Canadian Dairy Commission
Commission canadienne du lait

CANADIAN DAIRY COMMISSION

ANNUAL REPORT

07
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Canada

MANDATE OF THE CANADIAN DAIRY COMMISSION

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

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

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

Values
Integrity, leadership, respect and dignity, professionalism.

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

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LETTER TO THE MINISTER

Mister Minister,

I am pleased to submit the Canadian Dairy Commission's Annual Report for the 2007-2008 dairy year. As we conclude the year, the Canadian Dairy Commission (CDC) is in sound financial position and close to achieving most of the objectives it had set for itself. Some of these objectives were not reached either because the industry was not ready to move forward on some issues, or because circumstances required a change in direction. Overall, the CDC continued to help the Canadian dairy industry and its stakeholders respond positively to the many challenges that arise.

On the world stage, prices for products such as skim milk powder continued to be strong. As a result, prices in the milk classes that follow world or US prices have provided Canadian dairy producers with higher revenues. In addition, this increase in world prices enabled Canada to export a larger quantity of surplus milk powder while respecting the limits imposed by the World Trade Organization (WTO).

Although the WTO ministerial conference of July 2008 failed to agree on the modalities of a new trade agreement, the possibility of a new WTO deal continues to create uncertainties for the Canadian dairy industry. Better harmonization of dairy policies remains the best way to prepare for any outcome. Quebec and Ontario, under the auspices of the Canadian Dairy Commission, continued to discuss the harmonization of milk allocation to dairy plants on their respective territories. Other policies that are considered for harmonization are fluid milk pricing in the Western provinces and the audit of milk utilization in dairy plants.

Demand for dairy products rose during the first half of 2007-2008. To meet this demand and replenish CDC butter stocks, industrial milk production increased to 50.6 million hl compared to 48.6 million hl a year earlier. Despite past measures to restrict the structural surplus of skim milk powder, increased milk production contributed to a structural surplus of solids non fat of 85,400 tonnes. At the end of the dairy year, approximately 27,500 tonnes remained to be marketed in the coming dairy year.

Last December, the CDC announced an increase in the support prices of skim milk powder and butter. This 0.98% increase was equivalent to 0.70 cent per litre of milk leaving the farm and became effective on February 1, 2008. Because of rapidly increasing feed, fertilizer and fuel costs, the Commission announced another increase for September 1, 2008. This increase was 1.45 cent per litre or 2%.

Throughout the year, the CDC maintained excellent working relationships with the stakeholders of the industry. I am pleased to report that the CDC is contributing $300 to each dairy producer who completes the validation process leading to certification under Dairy Farmers of Canada's Canadian Quality Milk Program. This will increase producers' participation in the program thereby helping ensure consumers receive the highest quality Canadian dairy products.

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

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

Randy Williamson
Chairman

THE CANADIAN DAIRY INDUSTRY

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

KEY HIGHLIGHTS OF 2007-2008

- The Canadian Dairy Commission (CDC) held its first public annual meeting in Ottawa on January 23, 2008.
- Discussions continued between Quebec and Ontario to harmonize the allocation of milk to processing plants.
- The Canadian Milk Supply Management Committee (CMSMC) took steps to reduce the farm gate price gap between the East and the West of the country for milk in classes 2 (ice cream, yogurt, etc.) and 3(a) (some cheeses).*
- Following a 1% increase on February 1, 2008, and because of the exceptional rise in farm costs, the CDC announced a 2% increase in support prices which took effect on September 1, 2008.

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

- The CMSMC decided to extend class 4(a)1 (rennet casein in non-standardized processed cheese, weight/muscle gain formulations, meal replacement products, medical and sports recovery drinks and infant food formulations) until January 31, 2011.
- At the beginning of the dairy year, a growth allowance was added to the industrial milk quota. This allowance represented 1.5% of the industrial milk quota between August 2007 and April 2008 and it was reduced to 0.5% from May to July as production was catching up with demand.
- At the end of the dairy year Canadian requirements were at 49.9 million hl, down 0.42% from the previous year.
- New compositional standards for cheeses were published in the Canada Gazette on December 26, 2007, in order to harmonize the Dairy Products Regulations and the Food and Drug Regulations. These standards will come into effect in December 2008 under the direction of the Canadian Food Inspection Agency.

MILK PRODUCTION

Farm cash receipts

As a key contributor to the Canadian economy in the 2007 calendar year, the dairy industry ranked fourth behind grains, red meats and horticulture, generating $5.2 billion in total farm receipts.

Number of farms and production per farm

In the 2007-2008 dairy year, Canada had 14,036 dairy farms. Although there has been a decline in the number of dairy farms in Canada, individual farming units have grown in size and have increased their efficiency. The average production per farm in the 2007-2008 dairy year was 5,942 hectolitres, a 7.81% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,538 kg of milk.

In the 2007-2008 dairy year, Quebec and Ontario had the greatest percentage of dairy farms at 81.1%, followed by 13.4% in the Western provinces, and 5.5% in the Atlantic provinces.

NUMBER OF FARMS AND COWS, AND TOTAL PRODUCTION

2003-2004 to 2007-2008

	Number of farms	Number of cows (thousand)	Total production* (million hl)
2003-2004	16,970	1,054.9	81.6
2004-2005	16,224	1,041.4	81.5
2005-2006	15,522	1,019.1	80.6
2006-2007	14,660	1,004.8	80.8
2007-2008	14,036	998.5	83.4

* At 3.6 kg of butterfat per hl

NUMBER OF DAIRY FARMS IN 2007-2008

Newfoundland and Labrador	38
Prince Edward Island	222
Nova Scotia	272
New Brunswick	240
Quebec	6,869
Ontario	4,508
Manitoba	425
Saskatchewan	230
Alberta	660
British Columbia	572
TOTAL	14,036

MILK PROCESSING

In the 2007 calendar year, the dairy processing industry generated $11.6 billion* worth of products shipped from approximately 445 processing plants (280 of which are registered with the Canadian Food Inspection Agency) accounting for 15% of all processing sales in the food and beverage industry. In the same year, the dairy processing sector employed 22,132 people.

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

MILK MARKETS

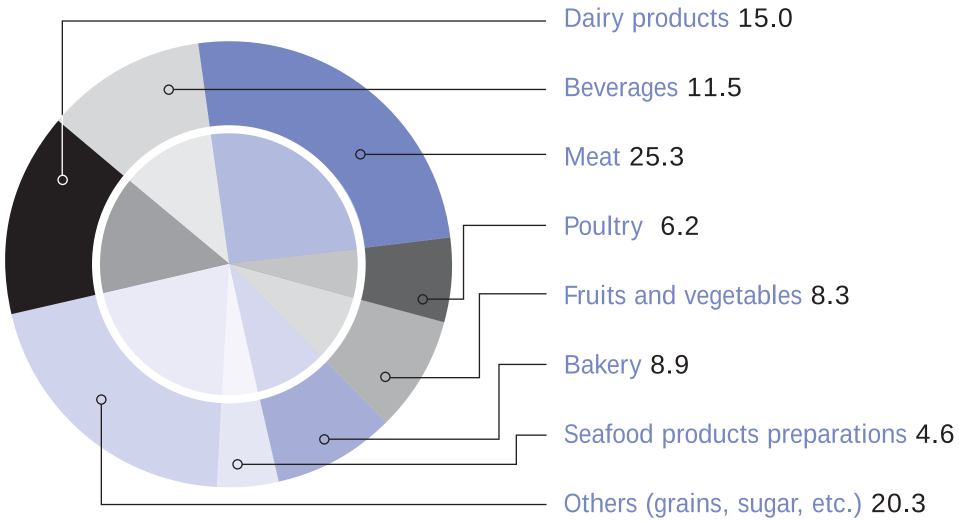
Canadian dairy producers supply two main markets:

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

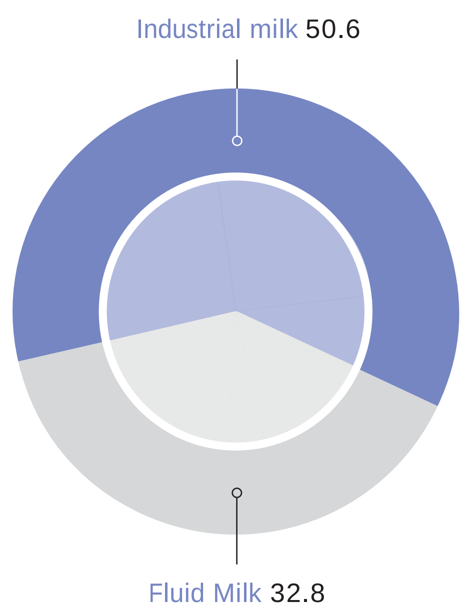
In the 2007-2008 dairy year, the fluid market accounted for approximately 39% of total producer shipments of milk, or 32.8 million hl*. The industrial market accounted for the remaining 61% or 50.6 million hl* of total producer shipments.

*At 3.6 kg of butterfat per hl.

SHARE OF MANUFACTURED SHIPMENTS IN CANADA – VALUE BASIS (2007)



INDUSTRIAL AND FLUID MILK PRODUCTION IN 2007-2008 (million hl)



PRODUCTION OF MILK* (million hl)

Province	2006-2007			2007-2008		
	Fluid	Industrial	Total	Fluid	Industrial	Total
Newfoundland and Labrador	0.4	0.1	0.5	0.4	0.2	0.6
Prince Edward Island	0.2	0.9	1.1	0.2	0.9	1.1
Nova Scotia	1.1	0.7	1.8	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	7.5	24.2	31.7
Ontario	12.6	13.8	26.4	12.8	14.4	27.2
Manitoba	1.3	1.9	3.2	1.4	2.0	3.4
Saskatchewan	0.7	1.6	2.3	4.0	2.9	6.9
Alberta	3.9	2.6	6.5	4.0	2.9	6.9
British Columbia	3.9	2.7	6.6	4.0	2.9	6.9
Total	32.2	48.6	80.8	32.8	50.6	83.4**

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

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

Ingredients market

Taste, functionality and health properties associated with dairy products and ingredients remain popular with dairy processors and finished food product manufacturers. Consumers appreciate that food products made with cream, butter and cheese taste better and are low in trans-fats. Finished food product manufacturers are responding with a variety of new high-end prepared meals, entrées and dessert products. The growing interest shown on the part of companies to develop new food formulations combined with the support offered under the CDC's dairy marketing initiatives helps to explain the continued growth in the use of dairy ingredients which under the Special Milk Class Permit Program amounted to 6.82 million hl of milk (at 3.6% butter fat) in 2007-2008 compared to 6.4 million hl in the previous dairy year, an increase of 6.6%. This growth requires that the CDC maintain its current marketing efforts to seek new opportunities for the solids non-fat (e.g. skim milk powder) being generated as a result of the strong demand for dairy ingredients rich in butterfat.

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 Canadian milk production was used in the last dairy year.

Class	Million hl	% of total milk
1	24.3	29.2%
2	5.3	6.4%
3(a) 3(b)	28.0	33.7%
4(a) and 4(a)1	17.1	20.5%
4(b), 4(c), 4(d), 4(m)	1.1	1.3%
5(a), 5(b), 5(c)	6.8	8.2%
5(d)	0.6	0.7%
TOTAL	83.2	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 advisor on matters related to the dairy industry. The CDC is part of the Agriculture and Agri-Food Portfolio along with Agriculture and Agri-Food Canada, the Canadian Food Inspection Agency, the Canadian Grain Commission, Farm Credit Canada and the National Farm Products Council.

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

The Commission employs 65 people who work in its offices which are located in Ottawa, Ontario.

Since the success of the CDC depends on its employees' pursuit of excellence, the CDC encourages and supports superior individual and organizational performance.

GOVERNING BOARD

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

- establishes and approves the CDC's strategic directions, Corporate Plan and budgets with input from senior management;
- reviews the financial statements of the CDC on a quarterly basis;
- approves the 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 Canadian Milk Supply Management Committee (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 Commissioner assists the Chairperson in ensuring that the Commission functions properly, meets its obligations and responsibilities, and fulfills its mandate. The Commissioner also acts as Chairperson in the absence of the Chairperson and, while doing so, has all the powers and duties of the Chairperson.

The CEO makes recommendations in the areas of planning and is responsible for the implementation of the Corporate Plan once it is approved by Treasury Board, of the strategic plan, and of 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 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.

COMMISSIONERS

Chairman (appointed August 1, 2007 for a three-year term)
Randy Williamson

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

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

Commissioner (appointed August 1, 2007 for a three-year term)
Gilles Martin

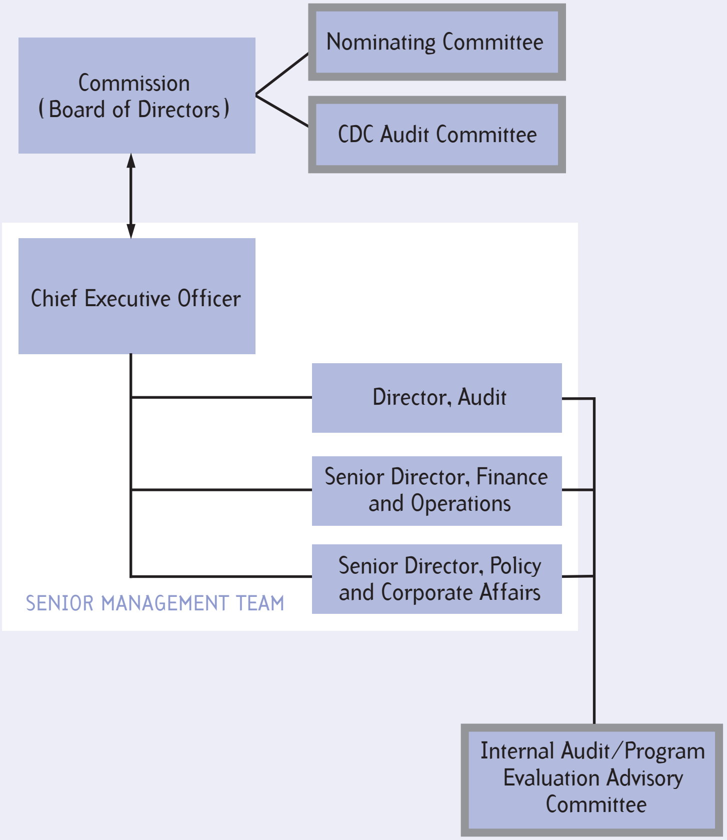
Mr. Martin has a post-secondary degree in Zootechnology from the Institut de technologie agroalimentaire in La Pocatière. He has been involved in the milk producing industry since 1977, and co-owns a dairy farm with his brother in Rivière-Ouelle, Quebec.

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 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 Groupe Dynaco as well as a member of the board of the regional agricultural education centre, Ferme-École la Pokita.

Chief Executive Officer (reappointed for three years effective October 7, 2008)
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.

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



COMMITTEES

Commission (Board of Directors)

Members

- Chairperson
- Commissioner
- Chief Executive Officer

Activities

The Commission met every 4 to 6 weeks to address governance issues such as the approval of the Corporate Plan, strategic directions and financial statements of the CDC and to discuss current dairy industry related issues.

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

Members

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

Nominating 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

The Committee met in April and June 2008 and sent its recommendation to the Minister in June 2008. Subsequently, John Core was reappointed CEO effective October 7, 2008.

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:
Roger Heard, Chief Economist; **Danie Doré**, Secretary to the Commission; **Cesarea Novielli**, Human Resources Advisor; **Benoît Basillais**, Chief, Policy; **Chantal Paul**, Chief, Communications and Strategic Planning; **Gilles Froment**, Senior Director, Policy and Corporate Affairs

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 and Administration; **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:
Hossein Behzadi, Manager, Program Audits; **Robert Hansis**, Director, Audit; **Nelson Coyle**, Manager, Evaluation; **Indira Gangasingh**, Manager, Assurance Services

CORPORATE GOVERNANCE

In 2007-2008, the Commission took the following measures to address accountability.

- The Commission held its first public annual meeting in Ottawa on January 23, 2008. About 50 stakeholders were present and were presented information about the CDC financial statements and the activities that supported its objectives for 2007-2008.
- The Commission approved the CDC's Strategic Plan for 2008-2009.
- Internal audits of the following activities were performed: the fluid skim-off calculation, the interaction between the financial systems of the CDC, AAFC and Public Works and Government Services Canada (PWGSC) and the Commission's use of contracted interpretation services.
- The evaluation of the Dairy Marketing Program was completed and various recommendations will be presented to the Commission.
- The Commission updated its Integrated Risk Management Plan, Governance Rules, and Delegation of Human Resources Management Authority.
- The Commission completed the documentation of its operational procedures.
- Training sessions were held for management on subjects such as change management and employee retention.

ACTIVITIES

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

CHAIRING THE CANADIAN MILK SUPPLY MANAGEMENT COMMITTEE (CMSMC)

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

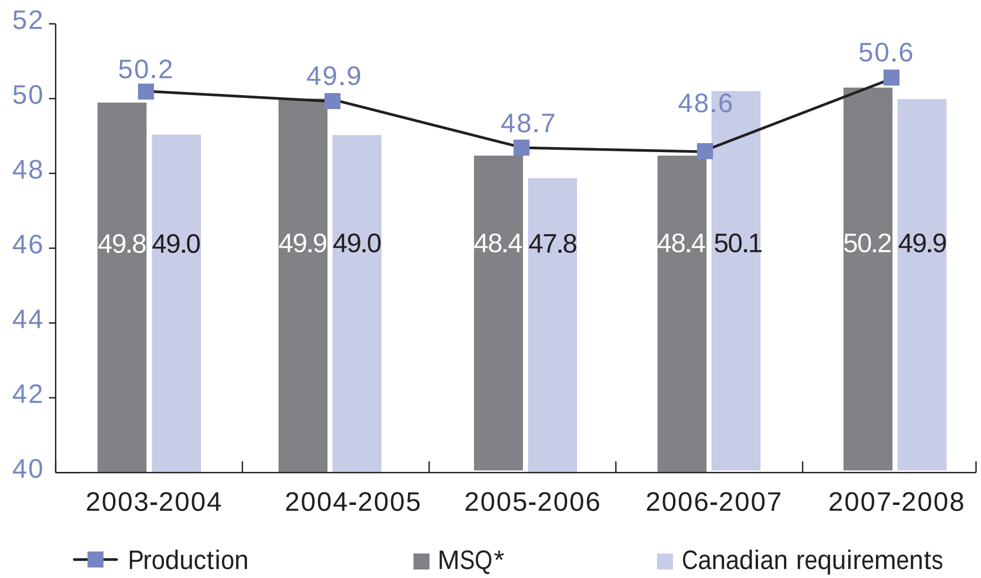
In August 2007, the CMSMC agreed to set the national solids non fat to butterfat ratio at 2.32 for milk leaving the farm. In September 2007, in order to rebuild stocks, the CMSMC decided to apply a growth allowance of 1.5% starting on August 1, 2007. Towards the end of the dairy year, as production was exceeding demand, it decided to reduce the allowance from 1.5% to 0.5% of domestic requirements from May 1 to July 31, 2008.

DETERMINING AND ADJUSTING QUOTAS

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

The national production target for industrial milk is called the Market Sharing Quota (MSQ). The MSQ is based on Canadian requirements. Demand is constantly monitored and, 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.

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



*Weighted average MSQ, including Domestic Dairy Product Innovation Program

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 when establishing the MSQ is to minimize the possibility of shortages or surpluses in the domestic market.

Over the course of the 2007-2008 dairy year Canadian requirements were 49.9 million hl, down 0.4% from the previous year. Demand for dairy products such as cheese, butter and yogurt continued to grow throughout the year. However, this growth was offset by weakness in ice cream sales and an increase in skim-off from the fluid market.

During the same period, industrial milk production increased significantly to 50.6 million hl compared to 48.6 million hl a year earlier as production was catching up to the demand. In addition, a growth allowance of 1.5% was included in the MSQ from August to April to reduce the risk of shortages in the fall and to rebuild the butter stocks that had been depleted to satisfy demand in the previous year. Once the butter stocks were at adequate levels, the CMSMC decided to reduce the growth allowance to 0.5% for the remainder of the year.

Any surplus that occurs is managed by adjusting the Market Sharing Quota, or by exporting within Canada's trade commitments.

PROVINCIAL SHARES OF MSQ* – JULY 31, 2008*

	Butterfat (million kg)	Milk (million hl)	%
Newfoundland and Labrador	0.76	0.21	0.42
Prince Edward Island	3.07	0.85	1.70
Nova Scotia	1.98	0.55	1.10
New Brunswick	2.36	0.66	1.30
Quebec	81.63	22.67	45.14
Ontario	57.27	15.91	31.67
Manitoba	6.54	1.82	3.62
Saskatchewan	4.81	1.34	2.66
Alberta	11.78	3.27	6.51
British Columbia	10.63	2.95	5.88
Total	180.83	50.23	100

*Before sharing of markets

POOLING OF MARKETS AND PRODUCER RETURNS

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

Comprehensive Agreement on Pooling of Milk Revenues

Under the Special Milk Class Permit Program implemented in 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 (P5)

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

Discussions amongst P5 signatories regarding the redrafting of the agreement are in their final stage. The P5 Technical Committee has devoted a lot of time and energy to reviewing all aspects of Class 5(c) milk and to assessing the impact of any adjustment of the calculations of milk movement obligations. Discussions will continue over the coming months.

In 2007-2008, the P5 Supervisory Body looked into reviving the P5/Newfoundland and Labrador Negotiating Committee. A number of exploratory meetings have been organized and both parties have submitted documents to clarify their positions and expectations, but no official decision has yet been taken on the resumption of negotiations.

The Ontario and Quebec bilateral negotiations regarding the harmonization of plant allocation policies continued over the last 12 months. Discussions mainly focussed on various legal issues and took place within the working group, the legal subgroup and at the signatories level. The CDC is chairing all these meetings at the request of stakeholders.

Western Milk Pooling Agreement (WMP)

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.

In 2007-2008, WMP stakeholders pursued discussions on fluid milk pricing. The proposed pricing methodology would allow WMP provincial boards to set fluid milk prices using a formula which takes into account the consumer price index, the cash costs of producing milk, and personal disposable income, and would be a step towards harmonizing fluid pricing methodologies at the national level. At the same time, discussions took place within Alberta to transfer the fluid milk pricing authority from the Alberta Utilities Commission to the provincial board, Alberta Milk. This transfer is crucial as it will allow the province to set the price based on the formula detailed above and will conclude more than three years of negotiations within the province. Manitoba, Saskatchewan and British Columbia are still reviewing this matter at the provincial level. WMP provinces identified production and delivery programs to be implemented and agreed to collect a fixed amount from the marketplace to finance them.

On February 1, 2008, the industrial milk price was adjusted for Classes 2 and 3(a) in order to reduce the discrepancies between the WMP and the P5.

The price reduction offered through the WMP innovation program was modified to 10% on Class 1(c) and 15% on Class 4(c). During the dairy year, there were three successful applications to the program within the WMP.

Towards the end of the dairy year, the four provincial boards organized a strategic planning session to provide an opportunity to review producer issues and identify improvements which could benefit the industry.

POOLS IN NUMBERS 2007-2008

	Fluid milk produced (million hl)	Industrial milk produced (million hl)	Blend price to producer* ($/hl)
P5	22.3	40.9	70.26
WMP	10.1	9.5	71.50

*In-quota milk at 3.6 kg butterfat per hl

PRICING

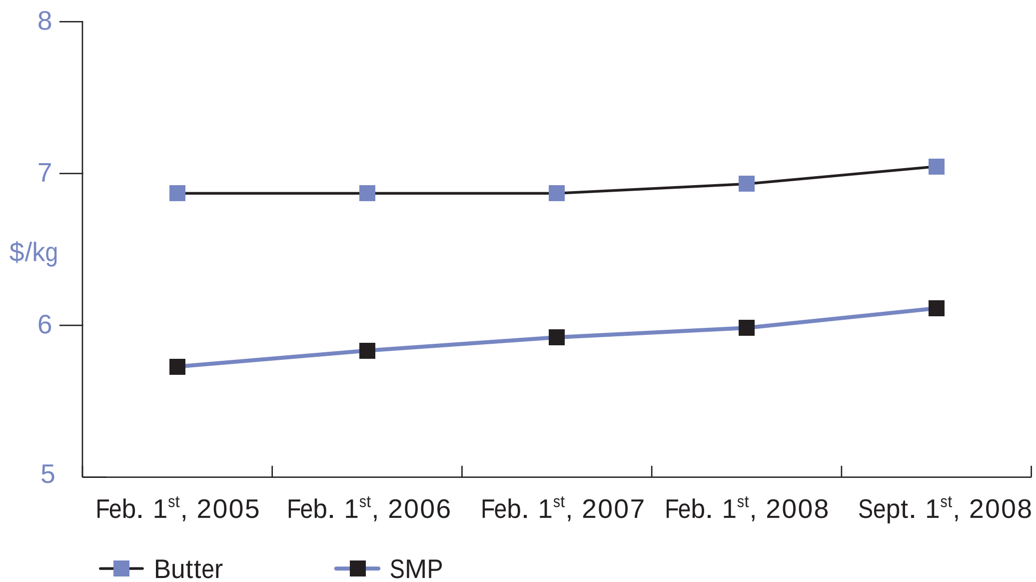
Each year, the CDC reviews and establishes support prices for butter and skim milk powder used by the CDC when purchasing or selling these dairy products. Support prices serve as a reference for agencies and provincial milk marketing boards when they establish the prices paid by processors for milk.

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 2007 was effective on February 1, 2008. The support price of skim milk powder rose from $5.9212 to $5.9835 per kg, and the support price of butter increased from $6.8695 to $6.9316 per kg. This represents an increase of 1.0% in the price of milk to producers. The assumed processor margin included in the support prices increased from $11.00 to $11.11/hl. Carrying charges for butter were increased from $0.10/hl to $0.12/hl.

Following a request from Dairy Farmers of Canada, the Commission reviewed support prices in June 2008. The request was prompted by the rapid rise of farm costs for animal feed and fuel. After careful examination of data and consultations with stakeholders, the CDC announced that effective September 1, 2008, the support price of skim milk powder would increase from $5.9835 to $6.1125 per kg and the support price of butter would increase from $6.9316 to $7.0462 per kg. This represents a 2% increase in the price of milk to dairy farmers. The assumed processor margin will increase from $11.11 to $11.22/hl. The carrying charges will be reduced to $0.10/hl.

SUPPORT PRICES FOR BUTTER AND SKIM MILK POWDER FROM 2005 TO 2008 ($ per kg)



AUDITING

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.

Six internal audits were performed in 2007-2008. Expenditures of the four organizations promoting fluid milk were reviewed and appropriate action was taken before the available funding of 3 million dollars was paid to those organizations. A review of the fluid skim-off calculation confirmed its accuracy and identified an opportunity to establish reasonability checks to facilitate regular reviews of provincially reported data. The audit of the CDC's internal operations system, AAFC's financial system and the system of Public Works and Government Services Canada concluded that these systems interact effectively and securely and that password control and system access could be strengthened. The audit report on the Commission's use of contracted interpretation services concluded that the contract was fairly awarded on the basis of appropriate criteria and at a lower cost than the cost of the government standing offer.

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 2007-2008 dairy year, 41 companies were audited, resulting in claims of approximately $801,935 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 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. Revisions to the National Audit Standards were approved during the year.

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

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.

EXPORTS

During the 2007-2008 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 2007-2008 dairy year, the CDC exported 16.4 million kg of skim milk powder. In 2007-2008, the CDC did not export butter since there was no surplus production of butterfat.

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 6,230 tonnes of cheese and were accounted for against Canada's export commitments to the WTO.

PROGRAMS

The CDC administers a number of programs related to market supply and growth on behalf of the dairy industry.

DOMESTIC SEASONALITY PROGRAMS

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.

Carrying charges associated with the CDC's Domestic Seasonality Programs for butter and skim milk powder totalled $7.3 million in 2007-2008. 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 $0.10/hl of industrial milk to $0.12/hl on February 1, 2008. Costs associated with butter stocks above normal inventories or with any other products under the Domestic Seasonality Programs are paid 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) set 12 million kg of butter as target stocks for the 2007-2008 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.

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.

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 2007-2008 dairy year with 11.5 million kg of butter and 10.6 million kg of skim milk powder in inventory. During the year, the CDC purchased 29.1 million kg of butter and 49.6 million kg of skim milk powder. Sales of 24.8 million kg of butter and 30.9 million kg of skim milk powder left respective closing inventories of 15.8 and 29.4 million kg as of July 31, 2008 (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.

DAIRY MARKETING PROGRAM

Promoting information, interaction and innovation remains the guiding objective of the Dairy Marketing Program (DMP). Through the DMP, the CDC has so far provided over $250,000 in funding to dairy and food processors under the Direct Access and Innovation Support Funds.

The DMP group continued meeting with companies and industry partners across Canada to promote CDC programs and offer business and marketing support relating to product development and innovation. In addition, DMP agents participated in several major food industry events such as the Annual Baking Congress, the Ethnic and Specialty Foods trade show and the Canadian Institute of Food Science and Technology conference trade show. With support of industry partners, the CDC organized a highly successful Western Canadian dairy ingredients seminar in Vancouver. An Atlantic Canada seminar will take place in Charlottetown, P.E.I. in mid-September. The MILKingredients.ca Web site carried new articles and reports relating to changes in Canadian demographics and new technologies for analyzing vitamins in milk.

Continued growth comes with challenges and the CDC is increasing its marketing efforts to seek new opportunities for the solids non fat, such as skim milk powder, which are generated as a result of the strong demand for dairy ingredients rich in butterfat. Nutraceutical companies as well as processed meat and pet food manufacturers are being targeted since these sectors currently use and/or have the potential to use milk protein concentrates and skim milk powder in their formulations.

SPECIAL MILK CLASS PERMIT PROGRAM

(Classes 5(a), 5(b) and 5(c))

The Special Milk Class Permit Program was implemented in 1995 to allow further processors to remain competitive in the marketplace. Through this system, milk components are made available at competitive prices to manufacture dairy ingredients destined for use in further processed products. Further processors are able to access competitively priced dairy ingredients by means of a Special Class Permit issued by the Canadian Dairy Commission.

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

Further processors used the equivalent of 6.82 million hl of milk in the 2007-2008 dairy year, an increase of 6.6% over the previous dairy year. The average revenues obtained for producers from these 3 classes amounted to $42.48/hl, an increase of 33.7%. A total of 1,454 permits were issued this year for classes 5(a), (b) and (c), most of which were class 5(b) permits. The number of further processors participating in the program rose to 1,200 in 2007-2008, up from 1,141 in the previous year.

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

Class		2003-2004	2004-2005	2005-2006	2006-2007	2007-2008
5(a)	Volume	1.954	1.955	1.979	2.156	2.161
	Price	$39.96	$41.90	$34.33	$33.67	$43.77
5(b)	Volume	1.872	2.088	2.274	2.662	3.091
	Price	$32.86	$36.74	$32.48	$31.79	$42.05
5(c)	Volume	1.548	1.566	1.436	1.585	1.571
	Price	$29.99	$29.78	$30.00	$29.92	$41.01
Total	Volume	5.374	5.609	5.689	6.403	6.823
	Price	$35.12	$37.05	$32.66	$31.79	$42.48

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

DOMESTIC DAIRY PRODUCT INNOVATION PROGRAM

The Domestic Dairy Product Innovation Program (DDPIP) encourages the manufacture of new and innovative products on the domestic market. It allows for the addition of specific volumes of milk to provincial quotas to ensure that the supply needed to produce an innovative product is available to a successful applicant.

During the 2007-2008 dairy year, firms in Quebec, Ontario, Alberta, British Columbia and Prince Edward Island used 33.3 million litres of milk under the DDPIP. In 2006-2007, the total was 14.9 million litres. The maximum utilization limit was established at 2% of the MSQ (approximately 100 million litres).

This year, the Selection Committee received 85 applications compared to 38 during the previous year. Most applications involved new specialty cheeses. Of the 85 applications received, 55 applications met the program criteria and were accepted, 21 were rejected and 9 still require additional information before a decision can be made.

PERFORMANCE AND GOALS

ACHIEVEMENTS FOR 2007-2008

The goals set by the Canadian Dairy Commission (CDC) for 2007-2008, along with a brief summary of the status of each goal, are described below.

Strategic Goals

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008	RESULTS	PERCENTAGE COMPLETE
An active negotiation on harmonization issues in preparation for a national pool negotiation (revenue and market sharing).	• A milk allocation agreement between Quebec and Ontario	• The CDC continues to facilitate these negotiations.	50%
	• An agreement on Class 1 pricing and other policies in the West	• Good progress. The Alberta milk board obtained pricing authority from its provincial government.	100%
	• Negotiations for Newfoundland and Labrador to join the Eastern milk pool have resumed	• Exploratory meetings have occurred and will continue.	25%
	• A motion from CMSMC to develop a national pool model	• Some provinces are resisting the idea of a national milk pool and therefore no motion has been put forth.	0%
An active and ongoing industry discussion on the future of pricing is underway.	• Stakeholders agree to participate in a taskforce on pricing	• Stakeholders took part in an exploratory meeting in June 2008.	10%
The CDC is prepared to deal with a completed Doha Round.	• Trade reports to the Commission are timely.	• Reports were timely.	100%
	• Regular meetings are held with AAFC's Chief Trade Negotiator.	• Meetings were held.	100%
	• Impacts of the new trade rules have been evaluated as needed.	• No evaluation was performed since no new trade rules were adopted.	0%

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008	RESULTS	PERCENTAGE COMPLETE
Knowledge of the Canadian dairy industry is enhanced.	• Two orientation sessions were offered to decision makers and two workshops were offered to technical advisors.	• Four sessions were given to decision makers. • A pilot session was held for technical advisors in June. The final version will be offered in the fall.	100% 60%

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008	RESULTS	PERCENTAGE COMPLETE
A renewed strategy to encourage the use of Canadian dairy ingredients has been agreed at CMSMC.	• Revised terms of reference for the Market Committee have been approved by the CMSMC.	• New terms of reference have been approved by CMSMC.	100%
	• A renewed strategy has been approved by CMSMC.	• Elements of the new strategy include a new pricing mechanism for class 5(c) and discussions on setting the price of skim milk powder at competitive levels for domestic markets.	100%
	• An increased utilization of Canadian milk protein concentrates and milk protein isolates	• The growth in use of milk protein concentrates in nutraceuticals is expected to continue as long as the component prices remain competitive.	100%
New marketing initiatives for the restaurant and food services sectors.	• A report containing recommendations was presented to CMSMC.	• No report was presented but needs continue to be evaluated.	0%
An adequate supply of cream across Canada.	• Supply of cream is properly matched to demand throughout the year.	• Cream supply was closely monitored and shortages were solved on a timely basis.	100%

Operations Goals

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008	RESULTS	PERCENTAGE COMPLETE
Tools are in place to support a continuous learning environment.	• More resources are spent on professional development. • Positive feedback from employees	• Expenses in training and development have increased by 30% over the previous year. • A computer-based system has been developed for performance management and it includes an individual development plan that allows for employee feedback.	100% 70%
The new governance structure is functioning effectively.	• 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	• Achieved • Achieved • A CEO report was presented to the Commission every month. • The revised delegation of authority was adopted. • Results of the board assessment show a strong sense of cooperation among members and an effective board.	100% 100% 100% 100% 100%
CDC practices and procedures are completely documented and regularly updated.	• Procedures are 100% documented and current.	• Procedures are 100% complete and a process is in place to ensure that they are reviewed at least once a year.	100%

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2007-2008	RESULTS	PERCENTAGE COMPLETE
Succession planning is complete.	• Competency profiles are written. • Potential candidates are identified. • Professional development plans are in place.	• 12 positions have been identified as key positions. Profiles have been written for 10 of these positions. • Potential candidates have yet to be identified. • Development plans will be put in place after candidates have been identified.	83% 0% 0%
A CDC that is more attractive to potential employees.	• Hire on first competition • Selected candidates accept offers.	• Since August 1, 2007 we hired on first competition in 100% of cases (13 competitions).	100%
The human resources of the CDC are used efficiently.	• Reviews of documents and attendance have been conducted and proposals presented to relevant committees.	• As intended by the performance indicator, the review of meeting attendance has been conducted and when possible, less CDC employees travel to industry meetings.	100%

OUTLOOK

In preparation for change: harmonization

After seven years of WTO negotiations, and more particularly after the failure of the mini-ministerial conference held in July 2008, the process that will be adopted to continue the negotiations remains unclear. The CDC will continue to monitor trade negotiations, be they multilateral, bilateral, or domestic. The CDC will also attempt to engage the major sectors of the industry in discussions about the current milk pricing mechanism as well as other related issues.

On the domestic front, the trend toward greater harmonization between provinces is strengthening. New cheese compositional standards will come into force in December 2008 and dairy farmers are hoping that similar national standards will be implemented for yogurt. Western Provinces are finalizing an agreement on the harmonization of fluid milk pricing which could later ease the transition to a national harmonization. Quebec and Ontario are still working on the details of a common milk allocation policy that would apply to the milk processing plants of both provinces. These two provinces are also discussing with the Maritimes the harmonization of quota management policies at the producer level.

The CDC is facilitating all these harmonization initiatives as well as others in the areas of auditing milk utilization by processing plants and measuring the cost of producing milk. The CDC believes that ultimately, these efforts should result in a national all milk pool that would level the playing field for the industry from sea to sea.

In the meantime, decision makers of the industry have expressed the need to better understand the structure of their industry so that they can reach better decisions more quickly. In response to this need, the CDC has developed two types of orientation sessions, one for decision makers and one for technical advisors. These two sessions will continue to be offered in 2008-2009.

Market expansion

During the 2007-2008 dairy year, the overall demand for dairy products was relatively stable and toward the end of the year, production was high enough to rebuild stocks. The CDC recommended to the industry that the growth allowance be reduced in anticipation of a more moderate increase in demand. As a result, the CMSMC reduced the growth allowance from 1.5% to 0.5% as of May 2008.

In the last few years, demand increased mostly for products that are high in butterfat. This, coupled with increased production, resulted in an increase in the structural surplus of solids non fat. New markets must be found for these milk components. The CDC has already undertaken several market development initiatives that complement the ones carried out by other stakeholders of the industry. Several of CDC's initiatives will be carefully examined in 2008-2009 and proposals for further market expansion will be presented to the dairy industry.

Trends in the workplace

As is the case with many organizations, the CDC must face the challenge of replacing key people leaving on retirement while keeping a motivated and interested workforce. The CDC started succession planning last year and this initiative will be continued in 2008-2009. In order to compare itself with other organizations in the private sector, the CDC has decided to participate in the "Employer of choice" survey that is administered by Hewitt. With the help of the survey results, the CDC will be in a better position to take measures for employee retention and engagement.

GOALS FOR THE PERIOD 2008-2009 TO 2012-2013

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 successfully adapts to change.

OBJECTIVES	PERFORMANCE INDICATORS FOR 2008-2009
The dairy industry has acted on a recommendation from a working group of key stakeholders on future pricing and its related issues.	• An exploratory meeting was held between the CDC, DPAC and DFC. • An agreed to process was identified to address the pricing issues, as well as the key steps of the process. • The process has been completed.
Important events and trends affecting the dairy industry, including the WTO negotiations, are monitored and their impacts are evaluated.	• Models or impact analyses are prepared which measure the impact of identified changes. • 12 trade reports are presented to the Commission. • 4 meetings are held with AAFC's Chief Negotiator. • Impacts of any new trade rules have been evaluated as needed.
An active negotiation on harmonization issues in preparation for a national pool negotiation (revenue and market sharing).	• A milk allocation agreement between QC and ON is prepared. • An agreement on Class 1 pricing in the 4 Western Provinces is signed.
The level of harmonization of plant milk utilization audits has improved.	• Harmonization opportunities have been identified and solutions proposed to CMSMC. • Ontario, Quebec, Alberta and BC have been invited to discuss the continuity of their audit function with the CDC. • Impact of expanding CDC's plant audit activities on the CDC's resources has been evaluated.
The stakeholders of the dairy industry have a better understanding of the mechanisms of their industry.	• Two training sessions have been offered to technical advisors of the industry. • A minimum of 5 sessions have been offered to decision makers of the industry in various regions of Canada.

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2008-2009
The CDC works in partnership with AAFC, DPAC, and DFC to develop a strategy for dairy-related research.	• The Commission has made a decision regarding its staff and financial involvement as part of the agreed dairy research strategy.

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2008-2009
The strategy to encourage the use of Canadian dairy ingredients has been further developed.	• The evaluation of the Dairy Marketing Program has been completed. • A survey of ingredient users has been completed. • Reports on market for dairy ingredients have been prepared. • A paper with proposals has been presented to CMSMC.
New uses for surplus SNF have been identified and recommendations have been presented to the Market Committee.	• The use of MPC in nutraceutical products under Class 4(a)1 has been reviewed. • The impact of classes 5(a), (b) and (c) pricing on use of SMP has been evaluated. • Potential new markets for SNF have been evaluated.
Recover lost markets and prevent future market losses.	• The major causes of market loss have been identified. • Impact analyses are completed. • Recommendations were presented to the Market Committee.
The CDC works in partnership with the industry stakeholders to grow the market.	• The performance of the 3-year fluid promotion program has been evaluated to determine its impact on market growth and a report has been presented to the Commission. • The CDC made a decision on its involvement in market growth activities beyond 2008. • Analysis and expertise to evaluate proposals brought forth by the industry have been provided.

Operational Goal

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2008-2009
The impact of the requirement to adopt the new international accounting standards has been identified.	• An impact review has been completed. • Financial Statements are prepared using International Financial Reporting Standards. • OAG gives clean audit report.
The OAG has approved CDC's implementation of the new accounting standards for financial instruments.	• Financial Statements are prepared using new standards. • OAG gives clean audit report. • A process/procedure has been developed for entering into contractual agreements. • All sections are following the new procedure for contracts.
The succession plan is completed and implemented.	• Key position profiles have been completed. • Feeder groups (internal and external) are identified. • Career paths for potential internal successors to key positions are established.
The new performance management program was fully implemented.	• Managers and staff are using the new performance review and feedback form and complying with the requirements of the program.
The training budget is based on individual development plans.	• Yearly training budget established according to new method. • All staff have an Individual Development Plan (IDP) with costs included in the administrative budget.
The CDC developed new initiatives for the purpose of employee retention and attraction.	• Survey results from the "Best Small and Medium Employers" are communicated to all staff. • An action plan was prepared based on survey results. • Recognition and Rewards Program has been evaluated. • Exit interviews are conducted.
The mandate and role of the CDC is better understood by Portfolio organizations.	• A communication strategy was written and approved by the Commission. • Activities of the communications strategy were carried out at an opportune time.

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, 2008 should be read in conjunction with the financial statements of the Commission enclosed herein and the Annual Report.

SELECTED KEY RESULTS OF OPERATIONS

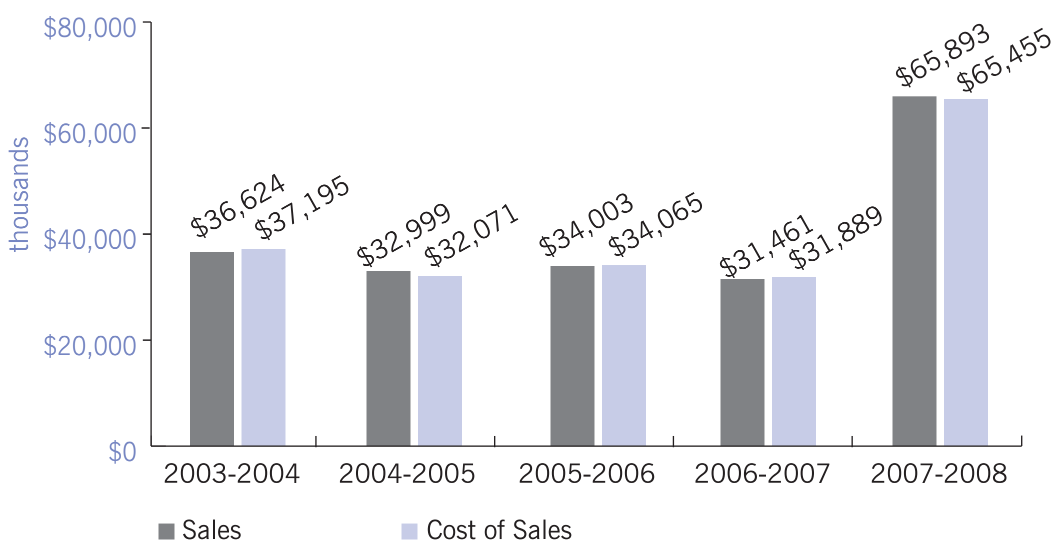
Export activities

Sales

Overall export sales revenue increased dramatically in relation to the previous dairy year in spite of the fact that there were no exports of butter this year. Export sales revenue was entirely from skim milk powder sales.

The CDC sold 15,973 tonnes of skim milk powder, which is significantly more than the previous year's sales of 10,013 tonnes. This increase, combined with much higher sales prices, translated into revenues for the year of $65.9 million versus $31.5 million for 2006-2007. World market prices for skim milk powder remained at record high levels for much of the year and allowed the CDC to generate these higher revenues. World market prices have decreased significantly since then and revenues will be affected accordingly next year.

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 sometime finish the dairy year with small gains or losses that reflect this price uncertainty.

For the dairy year ending July 31, 2008, the cost of export sales totalled $65.5 million, corresponding to sales of $65.9 million. This small profit compensated for an equivalent loss generated the previous year.

Domestic activities

Sales

In the 2007-2008 dairy year, total revenue from domestic sales decreased significantly by $29.8 million or 12 % compared to the previous dairy year. This is mainly due to lower sales of Plan B butter and skim milk powder (SMP), and to smaller volumes of 4(m) skim milk powder sold to domestic animal feed manufacturers.

In the case of Plan B butter and SMP, revenues from sales decreased by $19.5 million compared to 2006-2007. This decrease resulted from lower opening stocks in 2007-2008 than at the same period a year earlier. This directly impacted the amount of product available to be repurchased by processors. This decrease in quantities sold had little effect on net revenues as the purchase and resale of these products are made at support prices.

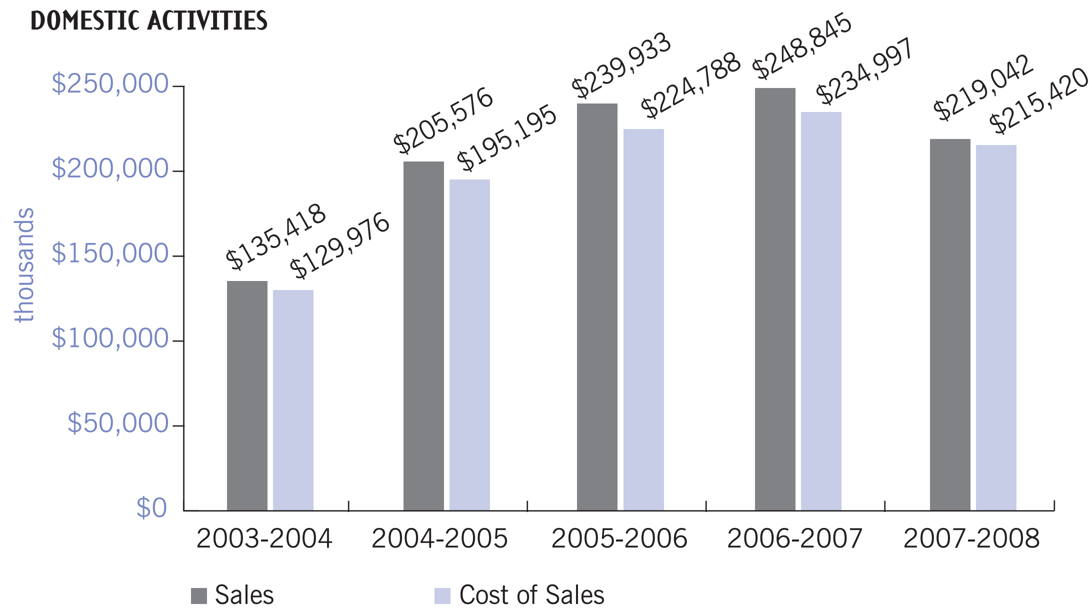
Sales of SMP to the animal feed sector amounted to 9,139 tonnes in 2007-2008, a decrease of 8,329 tonnes compared to the previous dairy year. The reason for the decrease was the limited CDC inventories of SMP available for sale during the first half of the dairy year. Although significant quantities of 4(m) skim milk powder were purchased in the second half of the dairy year, the delay in regaining the animal feed market significantly increased the inventory of this product by year-end and therefore some of it will need to be sold next year.

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.

The cost of butter and skim milk powder sold under Plan B closely matched sales prices during the year as these products are purchased and sold at the prevailing support prices.

DOMESTIC ACTIVITIES



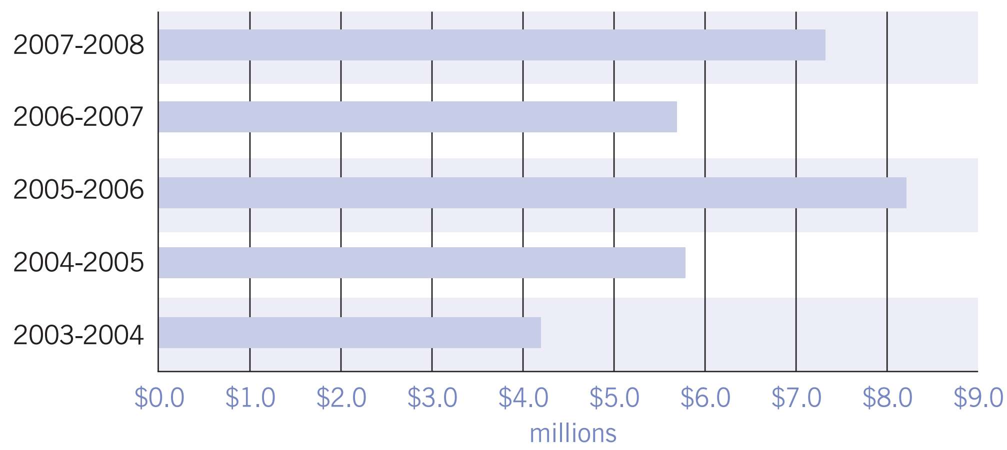
Skim milk powder costs in Class 4(m) vary in reaction to the market. Unforeseen changes in the market often result in over or under pricing of SMP purchases in this class. As a result of the sudden decline in prices for whey protein concentrates at year-end (which serve as a substitute for skim milk powder in animal feed), our purchase price ended up slightly higher than the selling price. In addition, as a result of the lower market value for this product, the CDC had to write down its year-end inventory by $10.3 million.

Carrying charges

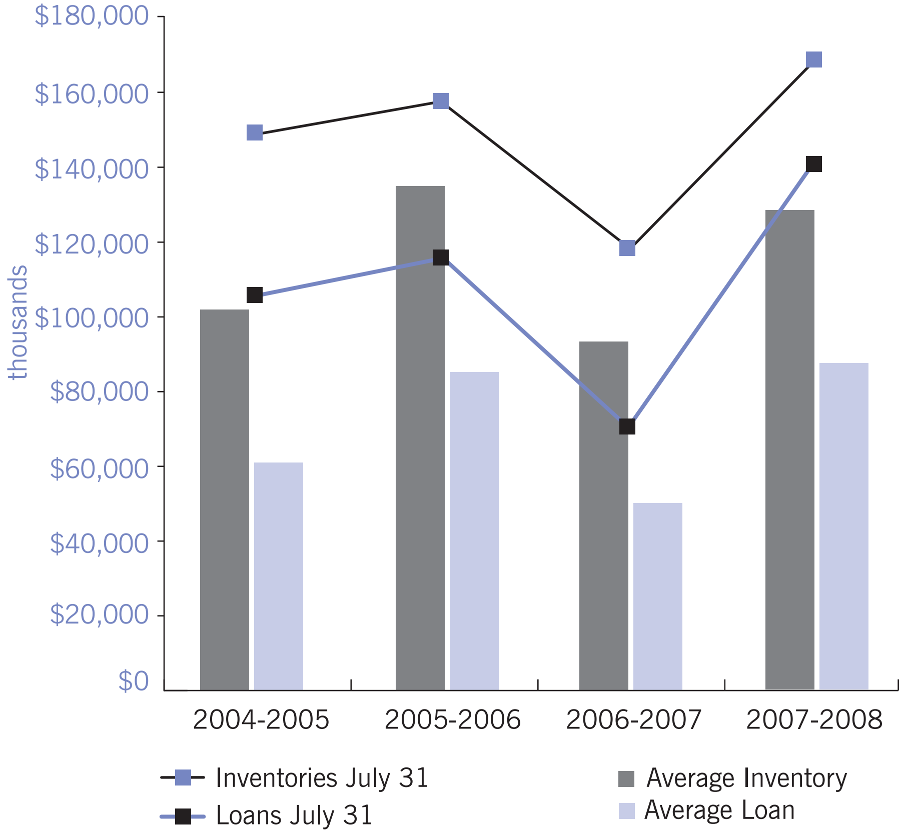
Two of the major components of carrying charges are storage costs for inventory and interest expense to purchase products. Carrying charges went from $5.7 million for 2006-2007 to $7.3 million for 2007-2008. Higher inventory levels during the year created a $443,000 increase in storage costs. These higher inventory levels also directly impacted interest costs on loans. Although interest rates decreased during the year from a July 31, 2007 rate of 4.69% to a July 31, 2008 rate of 2.54%, interest costs increased from $2.28 million for 2006-2007 to $3.25 million for 2007-2008.

Because of the higher level of inventory, the CDC had to borrow more than the $120 million loan limit from the Government of Canada. As a result, for the last three months of the dairy year, the CDC had to borrow from its commercial bank line of credit. Subsequently, as part of its Corporate Plan submission, the CDC requested and obtained approval from the Minister of Finance to increase the borrowing limit from $120 million to $150 million effective August 1, 2008.

CARRYING CHARGES



INVENTORIES AND LOANS



Risk management

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

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 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 development 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 help ensure continuity of operations.

Administrative expenses

Administrative expenses for the year totalled $7.4 million. Salaries and employee benefit plans of $5.3 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

As of April 1, 2007 the CDC's administrative expenses reflect gross costs, including those expenses that are recoverable from the milk pools or commercial operations.

Challenges for the future

For the coming year, the main factors that could affect the financial results of the Canadian Dairy Commission are the decreasing world prices for dairy products such as skim milk powder and the sale of large quantities of surplus skim milk powder in the lower value market of animal feed.

A major outlet for surplus SMP is through the export of SMP and dairy blends containing SMP. Next year, as a result of lower world prices for these products, and because of export subsidy limitations, the CDC will not be able to dispose of as much surplus SMP in the export market as it did in 2007-2008. This will require more SMP to be marketed domestically in the animal feed market. This year's increased surplus of solids non fat (SNF) in the domestic market forced the CDC to purchase more skim milk powder in Class 4(m) which could not be entirely sold for animal feed. Consequently, inventories of this type of powder have increased and will need to be sold during the next dairy year. In addition to high opening inventories of 4(m) skim milk powder, the CDC expects to purchase large quantities of surplus SMP in the 2008-2009 dairy year which will need to be sold in the animal feed market as well.

Since the sale of SNF in the animal feed market generates the lowest returns to producers, the CDC, in collaboration with the Market Committee of the CMSMC, continues to look for higher value opportunities for this fraction of the milk. In the coming year, a number of new initiatives will be examined by the Market Committee and those that are approved will be recommended to the CMSMC.

In the long term, world trade talks could have an influence on the financial performance of the CDC. New international trade deals could further limit the ability of the CDC to export surplus dairy products and could allow a greater quantity of foreign dairy products into Canada. Although these outcomes would have serious impact on the dairy industry, their effect on the CDC's financial results would likely be minor. At this time, WTO talks are suspended and their resumption is uncertain. If a new trade agreement was to be signed, it would likely include an implementation period that would allow the CDC to prepare for 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 12, 2008

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, 2008, and the statements of operations and comprehensive loss, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Commission's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Commission as at July 31, 2008 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, except for the change in the method of accounting for financial instruments as explained in Note 2 to the financial statements, on a basis consistent with that of the preceding year.

Further, in my opinion, except for the Commission's transfers of funds between the loans from the Consolidated Revenue Fund and a line of credit from a commercial bank, as described in Note 7, which are not allowed under the Canadian Dairy Commission Act, the transactions of the Commission that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canadian Dairy Commission Act* and regulations and the by-laws of the Commission.

Dale Shier, CA

Principal
for the Auditor General of Canada

Ottawa, Canada
September 12, 2008

BALANCE SHEET
as at July 31
(in thousands)

	2008	2007
Assets		
Current		
Cash	$ -	$ 392
Accounts receivable		
Due from provincial boards and agencies (pooling)	29,766	29,037
Trade	1,076	180
Derivative asset - foreign exchange contracts	19	-
Inventories (Note 4)	163,466	118,471
	$194,327	$148,080
Liabilities		
Current		
Bank indebtedness (Note 5)	$ 25,367	$ 959
Accounts payable and accrued liabilities		
Due to provincial boards and agencies (pooling)	25,767	26,828
Trade	13,417	16,795
Provision for margin payable to provincial milk boards and agencies (operational surplus)	718	8,370
Other liabilities	1,311	1,202
Loans from the Government of Canada (Note 6)	116,316	70,178
	182,896	124,332
Long-term		
Severance benefits (Note 11)	819	722
Equity (Note 8)		
Retained earnings	10,612	23,026
	$194,327	$148,080

Commitments (Note 13)

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 COMPREHENSIVE LOSS

for the year ended July 31
(in thousands)

	2008	2007
Sales and cost of sales		
Domestic sales	$219,042	$248,845
Cost of sales	215,420	234,997
Margin on domestic sales	3,622	13,848
Export sales (Note 9)	65,893	31,461
Cost of sales	65,455	31,889
Margin (loss) on export sales	438	(428)
Total margin on sales	4,060	13,420
Pooling of market returns activities		
Contributions from provincial boards and agencies	179,723	136,212
Equalization payments to provincial boards and agencies	170,020	129,612
Contributions withheld to fund operating expenses	9,703	6,600
Provision for margin payable to provincial milk boards and agencies (operational surplus)	718	8,370
Results before operating expenses	13,045	11,650
Operating expenses (Schedule of Operations by Product)	29,645	18,691
less: funding of administrative expenses by the Government of Canada (Note 10)	4,003	4,104
Net operating expenses after funding by the Government of Canada	25,642	14,587
Results of operations after funding by the Government of Canada and comprehensive loss	$(12,597)	$ (2,937)

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

STATEMENT OF CHANGES IN EQUITY

for the year ended July 31
(in thousands)

	2008	2007
Retained earnings at beginning of year	$ 23,026	$ 25,963
Transition adjustment on adoption of Section 3855 (Note 2)	183	-
Revised retained earnings at beginning of year	23,209	25,963
Results of operations after funding by the Government of Canada and comprehensive loss	(12,597)	(2,937)
Retained earnings at end of year	$ 10,612	$ 23,026

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)

	2008	2007
Cash flows from operating activities		
Cash receipts from customers	$284,012	$281,675
Cash paid to suppliers and others	(355,584)	(234,164)
Cash receipts from provincial boards and agencies (pooling)	178,994	127,220
Cash paid to provincial boards and agencies (pooling)	(171,081)	(119,861)
Cash paid to provincial boards and agencies (operational surplus)	(8,370)	(8,506)
Cash receipts from the Government of Canada	4,003	4,104
Interest paid on loans	(2,912)	(2,978)
Cash flows (used in) from operating activities	(70,938)	47,490
Cash flows from financing activities		
New loans from the Government of Canada	219,587	124,278
Loan repayments to the Government of Canada	(173,449)	(170,839)
Cash flows from (used in) financing activities	46,138	(46,561)
Net (decrease) increase in cash	(24,800)	929
Net bank indebtedness at beginning of year	(567)	(1,496)
Net bank indebtedness at end of year	$(25,367)	$ (567)
Components:		
Cash	$ -	$ 392
Bank indebtedness	(25,367)	(959)
	$(25,367)	$ (567)

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

NOTES TO FINANCIAL STATEMENTS

July 31, 2008

1. The Canadian Dairy 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. Changes in accounting policies

Financial instruments

On August 1, 2007, the Commission adopted the following recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook:

a) *Section 3855, Financial Instruments - Recognition and Measurement.*
   This Section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Under the new standard, financial assets and liabilities are initially recorded at fair value. Subsequently, financial instruments classified as financial assets or liabilities held for trading, financial assets available-for-sale and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value on the balance sheet at each reporting date. Other financial instruments such as loans and receivables, financial assets held to maturity and other liabilities, are measured at amortized cost using the effective interest method.

   Under the transitional provisions of Section 3855, the Commission has recorded an adjustment to increase opening retained earnings by $183,000 to reflect the effective portion of the change in fair value of the transitional derivative asset that previously qualified under Accounting Guideline "AcG-13", Hedging Relationships. The transitional adjustment was booked to retained earnings as a result of the Commission's decision to discontinue applying hedge accounting, which is optional, effective August 1, 2007.

Foreign currency gains and losses are included within export sales in the operating results in the year in which they occurred. Derivatives are reported on the balance sheet at their fair value with changes in fair value recorded through operating expenses.

No other adjustments were required as of August 1, 2007 as the measurement basis under the classifications used by the Commission did not change from the measurement basis prior to the adoption of Section 3855.

b) *Section 1530, Comprehensive Income.* This Section describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in equity, which results from transactions and other events and circumstances from non-owner sources. These transactions and events include unrealized gains and losses resulting from changes in fair value of investments classified as available-for-sale, effective cash flow hedges and from foreign currency translation of self-sustaining foreign subsidiaries.

The Statement of Operations was changed to the Statement of Operations and Comprehensive Loss, and a Statement of Changes in Equity was added to the Commission's financial statements.

c) *Section 3865, Hedges.* These recommendations expand the guidelines outlined in AcG-13, Hedging Relationships. This section describes when and how hedge accounting can be applied, as well as disclosure requirements. Hedge accounting enables the recording of gains, losses, revenue and expenses from the derivative financial instruments in the same period as for those related to the hedged item.

While hedge accounting was discontinued in fiscal 2008, the Commission did use hedge accounting in accordance with AcG-13, Hedging Relationships in fiscal 2007.

d) *Section 3861, Financial Instruments - Disclosure and Presentation.* This Section establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

e) *Section 3251, Equity.* This Section, which replaces Section 3250, Surplus, establishes standards for the presentation of equity and changes in equity during the reporting period as a result of the application of Section 1530, Comprehensive Income.

The corresponding figures for the comparative year ended July 31, 2007 have not been restated, in accordance with the relevant transitional provisions of the new sections.

3. Significant accounting policies

Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and include the following 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. These costs are charged to cost of sales when the goods are shipped to customers.

Pooling of market returns activities

Contributions from and equalization payments to provincial milk boards and agencies represent a redistribution of milk revenues among provinces, which are recorded based on milk production and milk utilization incurred by the provincial milk boards and agencies. A fixed portion, agreed upon annually, is withheld from the distributions to fund the Commission's operating expenses.

Foreign currency translation

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

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

Most sales and purchases in foreign currencies have corresponding forward exchange contracts. See "Note 12: Financial Instruments – *Foreign exchange risk*".

Financial instruments

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Commission's designation of such instruments.

Classifications

Cash	Held for trading
Accounts receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Government loans	Other liabilities

Held for trading

Held for trading financial assets are measured at fair value at the balance sheet date with changes in fair value recorded in earnings.

Loans and receivables

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

Other liabilities

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

Transaction costs

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

Derivative financial instruments

The Commission uses derivative financial instruments such as forward contracts to counter the adverse movements in foreign exchange related to purchases and sales denominated in foreign currencies, including anticipated transactions, as well as to manage its cash balances and requirements. The Commission's policy is not to utilize freestanding derivative financial instruments for trading or speculative purposes.

Embedded derivatives

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when: a) their economic characteristics and risks are not closely related to those of the host contract; b) the terms of the embedded derivative are the same as those of a freestanding derivative; and c) the combined instrument or contract is not measured at fair value with changes in fair value recognized in earnings. Embedded derivatives that must be recognized separately from their host contract are measured at fair value with changes therein recognized in earnings. The Commission selected August 1, 2002 as the transition date for embedded derivatives.

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 benefit provided to employees after employment or on retirement.

Capital assets

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

Scholarship program

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

Measurement uncertainty

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

Future accounting changes

In December 2006, the CICA issued Section 3862, Financial Instruments - Disclosures; Section 3863, Financial Instruments - Presentation; and Section 1535, Capital Disclosures. All three Sections will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2007. Accordingly, the Commission will adopt the new standards for its fiscal year beginning August 1, 2008.

In March 2007, the CICA approved Section 3031 - Inventories. This new standard will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2008. Accordingly, the Commission will adopt the new standard for its fiscal year beginning August 1, 2008.

Financial instruments

Section 3862 on financial instruments disclosures requires the disclosure of information about: a) the significance of financial instruments for the entity's financial position and performance and b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863 on the presentation of financial instruments is unchanged from the presentation requirements included in Section 3861.

Capital

Section 1535 on capital requires the disclosure of information about an entity's objectives, policies and processes for managing capital.

Inventories

Section 3031 will affect the measurement and disclosure of inventory. The measurement changes include: the requirement to measure inventories at the lower of cost and net realizable value, the use of the specific cost method for inventories that are not ordinarily interchangeable and goods or services produced for specific purposes, the requirement for an entity to use a consistent cost formula for inventory of similar use, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories.

Financial statements will be required to disclose inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs.

The Commission is currently evaluating the impact of the adoption of these new sections on its financial statements. The Commission does not expect that the adoption of these new sections will have a material impact on its financial statements.

International financial reporting standards

In January 2006, the CICA Accounting Standards Board adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for publicly accountable enterprises are expected to converge with International Financial Reporting Standards (IFRS) by the end of 2011 for December year-ends.

The Commission is currently evaluating the impact of the adoption of IFRS on its financial statements. Complete adoption by the Commission is required by July 31, 2012.

4. Inventories

	2008	2007
	(in thousands)	
Butter	$ 109,299	$ 78,432
Skim milk powder	64,439	40,039
	173,738	118,471
Less:		
inventory write-down	(10,272)	-
Total net realizable value	$ 163,466	$ 118,471

The Commission's inventory includes 13,793 tonnes of butter and 1,830 tonnes of skim milk powder (2007 — 11,223 tonnes and 2,744 tonnes) with a total cost of $95.46 million and $10.90 million respectively (2007 — $77.24 million and $16.18 million) that must be repurchased by the manufacturers from the Commission within the course of the next dairy year at the then prevailing support prices. While manufacturers are contractually obliged to repurchase their product, the Commission is under no obligation to sell back the product. However, the Commission has customarily always honoured repurchase requests.

The balance of the inventory is comprised of 1,997 tonnes of butter and 27,533 tonnes of skim milk powder (2007 — 254 tonnes and 7,868 tonnes) with a total cost of $13.84 million and $53.54 million respectively (2007 — $1.19 million and $23.86 million).

As a result of declining prices in the animal feed market for skim milk powder, the Commission recorded a charge within operating expenses of $10.27 million (2007 — nil) or $0.52/kg to recognize an inventory write-down to net realizable value. See Note 15 for further information regarding skim milk powder prices subsequent to year end.

5. Bank indebtedness

To provide bridge financing and ensure the efficient operation of the pricing and pooling of market returns system, the Commission established a line of credit with a member of the Canadian Payments Association.

During the year, arrangements were made to increase this line of credit to $45 million (2007 — $5 million) until August 30, 2008, after which the maximum limit reverts back to $5 million. The bank indebtedness incurred under this line of credit is due on demand and bears interest at prime, which varied during the year from 6.25% to 4.75% per annum (2007— 6.00% to 6.25%).

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.

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

Loans from the Government of Canada's consolidated revenue fund, to a maximum of $120 million (2007 — $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 is repaid regularly during the year when funds are available.

Interest on the loans, which is at the normal rates established for Crown corporations by the government, varied from 2.10% to 4.82% (2007 — 3.80% to 4.57%) during the year and totaled $2.84 million (2007 — $2.28 million).

7. Transfers of funds

Sections 16.1 and 9(1)(f) to (i) of the *Canadian Dairy Commission Act* (the "Act") set out the purposes for which a line of credit with a commercial bank may be used, notably in the operation of price pools and related activities. In addition, Sections 16 and 9(1)(a) and (b) of the Act set out that loans from the Consolidated Revenue Fund may be used to finance the purchase of inventory and related operational expenses.

From time to time, the Commission transfers funds between its line of credit with a commercial bank and its loan from the Consolidated Revenue Fund to facilitate normal treasury operations, including reducing borrowing costs and facilitating payments in currencies other than the Canadian dollar.

During the year, the Minister of Finance approved an increase in the maximum loan amount from the Government of Canada from $120 million to $150 million, effective August 1, 2008. Subsequent to year-end, this additional increase was drawn upon and was used to repay the outstanding line of credit balance.

8. Equity

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

There have been no transactions during the year ended July 31, 2008 resulting in other comprehensive income and the Commission had no opening or closing balances for accumulated other comprehensive income.

9. Export sales

Export sales include $395,000 representing net losses (2007 — net gains of $17,000) arising from currency translation relating to transactions incurred in foreign currencies.

10. Costs funded by the Government of Canada

Funding of the Commission's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. The Government of Canada has funded $4.00 million (2007 — $3.88 million) of the Commission's administrative expenses of $7.40 million (2007 — $6.85 million), but provided no funding (2007 — $0.22 million) for professional services relating to cost of production data collection.

11. 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 $507,000 (2007 — $521,000), which corresponds to about 2.07 times (2007 — 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:

	2008	2007
	(in thousands)	
Accrued benefit obligation, beginning of year	$ 722	$ 802
Cost for the year	97	90
Benefits paid during the year	-	(170)
Accrued benefit obligation, end of year	$ 819	$ 722

12. Financial instruments

Market risk

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

Foreign exchange risk

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

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.

During the current fiscal year, the Commission did not designate its foreign exchange forward contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions in accordance with CICA Handbook Section 3865, Hedges, and accordingly did not use hedge accounting. As a result of this, foreign exchange forward contracts are recorded on the balance sheet at fair value in accounts receivable when the contracts are in a gain position and in accounts payable and accrued liabilities when the contracts are in a loss position. Changes in fair value of these contracts are recognized as gains or losses through operating expenses.

At the end of the year, the notional value of the Commission's outstanding forward exchange contract totaled $0.57 million Canadian equivalent (2007 — $19.14 million Canadian equivalent). This contract will mature over the period ending September 2008. The maturity date of the forward exchange contract corresponds to the estimated date when the Commission expects to receive the foreign currency proceeds arising from export sales contracts.

The Commission's forward exchange contract as at July 31, 2008 is as follows:

		(in thousands)	
Currency sold	Currency purchased	In USD	In Canadian
U.S. dollars	Canadian dollars	579	573

The fair value of the Commission's derivative financial instrument is determined using the Bank of Canada's published foreign exchange rates as of the balance sheet date. This valuation technique is a fair indicator of recent market transactions. The fair value is a point-in-time estimate that may change significantly in subsequent periods due to changes in market conditions.

Interest rate risk

Interest rate risk is the risk that a financial asset containing a fixed interest rate component decreases in value with a rise in interest rates or that a financial liability with a floating interest rate component results in increased cash outflow requirements as a result of an increase in interest rates. Other than the line of credit in which interest expense varies as a function of prime, the Commission does not have any other such financial assets or liabilities and therefore is not exposed to this risk.

Liquidity risk

Liquidity risk is the risk that the Commission will not be able to meet its financial obligations as they fall due. In managing liquidity risk, the Commission has access as of July 31, 2008 to additional borrowings from the Government of Canada in the amount of $3.7 million (2007 — $49.8 million) and has access to an additional amount of $19.6 million (2007 — $4.0 million) on its line of credit.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the Commission. Maximum credit exposure is the carrying value of the asset net of any allowance for losses. The Commission manages this risk using several strategies which include selling product on a "payment first" basis, securing of bank guarantees and obtaining letters of credit. As of both July 31, 2008 and 2007, the Commission did not have an allowance for doubtful accounts and all accounts receivable were current.

Fair values

The carrying value of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and loans from the Government of Canada approximates their fair values due to the immediate or short-term maturity of these financial instruments. As of the balance sheet date, no amounts representing changes in fair value of these financial instruments have been recorded in the Statement of Operations and Comprehensive Loss.

13. Commitments

Purchase commitments

As at July 31, 2008, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $6.25 million (2007 — $3.64 million).

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 $1.14 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 four years are as follows:

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. A total of $3.02 million (2007 — $1.60 million) has been contributed during the current dairy year.

14. Related party transactions

The Commission is related in terms of common ownership to all Government of Canada-created departments, agencies and Crown corporations. The Commission enters into transactions with these entities in the normal course of business and at normal trade terms. These transactions such as Employee Benefit Plans, accommodations and professional services, but excluding loans from the government, are recorded at their exchange amounts and totaled $1.52 million during the year (2007 — $1.61 million).

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

15. Subsequent event

As of September 12, 2008, the auditor's report date, prices for skim milk powder have decreased by an approximate additional $4.90 million, or $0.25/kg. This amount has not been charged to operations for the year.

16. Financial statement presentation

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

UNAUDITED SCHEDULE OF OPERATIONS BY PRODUCT

for the year ended July 31
(in thousands)

	2008				2007			
	Butter	Skim Milk Powder	Other Products*	Total	Butter	Skim Milk Powder	Other Products*	Total
Sales and cost of sales								
Domestic sales	$ 162,698	$ 56,344	$ -	$219,042	$177,343	$ 71,502	$ -	$248,845
Cost of sales	158,520	56,900	-	215,420	166,795	68,202	-	234,997
Margin (loss) on domestic sales	4,178	(556)	-	3,622	10,548	3,300	-	13,848
Export sales	-	65,893	-	65,893	4,735	26,726	-	31,461
Cost of sales	-	65,455	-	65,455	4,749	27,140	-	31,889
Margin (loss) on export sales	-	438	-	438	(14)	(414)	-	(428)
Total margin (loss) on sales	$ 4,178	$ (118)	$ -	$ 4,060	$ 10,534	$ 2,886	$ -	$ 13,420
Operating expenses								
Storage costs	$ 2,078	$ 1,251	$ -	$ 3,329	$ 2,048	$ 838	$ -	$ 2,886
Interest expense	2,874	377	-	3,251	2,096	181	-	2,277
Other carrying charges	449	319	-	768	333	178	-	511
Scholarships	-	-	-	-	3,000	-	-	3,000
Inventory write-down	-	10,272	-	10,272	-	-	-	-
Projects and promotional activities	3,413	-	42	3,455	1,981	-	135	2,116
Domestic dairy product assistance	-	-	203	203	-	-	64	64
	$ 8,814	$ 12,219	$ 245	21,278	$ 9,458	$ 1,197	$ 199	10,854
Administrative expenses								
Salaries and employee benefits				5,317				5,236
Other expenses				2,085				1,619
				7,402				6,855
Cost of production studies, interest and bank charges related to operation of the pooling of the market returns system				1,016				982
Unrealized gains on derivatives - foreign exchange contracts				(19)				-
Bad debt recovery				(32)				-
Total operating expenses				$ 29,645				$ 18,691

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

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

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

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