Canadian Dairy Commission
Commission canadienne du lait

CANADIAN DAIRY COMMISSION

ANNUAL REPORT

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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 2008-2009 dairy year. As we conclude the year, the Canadian Dairy Commission (CDC) is in a sound financial position and has achieved most of the objectives it had set for itself. Some of these objectives were not reached either because the industry was not ready to move forward on some issues or because circumstances required a change in direction. Overall, the CDC continued to help the Canadian dairy industry and its stakeholders respond positively to the many challenges that arose.

On the world stage, prices for dairy products have fallen drastically in the wake of the current economic recession and because of increased production in Oceania and increased stocks in the United States and the European Union. As a result, prices in the milk classes that follow world or US prices have been reduced and this has in turn limited the increase in overall returns of Canadian dairy producers. In addition, these world prices reduced the quantity of surplus skim milk powder that Canada could export while respecting the limits imposed by the World Trade Organization.

In the Canadian dairy industry, the harmonization trend that started last year continued in 2008-2009. Quebec and Ontario continued to discuss the harmonization of milk allocation to dairy plants on their respective territories. The Maritime provinces have started similar talks. In July, all 10 provinces agreed on a single formula to adjust the farm price of fluid milk and also solved some audit issues related to plant losses. The Eastern provinces have worked on harmonizing their producer quota policies and the implementation of this harmonized policy should continue into the new dairy year. The CDC has been actively involved in each of these initiatives.

Demand for dairy products was relatively stable in 2008-2009. Industrial milk production reached 49.91 million hl in the past year, compared to 50.62 million hl in 2007-2008. I am happy to report that the structural surplus of solids non fat totalled 57,100 tonnes this year compared to approximately 70,000 tonnes last year. This decrease can be mainly attributed to lower industrial milk production and an increase in cheese and yogurt production. Last December, the CDC announced an increase in the support prices of skim milk powder and butter. This 1.0% increase was equivalent to 0.74 cent per litre of milk leaving the farm and became effective on February 1, 2009.

One of the highlights of the year for the CDC was the launch of the Matching Investment Fund. Through this initiative, the CDC plans to invest up to $2 million per year over the next three years in dairy product and ingredient innovation projects, in partnership with Canadian companies, on a matching investment basis.

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 2008-2009

- WTO negotiations were suspended.
- While their counterparts in the U.S. and the EU struggled to remain profitable, Canadian dairy producers were insulated from a sharp and rapid decline in world dairy prices because of Canada’s supply management system.
- The drop in world prices and the competition of whey protein concentrates in the animal feed market hampered skim milk powder sales and caused stocks of solids non fat to remain relatively high.
- The CDC launched the Matching Investment Fund in June. It provides non-repayable funding to Canadian registered companies and Food Technology Centres to encourage dairy product development and the use of dairy ingredients.
- The Canadian Milk Supply Management Committee adopted the continuous quota system at the national level starting on August 1, 2008.
- The 10 provinces agreed on a common formula to adjust the price of fluid milk at the farm. This two-year agreement will begin on February 1, 2010.
- The renewed Agreement on Eastern Canadian Milk Pooling has been approved by all member provinces and is in the process of being signed. It now reflects the current context and mechanisms of the pool.
- Quebec, Ontario and the Maritimes have agreed to harmonize their policies regarding quota issued to producers.
- The P5/Newfoundland Negotiating Committee submitted to Newfoundland a document outlining its minimum requirements and expectations regarding a potential agreement for the entry of this province into the Eastern pool.
- Mainly because of unfavourable weather and poor forage quality, Ontario and Quebec fell short of their production quotas in 2008-2009.
- Negotiations between Quebec and Ontario surrounding the implementation of a common plant allocation policy resumed in December 2008 and continued throughout the year.
- The East-West Price Committee returned to its original mandate. The harmonization of fluid milk prices has been set aside and the focus will remain on industrial milk prices.
- Plan A butter stocks diminished in the fall of 2008 but started to rebuild rapidly at the beginning of 2009 to finish the dairy year slightly above 3,000 tonnes.
- At the end of the dairy year Canadian requirements were at 50.04 million hl, up 0.32% from the previous year.

MILK PRODUCTION

Farm cash receipts

As a key contributor to the Canadian economy in the 2008 calendar year, the dairy industry ranked fourth behind grains, red meats and horticulture, generating $5.3 billion in total farm receipts.

Number of farms and production per farm

In the 2008-2009 dairy year, Canada had 13,587 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 2008-2009 dairy year was 6,101 hectolitres, a 2.7% increase from the previous year. Based on Canadian Dairy Herd Improvement records, the average annual production of a dairy cow in Canada is 9,642 kg of milk.

In the 2008-2009 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 DAIRY FARMS IN 2008-2009

Newfoundland and Labrador	38
Prince Edward Island	212
Nova Scotia	261
New Brunswick	233
Quebec	6,661
Ontario	4,352
Manitoba	410
Saskatchewan	226
Alberta	638
British Columbia	556
TOTAL	**13,587**

NUMBER OF FARMS AND COWS, AND TOTAL PRODUCTION

2004-2005 to 2008-2009

	Number of farms	Number of cows (thousands)	Total production* (million hl)
2004-2005	16,224	1,041.4	81.47
2005-2006	15,522	1,019.1	80.64
2006-2007	14,660	1,004.8	80.77
2007-2008	14,036	998.5	83.40
2008-2009	**13,587**	**978.4**	**82.90**

* At 3.6 kg of butterfat per hl

MILK PROCESSING

In the 2008 calendar year, the dairy processing industry generated $13.1 billion* worth of products shipped from approximately 459 processing plants (276 of which are federally registered) accounting for 15% of all processing sales in the food and beverage industry. In the same year, the dairy processing sector employed 22,730 people.

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

MILK MARKETS

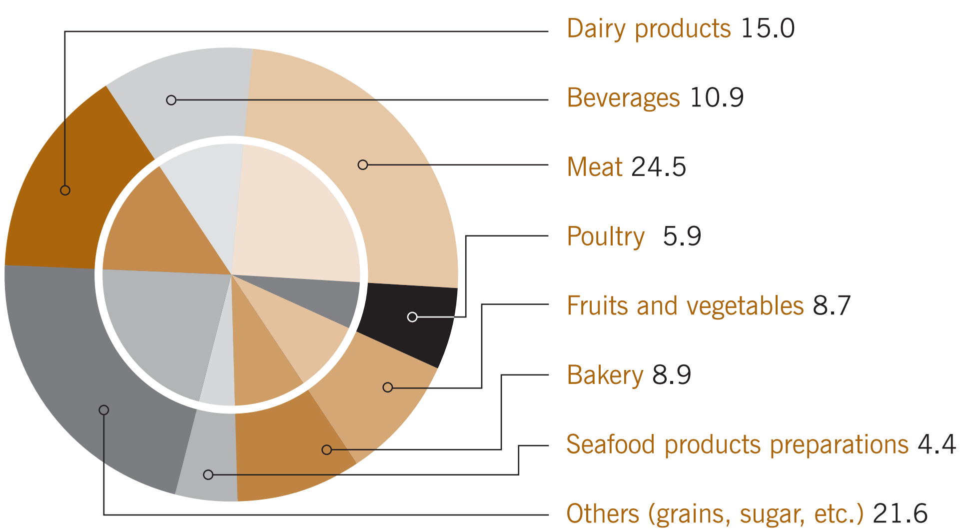
Canadian dairy producers supply two main markets:

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

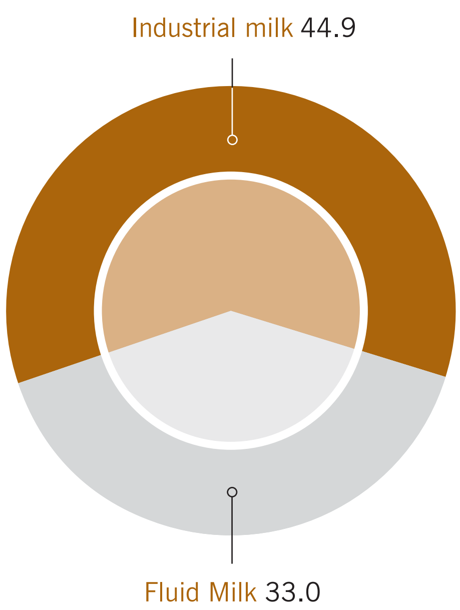
In the 2008-2009 dairy year, the fluid milk market accounted for approximately 40% of total producer shipments, or 33.00 million hl*. The industrial milk market accounted for the remaining 60% or 49.90 million hl* of total producer shipments.

* At 3.6 kg of butterfat per hl.

SHARE OF MANUFACTURED SHIPMENTS IN CANADA – VALUE BASIS (2008)



INDUSTRIAL AND FLUID MILK PRODUCTION IN 2008-2009 (million hl)



Ingredients market

Some plant closures in the further processing industry and a slow down in the Canadian economy made for challenging times in the ingredients market in 2008-2009. However, consumers tended to spend more of their food dollars on packaged and frozen foods in a recession which bodes well for Canadian food processors. Breakfast foods, frozen prepared meals and soup mixes were strong performing categories in the Special Milk Class Permit Program (SMCPP). The fact that these products use skim milk powder, cream, evaporated milk and cheddar cheese will help sustain and hopefully increase the demand for Canadian dairy ingredients. Also, current trends suggest that natural and healthy ingredients in processed foods are foremost in the minds of consumers.

The 2008-2009 dairy year saw a slight decline in the use of dairy ingredients under the SMCPP which amounted to the equivalent of 6.4 million hl of milk (at 3.6% kg of butterfat per hl) compared to 6.8 million hl in the previous year. Competitively priced dairy ingredients coupled with the introduction on August 1 2009 of the CDC's new Matching Investment Fund will provide increased and timely support to Canadian dairy and food product manufacturers to help bring new and innovative products to the marketplace.

PRODUCTION OF MILK* (million hl)

Province	2007-2008			2008-2009		
	Fluid	Industrial	Total	Fluid	Industrial	Total
Newfoundland and Labrador	0.36	0.19	0.55	0.37	0.15	0.52
Prince Edward Island	0.16	0.93	1.09	0.15	0.93	1.08
Nova Scotia	1.13	0.75	1.88	1.11	0.72	1.83
New Brunswick	0.72	0.72	1.44	0.73	0.71	1.44
Quebec	7.50	24.18	31.68	7.46	23.82	31.28
Ontario	12.84	14.40	27.24	13.03	13.98	27.01
Manitoba	1.36	2.01	3.37	1.37	2.03	3.40
Saskatchewan	0.71	1.69	2.40	0.71	1.75	2.46
Alberta	3.96	2.88	6.84	3.97	2.91	6.88
British Columbia	4.04	2.87	6.91	4.10	2.90	7.00
Total	**32.78**	**50.62**	**83.40**	**33.00**	**49.90**	**82.90****

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

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

MILK UTILIZATION BY CLASS

Provincial marketing boards and agencies purchase milk from producers and sell it to processors for the manufacture of dairy products. The milk sold to processors in Canada is classified according to its end use based on the Harmonized Milk Classification System (see Appendix 1). The price paid for milk by processors varies according to the milk class. The following table shows how Canadian milk production was used in 2008-2009.

Class	Million hl	% of total milk
1	24.42	29.5
2	5.62	6.8
3(a) 3(b)	28.26	34.2
4(a) and 4(a)1	16.39	19.8
4(b), 4(c), 4(d), 4(m)	1.12	1.3
5(a), 5(b), 5(c)	6.35	7.7
5(d)	0.54	0.7
TOTAL	**82.70**	**100.0**

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 Farm Products Council of Canada.

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

The Commission employs 61 people who work in its offices which are located in Ottawa, Ontario. Since the success of the CDC depends on its employees' pursuit of excellence, the CDC encourages and supports superior individual and organizational performance.

GOVERNING BOARD

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

- establishes and approves the CDC's strategic directions, corporate plan and budgets with input from senior management;
- reviews the financial statements of the CDC on a quarterly basis;
- approves the year-end 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 at least four times a year; and,
- receives and follows up on the Auditor General's annual audit report on the Commission's financial statements as well as on the Special Examination report which is issued by the Auditor General at least once every 10 years.

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

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

The CEO makes recommendations in the areas of planning and is responsible for implementing the corporate plan once it is approved by Treasury Board, the strategic plan, and 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 bring a balanced approach to satisfying the objectives of the stakeholders.

MEMBERS OF THE COMMISSION

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

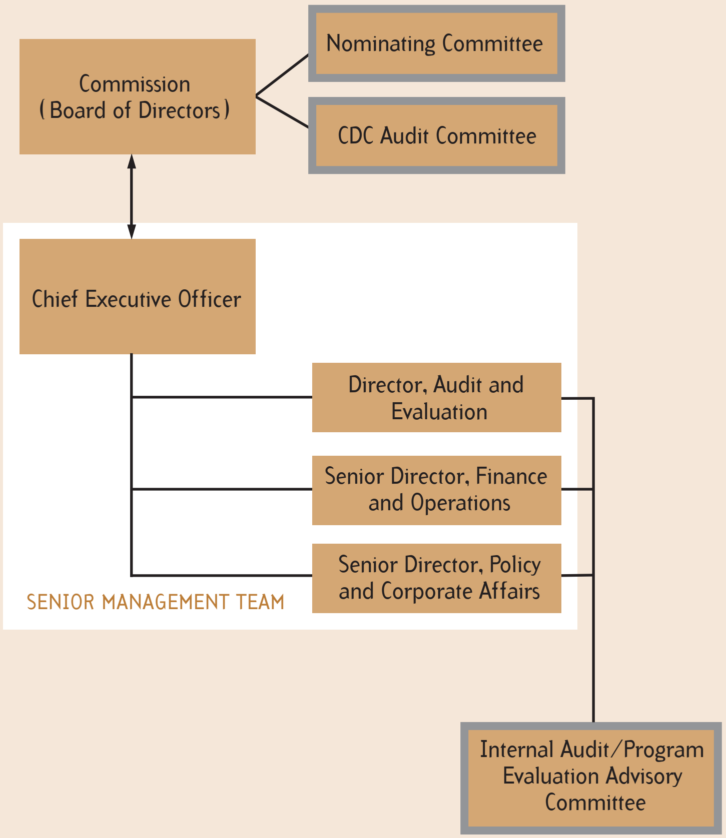
Mr. Martin has a post-secondary degree in Zootechnology from the Institut de technologie agroalimentaire in La Pocatière. He has been involved in the milk producing industry since 1977, and operates a dairy farm in Rivière-Ouelle, Quebec.

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

Chief Executive Officer (reappointed 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 (DFO) from 1981 to 2001. He chaired this organization from 1990 to 2001. He was also a member of the board of DFO from 1986 to 2001, and was the organization's President between 1999 and 2001. He is currently a member of the boards of the Guelph General Hospital and The Royal Agricultural Winter Fair.

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



COMMITTEES

Audit Committee

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 and Evaluation
- 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.

Senior Management Team

Members

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

Activities

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

Nominating Committee

Members

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

Activities

The Committee did not meet in 2008-2009 since no position became vacant.

1.

2.

3.

1. **Policy and Corporate Affairs Section**, from left to right: **Roger Heard**, Chief Economist; **Danie Cousineau**, 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 and Evaluation Section**, from left to right: **Hossein Behzadi**, Manager, Program Audits; **Robert Hansis**, Director, Audit and Evaluation; **Nelson Coyle**, Manager, Evaluation; **Indira Gangasingh**, Manager, Assurance Services

CORPORATE GOVERNANCE

In 2008-2009, the Commission took the following measures to ensure good accountability.

- It held the CDC's second annual public meeting on January 26 in Ottawa;
- The Commission developed and approved board skills profiles at the request of the Privy Council Office;
- The Commission acknowledged receipt of the Letter of priorities from the Minister of Agriculture and Agri-Food to the Chairman and reported on its achievements in June, as requested;
- The Commission updated its Governance Rules and the delegation of HR management;
- The Commission completed an evaluation of the Board which concluded that the Board functions efficiently;
- The Commission approved the CDC's Strategic Plan for 2009-2010;
- The Commission updated its Integrated Risk Management Plan;
- The Commission approved the annual report and financial statements for dairy year 2008-2009 as well as the budget for fiscal year 2009-2010;
- The CDC worked with AAFC to amend the Dairy Products Marketing Regulations. The revised regulations, which corrected an error, were gazetted on February 19, 2009 and immediately came into force;
- Evaluations of the Dairy Marketing Program and communication activities were received and acted on;
- The Commission updated its learning, training and development policy to include greater flexibility for employees to pursue career enhancement learning opportunities;
- A succession plan identifying key positions and skills was adopted.

ACTIVITIES

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

CHAIRING THE CANADIAN MILK SUPPLY MANAGEMENT COMMITTEE (CMSMC)

The CMSMC is the key national body for policy development and discussions in the sectors of dairy production and processing. It includes representatives of producers and governments from all provinces and non voting representatives of national consumer, processor and producer organizations.

As chair of the CMSMC, the CDC provides ongoing leadership, advice and analysis to the Canadian dairy industry while operating in close co-operation with national and provincial stakeholders and governments.

In October 2008, the CMSMC agreed to implement a continuous quota system at the national level effective August 1, 2008. The new quota management rules allow for the optimal fulfillment of market requirements by providing provinces greater production flexibility. The primary objective of the system is to reduce production volatility while keeping surplus production to a minimum.

DETERMINING AND ADJUSTING QUOTAS

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

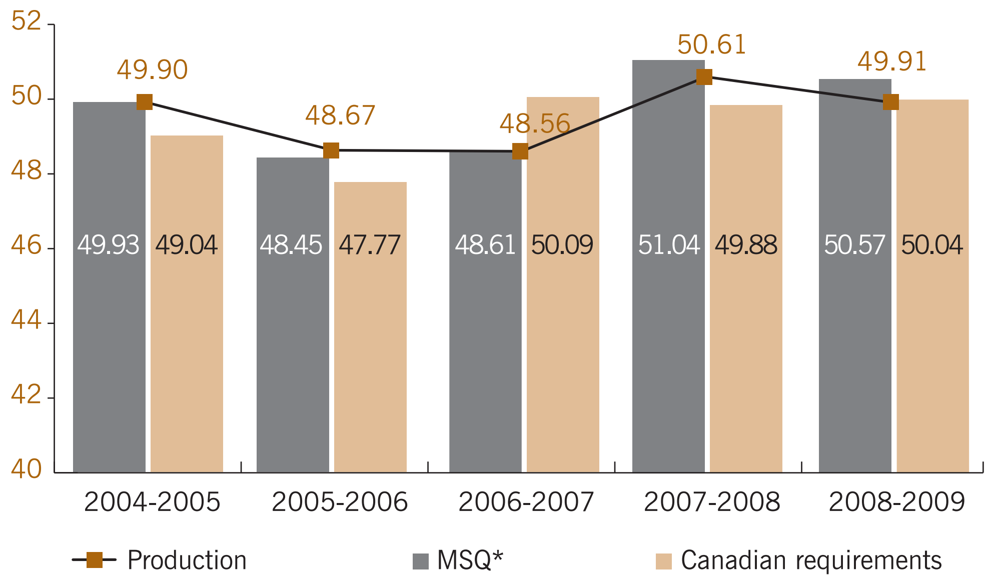
The national production target for industrial milk is called the Market Sharing Quota (MSQ). The MSQ is based on Canadian requirements. Demand is constantly monitored and, every two months, the MSQ is adjusted under the authority of the CMSMC to reflect changes in the domestic demand for industrial milk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

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

Over the course of the 2008-2009 dairy year, Canadian requirements were 50.04 million hl, up 0.32% from the previous year. Stronger than expected retail sales were evident as consumers shifted their buying behaviour to focus more on in-home dining given the current economy. Retail sales of butter and cheese were up 2.3% and 4.0% respectively from a year earlier. This increase in retail activity offset the weakness in butterfat demand in the further processing market and in the food services sector, which started to materialize in the first quarter of 2009.

During the same period, industrial milk production decreased to 49.91 million hl compared to 50.61 million hl a year earlier. Poor weather conditions and forage quality in the summer and fall of 2008 caused Quebec and Ontario to produce less than their quota. The production trend has shown signs of improvement in the spring of 2009 and is expected to continue strengthening into the fall.

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



*Weighted average MSQ, including Domestic Dairy Product Innovation Program

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

POOLING OF MARKETS AND PRODUCER RETURNS

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

Comprehensive Agreement on Pooling of Milk Revenues

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

PROVINCIAL SHARES OF MSQ* – JULY 31, 2009

	Butterfat (million kg)	Milk (million hl)	%
Newfoundland and Labrador	0.69	0.14	0.3
Prince Edward Island	3.07	0.85	1.7
Nova Scotia	2.06	0.58	1.2
New Brunswick	2.28	0.63	1.3
Quebec	81.25	22.58	45.4
Ontario	56.38	15.62	31.4
Manitoba	6.62	1.84	3.7
Saskatchewan	4.83	1.34	2.7
Alberta	11.88	3.29	6.6
British Columbia	10.34	2.86	5.7
Total	**179.42**	**49.73**	**100**

* Before sharing of markets

Agreement on All Milk Pooling

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

In January 2009, the P5 Signatory Committee approved the final version of the revised P5 Agreement named Agreement on the Eastern Canadian Milk Pooling. The signature process is under way and should be completed by December 2009. The revised version provides the P5 Supervisory Body with greater flexibility to adapt and respond to ongoing challenges faced by the dairy industry.

A P5 Milk Movement Obligations/Class 5(c) Committee was created to address a long-standing issue regarding the interprovincial movement of milk to meet a growing demand in Class 5(c). A compromise was reached and adopted by the P5 Supervisory Body in July 2009.

The Ontario and Quebec bilateral negotiations regarding the harmonization of plant allocation policies continued in 2008-2009. A committee was also created to discuss plant allocation policies in the Atlantic Provinces. The CDC is chairing all its meetings at the request of stakeholders.

P5 producers have also continued discussions to harmonize their policies regarding the management of producer quota. The CDC has been acting as a facilitator.

Western Milk Pooling Agreement

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

In 2008-2009, WMP stakeholders successfully completed negotiations on fluid milk pricing. In Alberta, the authority for fluid milk pricing was transferred from the Alberta Utilities Commission to Alberta Milk in August, 2008.

Effective September 1, 2008, the WMP adopted the fluid milk pricing formula used in the P5 but with two adjustments per year rather than one. This formula factors in the yearly changes in the consumer price index, the cash costs of producing milk, and personal disposable income. Negotiations took place later in the year and led to the adoption of a national formula.

Several other efforts to harmonize policies within the WMP provinces and at the national level took place in the past year. The WMP provinces adopted a harmonized metering policy allowing processors to be invoiced according to the meter reading at the plant. The WMP also brought their unaccountable losses policy in-line with the policy of the P5 provinces.

As a result of a Strategic Planning session held in 2008, the WMP provincial boards hired a consulting firm to seek ways of improving the effectiveness of milk allocation to processors and of the milk transportation system within the WMP, potentially leading to greater cooperation and system efficiency amongst the WMP members. The study's final report was released in June 2009 and was well received by WMP stakeholders. A steering committee was created to implement the report's recommendations.

Joint efforts from the P5 and WMP

Signatories to the P5 and the WMP decided to join efforts and meet twice each year. These joint meetings provide opportunities to discuss common issues and to share knowledge and expertise. A National Fluid Milk Pricing Committee which brought together representatives of processors and producers of the WMP and the P5 was created in December 2008. This Committee looked at how fluid milk should be priced in Canada. It reached a consensus at the July 2009 meeting when it was agreed and recommended to both the P5 and the WMP that a formula to index the price would be put in place in the pools. The elements of the formula are the consumer price index, personal disposable income and the indexed cash costs of producing milk plus interest. The P5 and WMP have since adopted the formula for a two-year period effective February 1, 2010.

In the fall of 2008, the P5 and the WMP explored the potential harmonization of antibiotic and inhibitor testing procedures in their provinces. Following the national meeting held in November 2008, a report was developed to explore the differences and similarities between the provinces. It contained two recommendations which were presented to both pools. They have been approved by the P5 Supervisory Body and the approval process is under way in the WMP.

POOLS IN NUMBERS 2008-2009

	Fluid milk produced (million hl)	Industrial milk produced (million hl)	Blend price to producer* ($/hl)
P5	22.48	40.16	$72.03
WMP	10.15	9.59	$74.91

* In-quota milk at 3.6 kg butterfat per hl

PRICING

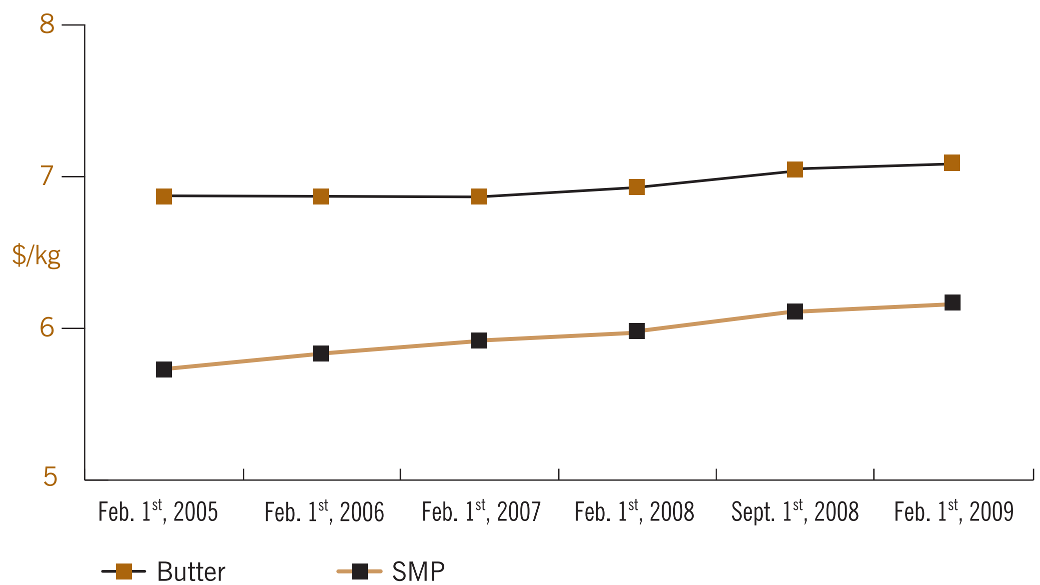
Each year, the CDC reviews and establishes support prices for butter and skim milk powder used by the CDC when purchasing or selling these dairy products. Support prices serve as a reference for provincial milk marketing boards and agencies when they establish the prices paid by processors for milk.

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.

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 an exceptional 2% mid-year increase of support prices which took effect on September 1, 2008.

The pricing decision announced by the CDC on December 3, 2008 was effective on February 1, 2009. The support price of skim milk powder rose from $6.1125 to $6.1783 per kg, and the support price of butter increased from $7.0462 to $7.1024 per kg. This represented an increase of 1.0% or $0.74 per hectolitre for industrial milk used to make products such as yogurt, cheese, butter and skim milk powder. The margin received by processors in the support prices for the skim milk powder and butter purchased by the Canadian Dairy Commission was increased by $0.113 per hectolitre (1.0%) to take into account rising costs.

SUPPORT PRICES FOR BUTTER AND SKIM MILK POWDER FROM 2005 TO 2009 ($ per kg)



AUDIT AND PROGRAM EVALUATION

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

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

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 (OAG) of Canada during its annual audit by providing relevant reports and information on CDC practices. This year, the CDC audit group has also been involved in coordinating the requests from OAG staff conducting the special examination which assesses the CDC's compliance with its statutory control objectives at least once every 10 years.

In 2008-2009 the following internal audit work was performed. Expenditures of the four organizations promoting fluid milk were reviewed and appropriate action was taken before the available funding of $4 million was paid to those organizations. Work is nearing completion on the audit of the CDC's purchase and disposal of hardware and software. The review of the Special Milk Class information system is in progress as is the work on vacation, leave and absence reporting. The administration of the Domestic Dairy Product Innovation Program (DDPIP) is being reviewed and audit work is being performed with the provinces to ensure milk is directed only to the development of innovative products.

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 2008-2009 dairy year, 41 companies were audited, resulting in claims of approximately $708,719 from these companies.

The CDC continues to work with provincial auditors to assist in the audit of Special Class transactions. It provides advice on practices related to plant utilization audits and on the implementation of the National Audit Standards to further harmonize these audit practices across Canada. Revisions to the National Audit Standards were made during the year with the major change being the harmonization of the treatment of unaccountable processing losses.

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.

Program Evaluation

As a result of the evaluation of the Commission's communications activities this year, a formal communication plan was drafted, the CDC market bulletin was improved and enhancements to the CDC Web site are planned.

An evaluation of the Domestic Dairy Product Innovation Program was also completed. Its conclusions were presented to the CMSMC in July 2009 and the decision on the renewal of the program will be made at the October meeting of the CMSMC.

A program evaluation of the CDC's two marketing technical assistance programs provided timely input as the marketing team was revamping and combining the programs in the new Matching Investment Fund.

An evaluation of the Commission's employee recognition initiatives was also undertaken late in the year.

IMPORTS

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product through butter manufacturers to the food sector. 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 LIMITS AND PRODUCTS EXPORTED

Category	Export limit (million $)	Product exported (million $)
Butter	11.025	0
Cheese	16.228	16.227
SMP	31.149	31.149
Others	22.505	22.382
Incorporated products	20.276	20.265

EXPORTS

During the 2008-2009 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 2008-2009 dairy year, the CDC exported 8.9 million kg of skim milk powder. Using 5(d) permits, it also purchased 233 tonnes of surplus butter that may be exported or reintroduced in the domestic market at a later date.

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 5,440 tonnes of cheese and were accounted for against Canada's export commitments to the WTO.

PROGRAMS

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

DOMESTIC SEASONALITY PROGRAMS

Domestic Seasonality Programs allow the industry to cope with the seasonal demand of dairy products. The industry has mandated the Canadian Dairy Commission (CDC) to operate these programs in cooperation with the private sector. Generally, the CDC buys and stores products when consumption is low and sells 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 $6.8 million in 2008-2009. 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 decreased from $0.12/hl of industrial milk to $0.10/hl on September 1, 2008 and to $0.08/hl on February 1, 2009. 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 quantity of butter in storage throughout the year. The CMSMC set 12 million kg of butter as target stocks for August 1 each year. This is referred to as the normal butter inventories. 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 which compensates manufacturers for the carrying charges associated with additional storage time.

Inventories

The Commission began the 2008-2009 dairy year with 15.79 million kg of butter and 29.36 million kg of skim milk powder in inventory. During the year, the CDC purchased 24.18 million kg of butter and 36.81 million kg of skim milk powder. Sales of 24.28 million kg of butter and 31.56 million kg of skim milk powder left respective closing inventories of 15.69 and 34.61 million kg as of July 31, 2009 (statistics include imports of butter and butteroil).

SURPLUS REMOVAL PROGRAM

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

DAIRY MARKETING PROGRAM

In 2008-2009, the CDC conducted a review of the purpose and objectives of its innovation support funds which had been in operation for the past four years. Consultations were held with dairy and food processor associations and individual companies. The results of a program evaluation of the Dairy Marketing Program were also considered. The comments and suggestions that were offered by industry partners and through the evaluation process led to the development of the new Matching Investment Fund (MIF) which took effect August 1, 2009.

The MIF offers increased funding for consulting services as well as the support needed to develop products incorporating dairy ingredients. It also offers more flexibility for larger companies equipped to perform "in-plant" product development and analysis. The CDC also expanded the scope of eligible activities. This timely industry support initiative will provide up to $6 million over 3 years to encourage companies to re-formulate and innovate using Canadian dairy products and ingredients. Particular attention will be devoted to projects that incorporate the use of solids non fat products such as skim milk powder and milk protein concentrate.

In September 2008, the CDC organized another successful dairy ingredients seminar in PEI. It also participated in the annual Canadian Institute of Food Technologists Suppliers Night event in Montreal, and took part in the Baking Congress Trade Show held in Vancouver. The CDC worked in partnership with Dairy Farmers of Canada to develop new content for the MILKingredients.ca Web site to promote the health and wellness benefits associated with dairy products and ingredients.

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 these 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 6.35 million hl of milk in the 2008-2009 dairy year, a decrease of 6.9% over the previous dairy year. The average revenues obtained for producers from these 3 classes amounted to $33.27/hl, a decrease of 21.7%. A total of 1,491 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 1,260 in 2008-2009, up from 1,200 in the previous year.

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

Class		2004-2005	2005-2006	2006-2007	2007-2008	2008-2009
5(a)	Volume	1.955	1.979	2.156	2.161	2.094
	Price	$41.99	$34.32	$33.67	$43.77	$36.23
5(b)	Volume	2.088	2.274	2.662	3.091	2.971
	Price	$36.75	$32.49	$31.80	$42.07	$31.68
5(c)	Volume	1.566	1.436	1.585	1.571	1.287
	Price	$29.79	$30.01	$29.93	$41.03	$29.35
Total	**Volume**	**5.609**	**5.689**	**6.403**	**6.823**	**6.352**
	Price	**$37.05**	**$32.66**	**$31.79**	**$42.48**	**$33.27**

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

DOMESTIC DAIRY PRODUCT INNOVATION PROGRAM

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

During the 2008-2009 dairy year, firms in Quebec, Ontario, Alberta, British Columbia and Prince Edward Island used 42.0 million litres of milk under the DDPIP. In 2007-2008, the total was 33.3 million litres. The maximum utilization limit was established at 2% of the MSQ (approximately 100 million litres).

This year, the Selection Committee received 40 applications compared to 85 during the previous year. Most applications involved new specialty cheeses. Of the 40 applications received, 36 met the program criteria and were accepted, 3 were rejected and 1 requires additional information before a decision can be made.

PERFORMANCE AND GOALS

ACHIEVEMENTS FOR 2008-2009

This section lists the goals set by the Canadian Dairy Commission (CDC) for 2008-2009 and describes the objectives, performance indicators and results related to each.

Strategic Goals

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
The dairy industry has acted on a recommendation from a working group of key stake-holders on future pricing and its related issues.	• An exploratory meeting was held between the CDC, the Dairy Processors Association of Canada (DPAC) and Dairy Farmers of Canada (DFC).	• Two meetings were held.	100
	• An agreed to process was identified to address the pricing issues, as well as the key steps of the process.	• The parties could not reach consensus on a process and discussions are on hold.	0
	• The process has been completed.		0
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.	• The CDC prepared analyses concerning the effectiveness of the import control measures, pricing of Class 5(c) and continuous quota management.	100
	• 12 trade reports are prepared for the Commission.	• The reports were prepared and presented to the Commission.	100
	• 4 meetings are held with Agriculture and Agri-Food Canada's Chief Negotiator.	• Meetings were held.	100
	• Impacts of new trade rules have been evaluated as needed.	• No evaluation was performed since no new trade rules were adopted. The CDC continues to monitor the status of tariff walls.	

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

OBJECTIVES	PERFORMANCE INDICATORS	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 QC and ON is prepared. • An agreement on Class 1 pricing in the 4 Western Provinces is signed.	• Negotiations are ongoing. • A national agreement is in place for February 2010.	50 100
The level of harmonization of plant milk utilization audits has improved.	• Harmonization opportunities have been identified and solutions proposed to CMSMC. • Ontario, Québec, 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.	• Discussions were held with the Western provinces and plant loss rules have been harmonized with the ones in the East. • Discussions were held with these provinces. • The CDC is unable to accept new mandates for plant audits at this time.	100 100 100
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.	• One session was given in September 2008 in Moncton, N.B., and a second one will be given in September 2009 in the Western provinces. • 8 sessions were held across the country.	50 100
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.	• The CDC participates in an initiative to develop a research cluster with AAFC, DPAC, and DFC.	100

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
The strategy to encourage the use of Canadian dairy ingredients has been further developed.	• The Dairy Marketing Program has been evaluated.	• The evaluation was performed and the report presented to the Audit Committee on June 10, 2008. Several recommendations are already implemented.	100
	• A survey of ingredient users has been completed.	• The survey was not completed formally but the same information was collected by the CDC's Innovation Champion during informal meetings with companies.	100
	• The market for dairy ingredients has been analyzed, a report prepared and proposals presented to the Canadian Milk Supply Management Committee.	• A Matching Investment Fund was approved in April 2009. Its objective is to support larger scale product development initiatives that incorporate the use of milk and milk ingredients. This fund has been announced and is available on August 1, 2009.	100
New uses for surplus SNF have been identified and recommendations have been presented to the Market Committee.	• The use of milk protein concentrate (MPC) in nutraceutical products under Class 4(a)1 has been reviewed.	• The review of MPC use in nutraceutical was completed and a verbal report was made to the Market Committee.	100
	• The impact of Class 5(a), (b) and (c) pricing on use of skim milk powder has been evaluated.	• The CMSMC and Market Committee approved a recommendation to adopt a more competitive pricing formula in Class 5(c) to encourage the use of SNF type products.	100
	• Potential new markets for solids non fat (SNF) have been evaluated.	• Evaluation of pet food, processed meat and nutraceutical sectors has been completed and a report was presented to the Market Committee.	100
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 and the Market Committee started work on the development of a long-term competitive strategy to preserve and grow the market for dairy ingredients.	75

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
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 four promotion agencies (DFC, Fédération des producteurs de lait du Québec, Prairie Milk Marketing Partnership and BC Dairy Foundation) presented a report to the Commission on March 10, 2009. The report showed that fluid milk sales increased following the promotion initiatives supported by the CDC.	100
	• The CDC made a decision on its involvement in market growth activities beyond 2008.	• The Commission decided to invest $2.5 million in 2009 for a national fluid milk promotion program provided that provinces match this contribution.	100
	• Analysis and expertise to evaluate proposals brought forth by the industry have been provided.	• Not required	

Operational Goal

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
The impact of the requirement to adopt the new International Financial Reporting Standards (IFRS) has been identified.	• Impact review completed.	• Achieved	100

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
The Office of the Auditor General (OAG) has audited CDC's implementation of the new accounting standards for financial instruments.	• Financial Statements prepared using new standards. • OAG gives a clean audit report. • A process/procedure to be followed by all sections when entering into contractual agreements has been developed. • All Sections are following the new procedure for contracts.	• Achieved • Achieved • Contract procedures have been drafted but no yet approved by Senior Management. • The CDC has recently purchased a contract management software to automate some of the processes and keep track of all contracts in a central database. The software will be implemented in the coming months.	100 100 75 10
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 Succession Plan was approved by senior management April 30, 2009. The abridged key position profiles have been completed. The completion of the detailed key position profiles is scheduled for September 2009. • Potential feeder groups will be identified in January 2010. • Development activities will be offered to each internal potential successor by the end of January 2010.	90 0 0
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.	• Achieved	100

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

OBJECTIVES	PERFORMANCE INDICATORS	RESULTS	PERCENTAGE COMPLETE
The training budget is based on individual development plans.	• Yearly training budget is established according to the new method.	• Achieved	100
	• All staff have an individual development plan with costs included in the administrative budget.	• Achieved	100
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.	• The CDC is currently reviewing the results from both the Public Service Employee Survey 2008 and the "Best Small and Medium Employers" survey. The results will be presented to employees by March 2010.	0
	• An action plan was prepared based on survey results.	• The plan will be prepared using results from both surveys.	0
	• Recognition and Rewards Program has been evaluated.	• The evaluation report of the Recognition and Rewards Program has been drafted but is not yet approved.	80
	• Exit interviews are conducted.	• Exit interviews are conducted when employees leave the CDC.	100
The mandate and role of the CDC is better understood by Portfolio organizations.	• Communication strategy was written and approved by the Commission.	• The CDC developed a brochure outlining its major programs which was circulated to all Portfolio organizations.	90
	• Activities of the communications strategy carried out at opportune time.	• A strategy is under consideration. The CDC made several presentations on its activities to Portfolio organizations. The CDC evaluated its communication activities.	90

OUTLOOK

The Canadian dairy industry and the world market

The sharp and rapid decline in world dairy prices this past year has hurt dairy producers the world over and has prompted the U.S. and the EU to reinstate dairy subsidies. In Canada however, producers have been able to remain profitable without government subsidies due to the stability of the supply management system.

As indicated in previous years, a new agreement at the World Trade Organization (WTO) could have some impact on Canadian dairy exports and the CDC. The CDC therefore continues to monitor multilateral and bilateral trade negotiations that could affect the industry. In the past year, WTO negotiations have made little progress.

Internationally, the drop in world prices and the competition from whey protein concentrates in the animal feed market have reduced producer returns from skim milk powder sales in 2008-2009 and stocks of skim milk solids will remain relatively high for the coming dairy year. Following much lower producer returns in 2008-2009, world milk production should remain stable and allow some price improvement on the global market. Already, current world market prices have increased by about 30% compared to the lows experienced last year for butter and whole milk powder and by about 20% in the case of skim milk powder. Any continued improvement in world prices will depend on the strength of the global economic recovery. Nevertheless finding domestic markets for Canada's surplus of milk solids non fat will remain crucial.

Domestic markets

Since the beginning of the 2008-2009 dairy year, overall demand for dairy products has been relatively flat. Demand from the restaurant sector has experienced a decline that can be attributed to the recession. Restaurant sales are expected to decline significantly in 2009, by as much as 2.5 % according to the Canadian Restaurant and Food Services Association. The economic weakness in 2009 may change dairy consumption as consumers modify their buying behaviour but overall, retail sales will likely remain stable as consumers decide to eat at home. A "trade down" is possible in the retail market as consumers shift to value brands and private labels.

Over the past year, an evaluation of the Domestic Dairy Product Innovation Program (DDPIP) has been conducted and its conclusions and recommendations were presented to the Canadian Milk Supply Management Committee (CMSMC) in July 2009. The decision on the renewal of the program was postponed to the October CMSMC meeting.

In June 2009, the CDC launched the Matching Investment Fund to which it has committed $6 million over 3 years. This initiative should broaden the domestic market for the structural surplus of solids non fat and provide more value-added markets for these products. In 2009-2010, the CDC will continue to work with the industry to find new markets for solids non fat.

The CDC also wants to develop a plan to ensure that there would be adequate domestic milk and dairy product supplies in case of an emergency or catastrophe.

The CDC is therefore planning to have discussions with Agriculture and Agri-Food Canada and the Canadian Food Inspection Agency to clarify the respective roles of each organization in such a situation.

Harmonization

On the domestic front, efforts to achieve greater harmonization will continue. In the past year, the CMSMC adopted the continuous quota system at the national level, Eastern provinces agreed to sign the renewed Agreement on the Eastern Canadian Milk Pooling, and the Western Milk Pool undertook a comprehensive review of the raw milk transportation system for harmonization and value for dollar purposes. Quebec and Ontario will continue negotiations surrounding the implementation of a common plant allocation policy in 2009-2010 and similar discussions will take place among the Atlantic Provinces. The Western Milk Pool harmonized its plant losses policy with the P5 and the two pools initiated joint meetings and adopted a unique formula for fluid milk pricing across Canada.

In the coming year, the East-West Price Committee will focus on reducing the price gap for industrial milk classes and the Eastern provinces will continue their harmonization of producer quota policies. The Western Milk Pool will be implementing the recommendations from the raw milk transportation harmonization study in the coming year. The CDC believes that ultimately, these efforts may result in a national all milk pool.

Trends in the workplace

Recruiting employees with specialized knowledge in the fields of agricultural economics and the dairy industry remains a challenge due to the small number of potential candidates. Employee attraction and retention are therefore important. The CDC has participated in the national “Best Small and Medium Employers Study” and the results of this study will be examined along with the results of the Public Service Employment Survey in an effort to better meet employee expectations.

Another important human resources challenge is to replace staff members who are retiring. The general strategy of the CDC will be to prepare successors for people in key positions who are eligible for retirement and to favour employee retention. It will achieve this by concentrating on planning, policies, learning, and employee retention measures.

GOALS FOR THE PERIOD 2009-2010 TO 2013-2014

The following goals are derived from the preceding 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 2009-2010
Key dairy industry stakeholders are discussing the evolution of the dairy industry within supply management.	• A background document on the main issues facing the dairy industry, including pricing methodology, national pooling and WTO issues, has been prepared. • Key stakeholders have been consulted. • Stakeholders are engaged in discussions.
The CDC is better prepared to deal with potential issues impacting the industry.	• The efficiency of tariff walls is monitored on a continuous basis and reported to the industry in collaboration with AAFC. • An industry plan has been developed to face a sudden surge of imports. • The roles of the CDC, AAFC and Canadian Food Inspection Agency (CFIA) have been clarified in the case of an industry emergency affecting domestic milk supply. • Regular WTO reports are presented to the Commission and regular meetings are held with Canadian negotiators. • New communication tools are put in place to better inform the dairy industry.

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2009-2010
Net opening stocks of skim milk powder equivalent on August 1, 2010 are below 20,000 tonnes.	• The Market Committee has been advised of new market opportunities reaching 10,000 t. • A new pricing strategy for milk solids non fat started on February 1, 2010. • A report outlining the potential means to reduce the production of milk solids non fat at the farm has been presented to the CMSMC. • Utilization of SMP in animal feed totals 30,000 t.
The growth of the Canadian market for dairy products and components is supported by CDC initiatives.	• 5 Matching Investment Fund projects are underway. • The CDC participates on the Board of Directors responsible of the administration of the research cluster funding from AAFC. • If applicable, a decision was made on CDC's participation in the research cluster funding proposal. • Agreements have been signed with industry promotion organizations.

Operational Goal

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

OBJECTIVES	PERFORMANCE INDICATORS FOR 2009-2010
CDC managers embrace creative best practices for employee attraction and retention.	• CDC managers have received training on the expectations of the various generations in the workplace. • The CDC employee turnover rate is below the average of the Public Service. • Within the succession plan of the CDC, potential successors for 50% of key positions have been identified. • Development plans have been established for these successors.
CDC employees have a good knowledge of the various CDC activities and a general understanding of the dairy industry.	• 5 teams of the CDC have presented their activities to the rest of the staff. • At least 20 staff members have followed a course on the processing of dairy products. • Staff meetings are held monthly. • An orientation session on the milk supply management system has been offered to all staff. • A new orientation method has been implemented and used with new employees.

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, 2009 should be read in conjunction with the financial statements of the Commission enclosed herein and the annual report.

SELECTED KEY RESULTS OF OPERATIONS

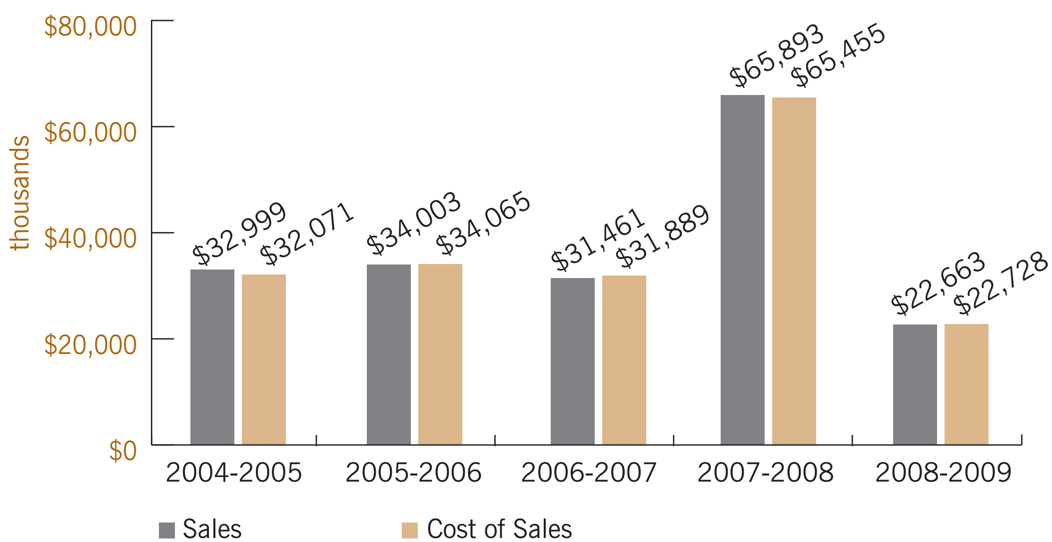
Export activities

Sales

Export sales revenue was entirely from skim milk powder sales. The unprecedented high world prices prevailing at the beginning of 2007-2008 eventually led to a global decrease in the demand for skim milk powder which along with the sharp down turn in the world economy resulted in equally dramatic decreases in world prices for this product.

The CDC sold 8,860 tonnes of skim milk powder, which is about half the 15,973 tonnes that were sold the previous year. This decrease, combined with much lower selling prices, translated into revenues of $22.7 million compared to $65.9 million for 2007-2008.

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

For the dairy year ending July 31, 2009, the cost of export sales totalled $22.7 million, corresponding to sales of $22.7 million.

Domestic activities

Sales

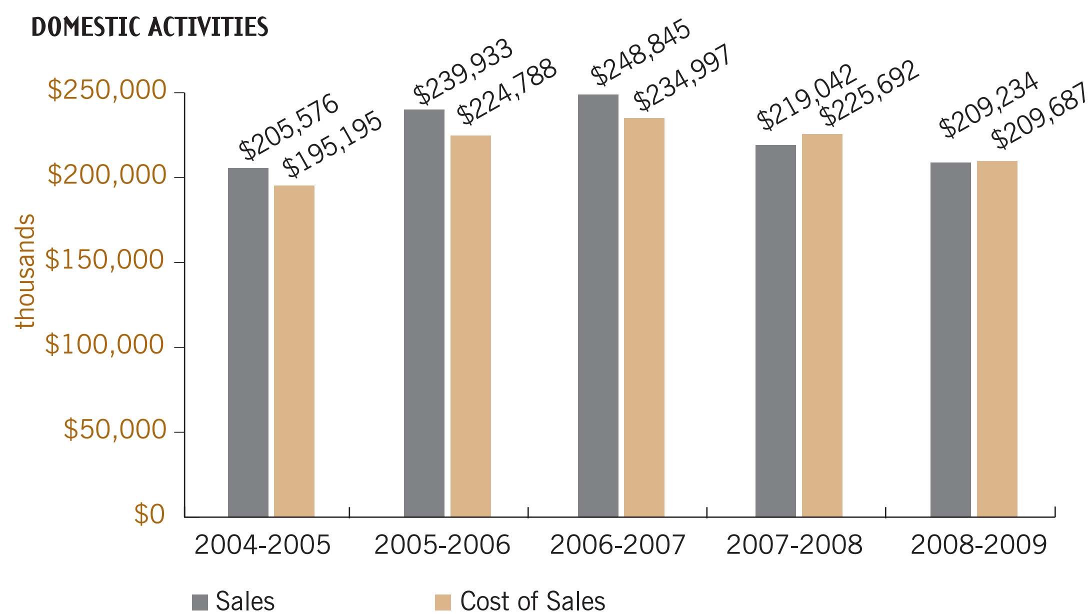
In the 2008-2009 dairy year, total revenue from domestic sales decreased by $9.8 million or 4.5% compared to the previous dairy year. This is mainly due to lower sales of Plan A butter and Plan B skim milk powder (SMP). While there was a decrease in revenue from the sale of these two products, the reduction in revenue was partly offset by an increase in Plan B butter sales and in SMP sold to domestic animal feed manufacturers under Class 4(m).

In the case of Plan B SMP, revenues from sales decreased by $15.4 million compared to 2007-2008. This decrease resulted from lower stocks in 2008-2009 than at the same period a year earlier because SMP manufacturers did not need to use the Plan B program as much as in the previous year. This decrease in quantities sold had little effect on the margin as the purchase and resale of these products are made at support prices.

Sales of SMP to the animal feed sector under Class 4(m) amounted to 19,558 tonnes in 2008-2009, an increase of 10,419 tonnes compared to the previous dairy year. The reason for this increase is that opening inventories of this type of SMP were considerably higher than the previous year and that purchases increased as well. Furthermore, the CDC was more aggressive in selling the product to prevent further growth in inventories.

Cost of sales

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



As most of the SMP sales under Class 4(m) involved product purchased when prices were higher, the cost of sales for this product exceeded the revenues. Sales of this product therefore accounted for all the losses generated in the domestic sales offsetting the margin obtained from the sale of other dairy products.

For the dairy year ending July 31, 2009 the cost of domestic sales totalled $209.7 million corresponding to sales of $209.2 million resulting in a small loss of $0.5 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 $7.3 million in 2007-2008 to $6.8 million in 2008-2009. This reduction of $0.5 million in the overall carrying costs is the result of an increase in storage costs which was offset by a significant decrease in interest costs.

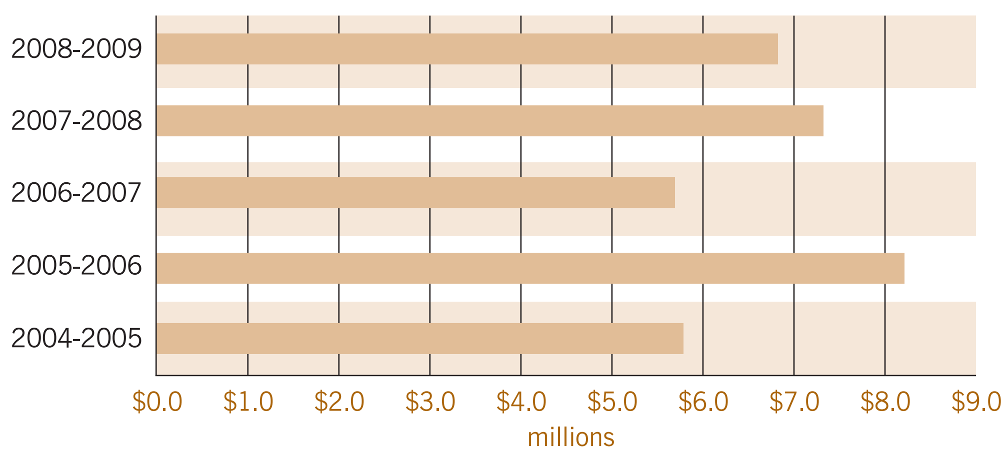
Storage costs have increased during the year by approximately $1 million over last year as a result of holding larger quantities of skim milk powder in inventory throughout the year. However this year's interest rates were at an unprecedented low as a result of the economic turmoil. Carrying charges benefited directly from these low rates with interest expense for the year totalling $1.8 million compared to $3.3 million in 2007-2008.

These low rates cannot be sustained over the long term so we anticipate a gradual return to more normal levels by the end of next year. As a result, carrying charges will increase if other variables remain constant.

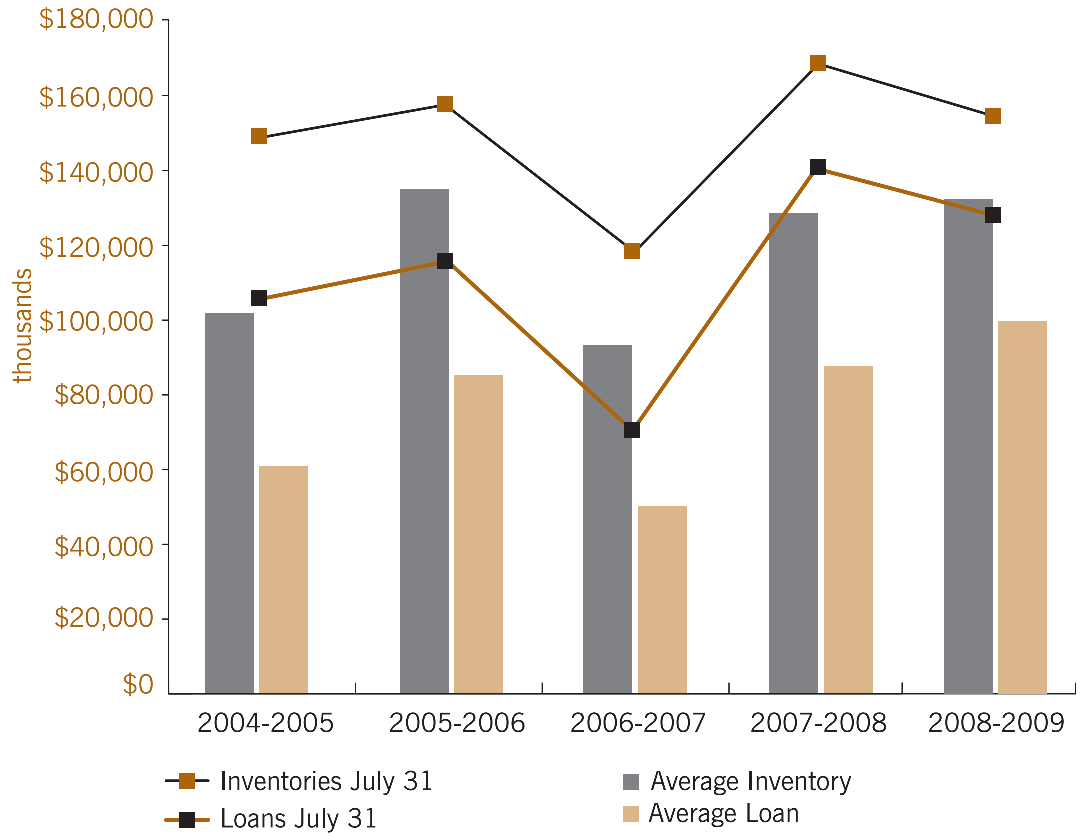
Inventories and loans

Average inventory levels were 2.4% higher in the 2008-2009 dairy year compared to the previous year which resulted in a slight increase in our average loan requirements. Although the loan of $150 million from the

CARRYING CHARGES



INVENTORIES AND LOANS



Government of Canada was sufficient to cover our borrowing requirements, at certain peak purchasing periods during the year, the borrowing requirements came fairly close to the limit. For this reason the CDC, as part of its Corporate Plan, requested and was granted an increase to the loan limit from $150 million to $175 million effective August 1, 2009 as a contingency to deal with these peak purchasing periods as well as any unexpected changes that may occur in the marketplace.

Risk management

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

The Commission has created an Integrated Risk Management Plan which is reviewed and updated at least once per year by CDC management (the latest review was conducted in February 2009). It outlines the risks identified by managers and directors as posing a threat to the core mandate of the CDC and/or to the achievement of its goals. The plan defines each risk, describes the existing measures for managing the risk, incremental risk management strategies and the group responsible for implementing these strategies. The Plan is taken into consideration when doing the environmental analysis during the Commission's annual strategic planning session.

Credit risk is the exposure to financial loss due to a customer failing to meet his financial obligations to the CDC. The CDC manages this risk by selling product on a "payment first" basis, securing bank guarantees and obtaining letters of credit.

Other strategies include carrying out business only with credit worthy customers.

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

Market risk is the most difficult to manage due to its unpredictability. The operations of the CDC are affected by many external factors such as world market conditions, developments in the World Trade Organization (WTO) negotiations on agriculture, domestic market trends and fluctuations of supply and demand. The CDC addresses these risks by instituting sound management practices, hiring and maintaining competent staff and staying abreast of any market or political development that may affect its operations. Since the CDC deals with supply managed products such as SMP and butter, we are a very small player in the world market therefore the export activity is a relatively small percentage of the overall revenues.

Nonetheless, the CDC manages the volatility of world markets by strategically selling its products to reliable exporters who seek value-added products.

Administrative expenses

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

Administrative expenses for the year totalled \$8.3 million. Salaries and employee benefit plans of \$5.6 million make up the bulk of these expenses. The remaining significant expense groupings are for rent, travel and administrative support.

Future accounting changes

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 CDC created an IFRS Working Group to review, recommend and implement the changes required to ensure compliance with the new IFRS by our deadline of July 31, 2012.

The IFRS project was divided in 3 phases: the diagnostic phase, the design and development phase, and the implementation phase. In January 2009, the diagnostic was completed and it identified key financial reporting issues, the effort required to achieve compliance and the potential implications on systems and processes. In April 2009, work began on Phase 2 of the project which involved a more detailed analysis of the specific financial statement items identified in the diagnostic report as being impacted by IFRS.

In July 2009, this phase was put on hold in order for the CDC to evaluate the impact of the Public Sector Accounting Board's amendment to its Exposure Draft addressing *Financial Reporting by Certain Government Organizations*. Depending on how the CDC will be classified, the amendment could propose allowing the adoption of either the Public Sector Accounting (PSA) Handbook or IFRS whichever is determined to be the most appropriate basis of accounting.

The CDC is still evaluating which classification the Commission falls under and the impact this will have on its previously-anticipated adoption of IFRS. Based on preliminary results of the Commission's own analysis, IFRS appears to be the most appropriate basis of accounting for the CDC. Management will consult with the Office of the Auditor General and will take an official position in the fall of 2009. The deadline for adoption of either IFRS or the PSA Handbook is the Commission's year ending July 31, 2012.

Challenges for the future

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

Although the structural surplus of skim milk powder has decreased in the 2008-2009 dairy year, we are currently experiencing some growth in these inventories because less could be exported in 2008-2009. The CDC is taking measures to reduce these inventories by increasing sales to animal feed manufacturers and developing new domestic markets that may create demand for skim milk powder. The CDC recognizes the importance of this issue and has developed specific objectives for the 2009-2010 dairy year to address the situation. Since these surpluses can only be sold at relatively low prices for either export or animal feed and negatively affect producers' overall returns, the CDC is working with the industry to find more lucrative markets for this product. The Market Committee, which is a subcommittee of the CMSMC, is the forum where the Commission analyzes options for new markets. This committee is expected to bring recommendations to the CMSMC on innovative marketing strategies that will assist the Commission in dealing with the surplus SMP in the long term.

In the next five years, the activities of the Canadian Dairy Commission could be influenced by the outcome of the WTO negotiations on agriculture. If a new WTO Agreement on Agriculture was reached, it could have some effects on the Canadian dairy industry. Because the CDC's activities are so closely linked to the situation of this industry, some impacts would be expected on the Commission. However, the exact nature and magnitude of these impacts are unknown at this time and negotiations have made little progress in the last year.

MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS

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

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

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

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

John Core, CEO

Gaëtan Paquette, Senior Director,
Finance and Operations

Ottawa, Canada
September 18, 2009

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Agriculture and Agri-Food

I have audited the balance sheet of the Canadian Dairy Commission as at July 31, 2009 and the statements of operations and comprehensive income (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, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Commission that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with Part X of the Fin*ancial 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 18, 2009

BALANCE SHEET

July 31
(in thousands)

	2009	2008
Assets		
Current		
Cash	$ 490	$ –
Accounts receivable		
Due from provincial milk boards and agencies (pooling)	28,053	29,766
Trade	969	1,076
Derivative asset - foreign exchange contracts	53	19
Inventories (Note 4)	154,621	163,466
	$184,186	$194,327
Liabilities		
Current		
Bank indebtedness (Note 5)	$ 825	$ 25,367
Accounts payable and accrued liabilities		
Due to provincial milk boards and agencies (pooling)	24,325	25,767
Trade	15,092	13,417
Provision for margin payable to provincial milk boards and agencies (operational surplus)	–	718
Other liabilities	895	1,311
Derivative liability - foreign exchange contracts	183	–
Loans from the Government of Canada (Note 6)	129,488	116,316
	170,808	182,896
Long-term		
Severance benefits (Note 12)	1,196	819
Equity (Note 7)		
Retained earnings	12,182	10,612
	$184,186	$194,327

Commitments (Note 14)

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

Approved:

Chief Executive Officer

Chairman

Senior Director, Finance and Operations

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

for the year ended July 31
(in thousands)

	2009	2008
Sales	$231,897	$284,935
Cost of sales	(232,415)	(291,147)
Total loss on sales	(518)	(6,212)
Operating and administrative expenses	(19,801)	(19,373)
Pooling contributions withheld to fund operating and administrative expenses (Note 10)	7,930	9,703
Funding of administrative expenses by the Government of Canada (Note 11)	4,270	4,003
Results after Pooling contributions and Government funding	(8,119)	(11,879)
Recovery of (provision for) operational deficit (surplus) from (to) provincial milk boards and agencies	9,689	(718)
Results of operations and comprehensive income (loss)	$ 1,570	$ (12,597)

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

STATEMENT OF CHANGES IN EQUITY

for the year ended July 31
(in thousands)

	2009	2008
Retained earnings at beginning of year	$ 10,612	$ 23,026
Transition adjustment on adoption of financial instruments standards	–	183
Revised retained earnings at beginning of year	10,612	23,209
Results of operations and comprehensive income (loss)	1,570	(12,597)
Retained earnings at end of year	$ 12,182	$ 10,612

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

STATEMENT OF CASH FLOWS
for the year ended July 31
(in thousands)

	2009	2008
Cash flows from operating activities		
Cash receipts from customers	$232,013	$284,012
Cash paid to suppliers and others	(239,058)	(355,584)
Cash receipts from provincial milk boards and agencies (pooling)	159,237	178,994
Cash paid to provincial milk boards and agencies (pooling)	(151,036)	(171,081)
Cash received from (paid to) provincial milk boards and agencies (operational deficit/surplus)	8,971	(8,370)
Cash receipts from the Government of Canada	4,270	4,003
Interest paid on loans	(2,537)	(2,912)
Cash flows from (used in) operating activities	11,860	(70,938)
Cash flows from financing activities		
New loans from the Government of Canada	188,575	219,587
Loan repayments to the Government of Canada	(175,403)	(173,449)
Cash flows from financing activities	13,172	46,138
Net increase (decrease) in cash	25,032	(24,800)
Net bank indebtedness at beginning of year	(25,367)	(567)
Net bank indebtedness at end of year	$ (335)	$ (25,367)
Components:		
Cash	$ 490	$ –
Bank indebtedness	(825)	(25,367)
	$ (335)	$ (25,367)

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

NOTES TO FINANCIAL STATEMENTS

July 31, 2009

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 operates on a dairy year basis which starts August 1 and ends July 31.

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

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

2. Adoption of new accounting standards

Effective August 1, 2008, the Commission adopted the following new standards issued by the Canadian Institute of Chartered Accountants (CICA):

Financial instruments – disclosure and presentation

CICA Handbook, Sections 3862, *Financial Instruments – Disclosures* and 3863, *Financial Instruments – Presentation* replace Section 3861, *Financial Instruments – Disclosure and Presentation*. These new sections place increased emphasis on disclosures about the nature and extent of the risks arising from financial instruments and how the Commission manages those risks.

Capital disclosures

CICA Handbook Section 1535, *Capital Disclosures*, requires the disclosure of the Commission's objectives, policies, and processes for managing capital, quantitative data about what is regarded as capital, whether all capital requirements have been complied with and, if not, the consequences of such non-compliance.

These new standards have resulted in increased disclosure in the financial statements (see Notes 8 and 13), but had no impact on the financial results of the Commission for the current year.

Inventories

CICA Handbook Section 3031, *Inventories*, supersedes Handbook Section 3030, *Inventories*. This section provides changes to the measurement and disclosure of inventories, including the requirement to measure inventories at the lower of cost and net realizable value, the allocation of overhead based on normal capacity, the use of the specific cost method for inventories that are not ordinarily interchangeable and for goods or services produced for specific purposes, the requirement 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. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed.

The effect of the adoption of this new standard on the Commission is included in the disclosures in Note 4. The implementation of this new standard had no impact on the financial results of the Commission for the current year.

3. Significant accounting policies

Basis of presentation

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

Inventories

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

Inventories exclude storage charges, which are expensed when incurred.

Revenues

Revenues from sales of product are recognized upon shipment.

Cost of sales

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

Pooling of market returns activities

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

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

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

Foreign currency translation

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

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

Most sales and purchases in foreign currencies have corresponding forward exchange contracts (see "Derivative financial instruments" below and Note 13 - Financial Instruments – *Currency 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
Loans from the Government of Canada	Other liabilities

Held for trading

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

Loans and receivables

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

Other liabilities

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

Transaction costs

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

Derivative financial instruments

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

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

Employee future benefits

Pension benefits

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

Severance benefits

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

Other future benefit plans

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

Scholarship program

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

Measurement uncertainty

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

Future accounting standards

In July 2009, the Public Sector Accounting Board issued an amendment to its Exposure Draft addressing *Financial Reporting by Certain Government Organizations*. Depending upon classification of the entity, the amendment could propose allowing the adoption of either the Public Sector Accounting Handbook or International Financial Reporting Standards (IFRS), whichever is determined to be the most appropriate basis of accounting. The Commission is currently evaluating this Exposure Draft and the potential impact it may have on its previously-anticipated adoption of IFRS for its July 31, 2012 year-end.

4. Inventories

	2009	2008
	(in thousands)	
Butter	$ 108,337	$ 109,299
Skim milk powder	49,576	64,439
	157,913	173,738
Less:		
inventory write-down	(3,292)	(10,272)
Total net realizable value	**$ 154,621**	**$ 163,466**

The Commission's inventory includes 11,818 tonnes of butter and 1,260 tonnes of skim milk powder (2008 — 13,793 tonnes and 1,830 tonnes) with a total cost of $84.32 million and $7.78 million respectively (2008 — $95.46 million and $10.90 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 3,870 tonnes of butter and 33,354 tonnes of skim milk powder (2008 — 1,997 tonnes and 27,533 tonnes) with a total cost of $24.02 million and $41.80 million respectively (2008 —- $13.84 million and $53.54 million).

The Commission recorded a charge to cost of sales of $3.29 million in the current year (2008 - $10.27 million) to recognize an inventory write-down to net realizable value (NRV). This write-down is primarily the result of a transfer of skim milk powder from stocks originally held for export sale, which have a higher NRV, to stocks destined for the animal feed market, which warrant a lower NRV. Transfers between these two types of skim milk powder are not uncommon practice and are necessary as a result of the age of the inventory. A slight decline in the NRV of the Commission's opening stocks of skim milk powder destined for the animal feed market also contributed to the inventory write-down.

To ensure consistency of presentation, and as a result of the new CICA Handbook Section on Inventories, the prior year inventory write-down of $10.27 million has been reclassified from operating expenses to cost of sales.

5. Bank indebtedness

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

During the prior dairy year, arrangements were made by the Commission to increase its line of credit to $45 million until August 30, 2008, after which its limit reverted back to $5 million. As at July 31, 2009, the Commission's line of credit remained at $5 million.

The bank indebtedness incurred under the Commission's line of credit is due on demand and bears interest at prime, which varied during the year from 4.75% to 2.25% per annum (2008 — 6.25% to 4.75%).

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

Loans from the Government of Canada's Consolidated Revenue Fund, to a maximum of $150 million (2008 — $120 million), are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest are repaid regularly during the year when funds are available.

Interest on the loans, which is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent, varied from 3.46% to 0.32% (2008 — 4.82% to 2.10%) during the year and totaled $1.88 million (2008 — $2.83 million).

During the year, the Minister of Finance approved an increase in the maximum loan amount from the Government of Canada from $150 million to $175 million, effective August 1, 2009.

7. Equity

The Commission indirectly collects amounts from consumers through a charge included in the retail sale price of butter. This charge is used to fund the carrying costs associated with the normal levels of butter inventory. This amount is included in contributions withheld to fund operating expenses presented in the Statement of Operations and Comprehensive Income (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, 2009 resulting in other comprehensive income or losses and the Commission had no opening or closing balances for accumulated other comprehensive income or losses.

8. Capital disclosures

The Commission's capital consists of its loans from the Government of Canada (Note 6) and retained earnings. As at July 31, 2009 these accounts totaled $129.49 million (2008 — $116.32 million) and $12.18 million (2008 — $10.61 million) respectively. The Commission is not subject to any externally imposed capital requirements.

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

9. Export sales

Export sales include $0.54 million representing net losses (2008 — net losses of $0.39 million) arising from currency translation relating to transactions incurred in foreign currencies.

10. Pooling of market returns activities

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

	2009	2008
	(in thousands)	
Contributions from provincial boards and agencies	$157,524	$179,723
Equalization payments to provincial boards and agencies	149,594	170,020
Contributions withheld to fund operating expenses	$ 7,930	$ 9,703

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

11. Costs funded by the Government of Canada

Funding of the Commission's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. During the year, the Government of Canada funded $4.27 million (2008 — $4.00 million) of the Commission's administrative expenses of $8.31 million (2008 — $7.40 million).

12. Employee future benefits

Pension plan

The Commission and all eligible employees contribute to the Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. Operating expenses include the Commission's contributions to the Public Service Pension Plan during the year totaling $0.58 million (2008 - $0.51 million), which corresponds to about 1.96 times (2008 – 2.07 times) the employees' contributions to the Plan.

Severance benefits

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

	2009	2008
	(in thousands)	
Accrued benefit obligation, beginning of year	$ 819	$ 722
Cost for the year	398	97
Benefits paid during the year	–	–
Accrued benefit obligation, end of year	$ 1,217	$ 819

Twenty-one thousand dollars of the total year end obligation is estimated by the Commission to be payable within the next year and is included in Other Liabilities, under Current Liabilities, on the balance sheet.

13. Financial instruments

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

Market risk

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

Currency risk

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

At the end of the year, the notional value of the Commission's outstanding forward exchange contracts totaled $2.72 million Canadian equivalent (2008 — $0.57 million Canadian equivalent). These contracts will mature over the period ending October 2009. The maturity dates of the forward exchange contracts correspond to the estimated dates when the Commission expects to receive the foreign currency proceeds arising from export sales contracts or when payment for purchases in foreign currencies are due.

The fair value of the Commission's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the balance sheet date.

The Commission's forward exchange contracts as at July 31, 2009 are as follows:

		(in thousands)	
Currency sold	**Currency purchased**	**In USD**	**In CAD**
U.S. dollars	Canadian dollars	$810	$926
Canadian dollars	U.S. dollars	$1,497	$1,796

As at July 31, 2009, the Commission's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

	(in thousands)
	In CAD
Accounts receivable (trade)	$ 797
Accounts payable (trade)	(434)
Net derivative liability	(130)
Net exposure	$ 233

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

Interest rate risk

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

Other price risk

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

Liquidity risk

Liquidity risk is the risk that the Commission will not be able to meet its financial obligations as they fall due. At year-end, virtually all of the Commission's assets and liabilities were current and the Commission had a current ratio equal to 1.08 (2008 – 1.06). In managing liquidity risk, the Commission has access as of July 31, 2009 to additional borrowings for commercial operations from the Government of Canada in the amount of $20.51 million (2008 — $3.68 million) and on its line of credit, for the pooling of market returns, in the amount of $4.18 million (2008 — $19.63 million).

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the Commission. Maximum credit exposure is the carrying amount of the pooling and trade accounts receivable balances, net of any allowance for losses. The Commission manages this risk using several strategies which include selling product on a "payment first" basis, securing of bank guarantees and obtaining letters of credit. As of both July 31, 2009 and 2008, the Commission did not have an allowance for doubtful accounts and all accounts receivable are current.

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

Fair values

The carrying value of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities 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 Income (Loss).

14. Commitments

Purchase commitments

As at July 31, 2009, the Commission was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately $1.65 million (2008 — $6.25 million) and are due to be fulfilled by December 2009.

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 $0.83 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 three years are as follows:

2009–2010	$0.31 million
2010–2011	$0.31 million
2011–2012	$0.21 million

Promotional funding

For the 2009-2010 dairy year, the Commission will contribute up to $2.50 million for fluid milk promotion activities conditional to participating provinces providing equal funding. The Commission will allocate funds to participating provinces on a pro-rata basis using their respective fluid milk sales of the previous dairy year.

Canadian Quality Milk funding

The Commission has agreed to partially fund the Canadian Quality Milk Program, a program designed to help producers prevent, monitor and reduce food safety risks on their farms. The agreement to provide this funding, which commenced August 1, 2007, has been extended to July 31, 2012. Under the terms of the agreement the Commission will contribute up to $300 per eligible farm, which translates into a maximum of $4.21 million over the life of the agreement. A total of $0.17 million has been contributed during the current dairy year. No other program costs have been incurred by the Commission thus far.

Matching Investment Fund

The Commission has developed the Matching Investment Fund which provides non-repayable contributions to Canadian registered companies or Food Technology Centres for product development, on a matching investment basis. The Commission has committed $2 million per year over the next three years, commencing August 1, 2009 and ending July 31, 2012.

15. Related party transactions

The Commission is related in terms of common ownership to all Government of Canada-created departments, agencies and Crown corporations. The Commission enters into transactions with these entities in the normal course of business and at normal trade terms. These transactions such as Employee Benefit Plans, accommodations and professional services, but excluding loans from the government, are recorded at their exchange amounts and totaled $1.65 million during the year (2008 — $1.52 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.

16. Financial statement presentation

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

DETAILED SCHEDULE OF OPERATIONS
for the year ended July 31
(in thousands)

	2009	2008
Sales and cost of sales		
Domestic sales	$ 209,234	$ 219,042
Cost of sales	209,687	225,692
Loss on domestic sales	(453)	(6,650)
Export sales (Note 9)	22,663	65,893
Cost of sales	22,728	65,455
(Loss) margin on export sales	(65)	438
Total loss on sales	$ (518)	$ (6,212)
Operating expenses and other charges		
Storage costs	$ 4,383	$ 3,329
Projects and promotional activities	3,230	3,455
Interest expense (operations)	1,790	3,251
Cost of production studies	892	982
Other carrying charges	632	768
Domestic dairy product assistance	312	203
Unrealized losses (gains) on derivatives - foreign exchange contracts	149	(19)
Donation	75	-
Interest expense and bank charges (pooling)	24	34
Bad debt recovery	-	(32)
Total operating expenses and other charges	$ 11,487	$ 11,971
Administrative expenses		
Salaries and employee benefits	$ 5,610	$ 5,381
Other expenses	2,804	2,113
Recovered audit services	(100)	(92)
Total administrative expenses	$ 8,314	$ 7,402
Total operating and administrative expenses	$ 19,801	$ 19,373

APPENDICES

APPENDIX 1

HARMONIZED MILK CLASSIFICATION SYSTEM

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

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

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

Class	Products
4(a)	All types of butter and butteroil, all types of powder, concentrated milk as an ingredient in the food industry[3], all other products not elsewhere stated
4(a)1[4]	Milk components for the manufacture of rennet casein (dry or curd), milk protein concentrate (dry or liquid) or skim milk (dry or liquid) to be used in the manufacture of non-standardized final products in the processed cheese category 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.