006 – 12,983 tonnes and 4,668 tonnes) with a total cost of \$77.24 million and \$16.18 million respectively (2006 – \$89.40 million and \$27.20 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.

The balance of the inventory is comprised of 254 tonnes of butter and 7,868 tonnes of skim milk powder (2006 – 6,075 tonnes and 14,274 tonnes) with a total cost of \$1.19 million and \$23.86 million respectively (2006 – \$22.21 million and \$21.13 million).

4. Bank indebtedness – Pooling account

To provide bridge financing and ensure the efficient operation of the pricing and pooling of market returns system, the Commission established a \$5 million (2006 – \$5 million) 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. The bank indebtedness incurred under this line of credit is due on demand and bears interest at prime which on July 31, 2007 was 6.25% per annum.

5. Loans from the Government of Canada

Loans from the Government of Canada, to a maximum of \$120 million (2006 – \$120 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 is at the normal rates established for Crown corporations by the government and varied from 3.80% to 4.57% (2006 – 2.59% to 3.77%) during the year and totaled \$2.28 million (2006 – \$2.90 million).

6. Surplus

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 Surplus. The surplus 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.

7. Export sales

Export sales include \$17,000 representing net losses (2006 – net gains of \$30,000) arising from currency translation relating to transactions incurred in foreign currencies.

8. 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. The

Government of Canada has funded \$3.88 million (2006 – \$3.52 million) of the Commission's administrative expenses of \$6.85 million (2006 – \$6.63 million), as well as \$225,000 (2006 – \$50,000) for professional services relating to costs of production data collection.

9. Employee future benefits

Pension Plan

The Commission and all eligible employees contribute to the Public Service Pension Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. Operating expenses include the Commission's contributions to the Public Service Pension Plan during the year totaling \$521,000 (2006 – \$540,000), which corresponds to about 2.14 times (2006 – 2.14 times) the employees' contributions to the Plan.

Severance benefits

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

Information about the plan, measured as at the balance sheet date, is as follows:

	2007	2006
	(in thousands)	
Accrued benefit obligation, beginning of year	\$ 802	\$ 820
Cost for the year	90	105
Benefits paid during the year	(170)	(123)
Accrued benefit obligation, end of year	<u>\$ 722</u>	<u>\$ 802</u>

The severance benefit liability is included on the Balance Sheet in Other liabilities.

10. Financial instruments

Forward exchange contracts

As part of its foreign exchange risk management, the Commission enters into forward exchange contracts with regard to its export sales contracts and purchase contracts requiring settlement in foreign currencies. The primary risk to the Commission when

entering into foreign exchange contracts is represented by credit risk, wherein the counterparty fails to perform an obligation as agreed upon causing a financial loss. The Commission manages its exposure to credit risk by contracting only with creditworthy counterparties. All of the Commission's foreign exchange contracts are with major Canadian financial institutions.

At the end of the year, the notional value of the Commission's outstanding forward exchange contracts totaled \$19.14 million Canadian equivalent (2006 – \$3.55 million Canadian equivalent). These contracts will mature over the period ending December 2007. 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 and when settlement is due for purchases in foreign currencies. The Commission's forward exchange contracts as at July 31, 2007 are as follows:

		(in thousands)	
Currency sold	Currency purchased	In USD	In Canadian
U.S. dollars	Canadian dollars	18,114	19,141
Total		18,114	19,141

Due to the proximity of the settlement dates of the forward exchange contracts to July 31, 2007, fair value approximations are immaterial.

Other financial instruments

The carrying amounts of the accounts receivable, bank indebtedness, accounts payable and accrued liabilities and loans from the Government of Canada approximate their fair values because of the short-term to maturity.

11. Commitments

Purchase commitments

As at July 31, 2007, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately \$3.64 million (2006 – \$5.27 million). Most of these commitments are in foreign currencies and are covered by forward exchange contracts.

Long term lease

The Commission is committed under a long term lease with Agriculture and Agri-Food Canada for office accommodation ending in 2012. The lease contains escalation clauses regarding maintenance costs and taxes. This lease may be automatically renewed at the Commission's option for another period of 5 years with rates possibly revised in order to reflect the rental market value pursuant to Treasury Board's Policy on Real Property.

The remaining minimum lease payments totaled \$1.45 million at year-end. For 2011-2012 the rent is for 8 months as the lease term ends March 31.

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

2007-2008	\$0.31 million
2008-2009	\$0.31 million
2009-2010	\$0.31 million
2010-2011	\$0.31 million
2011-2012	\$0.21 million

Promotional funding

The Commission has entered into agreements to promote the sale of fluid milk. Under the terms of the agreement the Commission will contribute up to \$4 million per calendar year for the years 2006, 2007 and 2008. As at July 31, 2007 a total of \$1.60 million has been contributed.

12. 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, totaled about \$1.61 million during the year (2006 – \$1.51 million).

SCHEDULE OF OPERATIONS BY PRODUCT

for the year ended July 31
(in thousands)

	2007				2006			
	Butter	Skim Milk Powder	Other Products*	Total	Butter	Skim Milk Powder	Other Products*	Total
Sales and cost of sales								
Domestic sales	\$ 177,343	\$ 71,502	\$ -	\$ 248,845	\$ 180,248	\$ 59,685	\$ -	\$ 239,933
Cost of sales	166,795	68,202	-	234,997	174,329	50,459	-	224,788
Margin on domestic sales	10,548	3,300	-	13,848	5,919	9,226	-	15,145
Export sales	4,735	26,726	-	31,461	8,848	25,155	-	34,003
Cost of sales	4,749	27,140	-	31,889	8,547	25,518	-	34,065
Margin (loss) on export sales	(14)	(414)	-	(428)	301	(363)	-	(62)
Total margin on sales	\$ 10,534	\$ 2,886	\$ -	\$ 13,420	\$ 6,220	\$ 8,863	\$ -	\$ 15,083
Operating expenses								
Storage costs	\$ 2,048	\$ 838	\$ -	\$ 2,886	\$ 3,256	\$ 1,204	\$ -	\$ 4,460
Interest expense	2,096	181	-	2,277	2,694	204	-	2,898
Other carrying charges	333	178	-	511	634	205	-	839
Scholarships	3,000	-	-	3,000	-	-	-	-
Projects and promotional activities	1,981	-	135	2,116	1,376	-	140	1,516
Domestic dairy product assistance	-	-	64	64	-	-	306	306
	\$ 9,458	\$ 1,197	\$ 199	10,854	\$ 7,960	\$ 1,613	\$ 446	10,019
Administrative expenses								
Salaries and employee benefits				5,236				5,144
Other expenses				1,619				1,491
				6,855				6,635
Cost of production studies, interest and bank charges related to operation of the pooling of the market returns system				982				988
Donation				-				22
Total operating expenses				\$ 18,691				\$ 17,664

*Includes whole milk powder, concentrated milk and cheese

APPENDICES



APPENDIX I

HARMONIZED MILK CLASSIFICATION SYSTEM

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

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

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

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

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

⁴ Pricing and Administration

- i. Provincial boards or agencies will set the butterfat price for class 4(a)1 at the 4(a) price and will set the price for protein and other solids for class 4(a)1 at the price established by the CMSMC on a semi-annual basis (August 1st and February 1st)
- ii. CDC will receive the milk utilisation declaration from the provincial boards and agencies on a monthly basis for pooling of revenue purposes. Provinces agree that the revenues from class 4(a) will be pooled at the P10 level.
- iii. Audit of Class 4(a)1 will be performed by the usual organizations responsible for performing that task in the provinces. In the case of interprovincial movement of product, the CDC will coordinate the audit and supporting information with provincial auditors. The processor receiving the raw milk used to make rennet casein (dry or curd) or MPC under Class 4(a)1 will be responsible for providing documentation which supports the claim that the components were utilized in the manufacture of non-standardized final products in the processed cheese category. Participating provinces will undertake to implement the proper audit procedures to ensure compliance within this class.
- iv. Class 4(a)1 will be renewed upon successful review and approval of the CMSMC by February 1, 2008.

⁵ Losses: Explained losses (dumps, fluid returns, dead vats, etc.) Unexplained losses: Up to 2% for processing (West only).

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

APPENDIX 2

GLOSSARY

Canadian Milk Supply

Management Committee (CMSMC)

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

Canadian Requirements

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

Dairy Producers

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

Dairy Year

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

Domestic Requirements

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

Further Processors

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



Industrial Milk

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

Market Sharing Quota (MSQ)

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

Milk Class

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

National Milk Marketing Plan

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

Processors

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

Supply Management

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

Structural Surplus

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

Support Prices

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